MONTHLY UPDATE

Latest views from the investment team

End of Aaa Era

De-escalation in the tariff dispute between the US and China as well as President Trump's 'Big, Beautiful Bill', which included tax cuts while reducing red tape, paved the way for stock markets to rise in May. US stocks gained 6%, or 5% for UK investors, while the UK market rose around 3%. Bonds, however, fell, as yields rose with investors demanding a greater return for lending to governments over the long-term. Rating agency Moody's downgraded the triple-A credit status of the US (from Aaa to Aa1) as the new budget bill fuelled concerns about the government's mounting debt burden.

Trade tensions have eased significantly, with the US lowering tariffs on Chinese goods from 145% to 30%, while China has reduced its tariffs on US imports to 10%. It is expected that this reduction, initially agreed for 90 days, is sufficient to enable a return to reasonably normal trade volumes. Meanwhile, a major budget bill featuring tax cuts and deregulation has passed both the congressional budget committee and the House of Representatives. Although some amendments are likely before it reaches final approval in the Senate, the current version includes hundreds of billions of dollars in tax cuts that are not offset by spending reductions. This will mean that more government bonds need to be issued to fund this spending. The Congressional Budget Office estimates the bill will add approximately USD 2.3 trillion to the US national debt over the next 10 years. Key provisions include extending the 2017 tax cuts set to expire in 2026, eliminating taxes on overtime pay, and expanding child tax credits. Treasury Secretary Bessent has made it clear that, due to the bill, government spending will remain high, marking a turnaround in tone from the spending cuts that were in focus a couple of months ago.

Rather than offsetting this increased spending with cuts, the administration plans to raise tax revenues by driving economic growth. High government spending is a familiar policy of recent years and should provide ongoing support to jobs, consumer spending and corporate earnings – creating what should be a favourable backdrop for equity markets. However, this spending, albeit less than feared, and increased tariffs are still likely to put upward pressure on inflation. Additionally, credit ratings agency Moody's downgraded the US sovereign rating by one notch (from Aaa to Aa1), citing concerns related to ongoing growth in the national debt. Moody's was the last of the three major agencies to act, following similar downgrades by S&P in 2011 and Fitch in 2023. The downgrade prompted a sell-off in government bonds and an increase in yields, reflecting market expectations that the administration's spending plans will require even greater debt issuance.

In the UK, public borrowing is also growing, despite recent cuts to welfare and winter fuel payments. However, the economy recorded impressive growth of 0.7% in the first three months of the year - a welcome data point for Chancellor Reeves. Strong wage growth is supporting consumer finances, helping bars and restaurants, while business investment expanded in the first quarter and export volumes increased. Further good news came as PM Starmer reached a trade agreement with the US whereby tariffs on steel, aluminium and car exports will be reduced. It is not all good news though, consumer confidence has been fading and inflation jumped to 3.5% in April, driven by higher energy bills after regulators raised the household price cap by over 6%. As a result, investors scaled back expectations for further interest rate cuts, pushing bond yields higher, with the UK 30-year gilt yield rising to its highest level since 1998. Nonetheless, confirmation of a positive start to the year helped UK stocks and Sterling gain in May.

Bottom Line

There are likely to be ongoing bumps in the road over the coming months as tariff negotiations continue. Therefore, careful construction of multi-asset portfolios is important. Notably, May marked a significant shift in tone after months of market turbulence. President Trump's decision to ease off on both tariffs and spending cuts has helped restore a more supportive medium-term outlook for global growth and equity markets.

NORTH CAPITAL

Month in Numbers

Change in various markets over the month:

ASSET NAME		CHANGE / VALUE
EQUITIES Local Currency		
United Kingdom	▲	3.27%
Eurozone	▲	5.75%
United States	▲	6.15%
Emerging Markets	▲	2.86%
Japan	▲	5.33%
BONDS/RATES Absolute change (%)		
Bank of England Base Rate	▼	-0.25% / 4.25%
Federal Reserve Funds Rate	-	0.00% / 4.50%
UK 10-Year Gilt Yield	▲	0.21% / 4.65%
US 10-Year Treasury Yield	▲	0.23% / 4.39%
CURRENCIES		
GBP/USD	▲	0.98% / $1.35
GBP/EUR	▲	0.80% / €1.19
DXY (USD Index)	▼	-0.14% / 99.33
COMMODITIES		
Gold (USD/ Troy Oz)	▼	-0.69% / $3,285.34
Brent Crude Oil (USD/Barrel)	▼	-0.64% / $63.92
NOTEWORTHY		
NVIDIA Corp.	▲	24.06%

June 2025

As of 31 May 2025

Q&A

The Rise of Artificial Intelligence

Artificial intelligence, or AI, is the ability of machines to replicate human intelligence by learning from data, recognising patterns, understanding language, making decisions, and continuously improving. This enables AI to handle tasks such as facial recognition, speech processing, personalised recommendations, and even autonomous driving. AI is already transforming industries like healthcare, finance, education, and entertainment by driving efficiency, enhancing productivity, and unlocking new possibilities. One of the most well-known AI tools, ChatGPT, has experienced explosive growth since its launch in 2022, reaching nearly a billion weekly users and becoming one of the fastest growing consumer applications in history. This surge in adoption reflects just how deeply AI has become embedded in everyday life, with India accounting for 14% of users and the United States 9%. In the investment world, early adopters like Microsoft and Meta have already seen notable earnings growth from their AI initiatives. As we enter the next phase of adoption, the benefits of AI are poised to spread across all sectors. Companies across a broad range of industries are now using AI to optimise operations and fuel innovation. For instance, John Deere is leveraging AI to enhance both its manufacturing processes and its agricultural equipment. By integrating AI into its tractors, the company enables precision agriculture, where machines analyse field conditions in real time and automatically adjust settings for planting, spraying, and harvesting with greater accuracy and minimal waste. Looking ahead, AI's rapid advancement represents more than a technological leap; it marks a fundamental shift in how businesses operate, compete, and create value in a fast-changing world.

Was Putting Musk in Charge of DOGE Symbolic or Effective?

Elon Musk's controversial spell as head of the Department of Government Efficiency (DOGE) has ended, marking a key moment in the US administration's ongoing tension between fiscal restraint and deficit funded populism. His appointment was both symbolic and political, pitched as a way to rein in government excess while also rewarding Musk for his sizeable financial support of the Trump campaign. Despite early optimism, Musk's tenure was defined by erratic communication, internal discord, and limited policy cohesion. The administration ultimately pivoted away from fiscal discipline, unveiling Trump's "Big Beautiful Bill" and abandoning most of DOGE's cost cutting agenda. During his time in office, Musk oversaw sweeping layoffs and programme cancellations, claiming $160 billion in savings. However, independent estimates suggested these cuts could cost taxpayers $135 billion in the near term and delivered little towards Musk's ambitious $2 trillion annual savings target. Legal challenges and political opposition further hindered progress. As seen in the UK under Rachel Reeves, the US has discovered that spending is politically easier than delivering cuts. Musk's appointment also coincided with marked volatility in Tesla's share price. The stock initially rallied on hopes of favourable policy alignment, particularly after Trump publicly endorsed the company, appeared with a newly purchased Tesla, and announced a federal order for armoured vehicles. Shareholder confidence began to erode as concerns mounted over Musk's divided focus and the perception that Tesla was being drawn into partisan politics. Operational issues at the company added to investor unease, while international backlash against US policy saw Tesla's global sales slow. By the time Musk's tenure at DOGE ended, Tesla's share price had given up most of its earlier gains. Though Musk's government role ended in failure, the return to expansionary fiscal policy is significant. It should benefit US equities and stores of value, while reinforcing negative pressure on bonds as deficits widen.

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