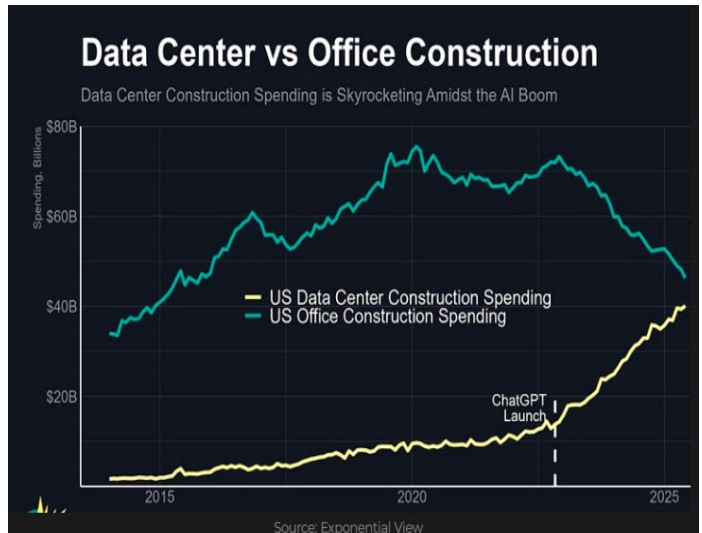
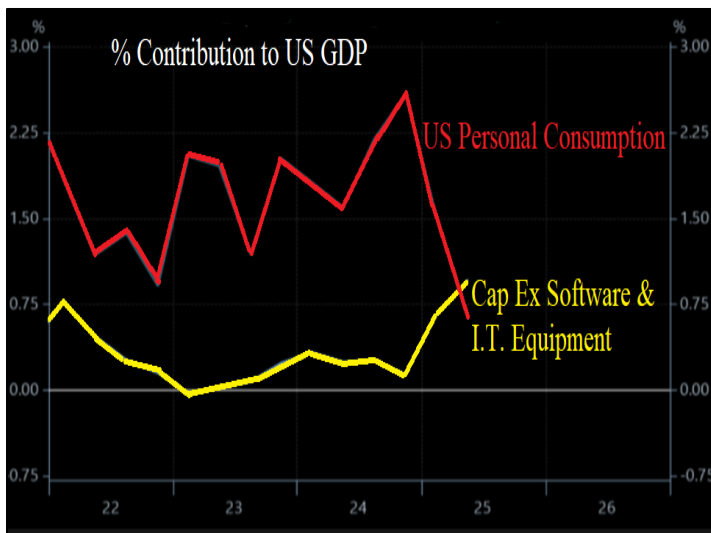


August 1st saw the big EU/USA trade deal that the markets were waiting for. This is a flat 15% tariff with a commitment to buy virtually all of the US's current gas production. Very similar to the Japan deal and at the higher end of market expectations. The overall effective tariff rate, according to Fitch, is now 17%, towards the top of the initial 10%-20% range. The EU deal is very one-sided and raises more questions than it answers. Notwithstanding any political fallout in Europe, it appears that Brussels has "caved in" to every Trump demand. The gas deal seems impossible to fulfill; what happens then? Pharmaceuticals are not included, which has big implications for Ireland and Denmark. More importantly, is this deal and the others just part of a process whereby the US President continually uses tariffs as a leverage tool for any foreign policy issue? Trump's success so far seems to have emboldened him to use the threat of tariffs for non-trade issues. Brazil and India are experiencing this just now. The risk for markets is that, far from passing, US trade tariffs are now a constant issue. More importantly, what impact will these tariffs have on the US economy? Job growth seems to have already collapsed and prompted the immediate sacking of the head of the department that collates the figures. Not a good image for the US. The market's attention will now move to the economic impact on US inflation and US consumer behaviour.

The US Consumer and A.I. Data Centres



These charts in a nutshell show exactly what is happening in the US economy. Trump's actions have scared the US consumer. Whether this is fear of unemployment or indeed deportation, inflation and tariff-led fear of inflation all have had an impact on consumer behaviour. Mortgages and auto finance interest rates have a big impact on disposable income. The fear that tariffs will stimulate inflation is keeping US interest rates at high real levels. The widely used 30-year Fixed Rate Mortgage is currently at 6.78%. "Refi," i.e., remortgaging to take out equity from a property, is a big part of US consumer behaviour. This is why Trump continues to verbally abuse the Chair of the US Federal Reserve Bank on a daily basis. The reality is that without the tariffs, US interest rates would probably be at a much lower level. Logically, tariffs must harm the US economy (unless there is a counterbalancing cut in interest rates) and that seems to be already happening. Since the Presidential Election, the US consumer has gone on strike, just as they did during Trump's first term of office. The decline in the Red line shows that the growth in the US economy is now primarily due to capital expenditure on technology rather than consumer spending. This is all A.I. infrastructure and does not include the matching expenditure on electricity generation and transmission. A.I. expenditure is masking the weakness in the US consumer.

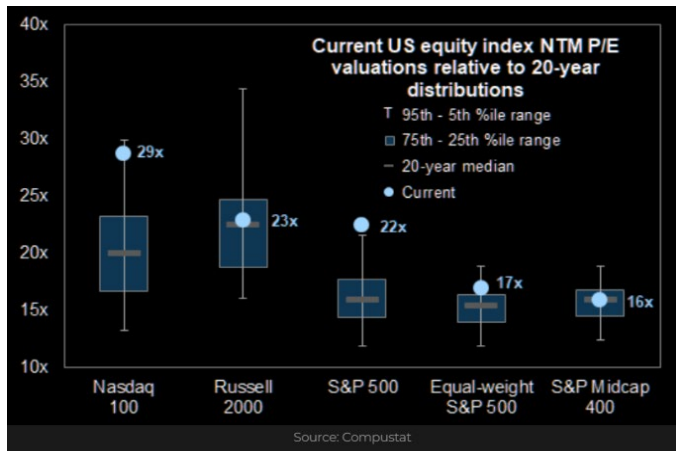
US Interest Rates and the US Labour Market

Until recently, the markets expected maybe only one interest rate cut from the Fed this year and that was dependent on the tariff impact on inflation. However, the Fed, unlike the Bank of England, has a dual mandate: inflation and employment. Clearly, the two are linked. Normally, inflation is choked off by slowing an economy down, which in turn leads to unemployment. That didn't happen during the last inflation/interest rate cycle, as post-Covid businesses sought to retain as many staff as they could. However, Donald Trump's policies on immigration and the likely tariff impact are clearly impacting consumer demand and thus some businesses are starting to struggle and appear to be laying off staff. The last US Non-Farm Payrolls data was poor and led to an immediate

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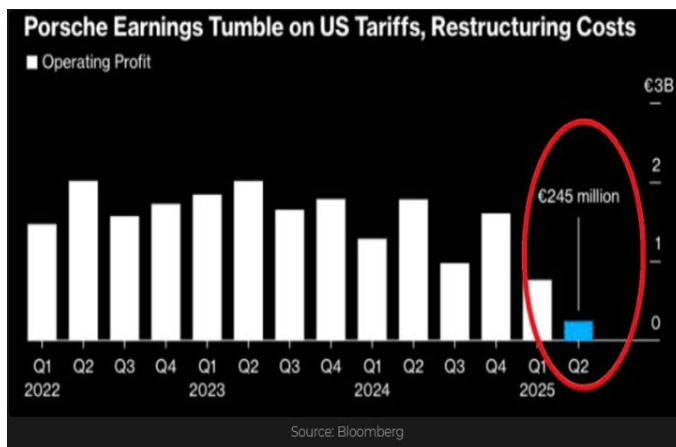
expectation for US interest rates to be cut in September. The numbers were so bad that the head of the US statistics office was promptly sacked. There is a long-standing debate about economic statistics, with each country using its own peculiar methods to calculate the data, which the markets are entirely reliant on. Nevertheless, markets are now convinced that interest rates are coming down. While inflation will rise, the Fed will be forced to act by a slowing economy and rising unemployment.

US Valuations



As earnings recover, the recent US corporate earnings season has seen the average earnings per share of all S&P 500 companies reach a record high. Attention often turns to the valuation side of the equation. The perfect investment environment is rising profits, rising expectations, and cheap valuations. The problem is that A.I.-related tech is distorting the valuation calculation and making the US look very expensive. However, as this table shows, outside the big tech companies, valuations are well within range. Indeed, shares are often at their most expensive in the first year of a new cycle, which is where we are now. Small (Russell 2000) and Mid Cap valuations are particularly striking. As long as tariffs do not precipitate a collapse in US corporate earnings, then reasonable valuations will help underpin markets.

Porsche



Porsche, by profit margin, always used to be the most profitable car maker in Europe, if not the world. Operating profits reliably topped €2 billion a quarter; last quarter, they fell to €245 million. Unlike BMW and Mercedes, Porsche does not have a US manufacturing base; indeed, most cars are still made in Germany. If any company is likely to suffer from tariffs, it is Porsche. Also, as a relatively small-scale manufacturer, investment in electric and hybrid vehicles is a big percentage of costs. With the US and EU now going separate ways on electric vehicles strategically, Porsche is facing huge challenges. Can it cut costs in Germany given the powerful unions? Does it switch to military vehicles? Does it move production of the high-margin Cayenne from Slovakia to the USA? With a share price down two-thirds from its recent high, Porsche is facing a difficult post-tariff world.

Markets

The first stage of the US tariffs is reaching its conclusion. The average tariff placed on US importers will average out at around 17%, which is at the top end of the market's "acceptable" range. It will take some months for the pricing impact to be seen by US consumers and thus in the US inflation numbers. So far, the markets believe that it will cause a one-off blip in the numbers that the Fed will (or will be forced to) see through. Trump needs interest rates down and the slowdown in US consumer spending cannot be a coincidence with the tariffs. Economists believe that it will be the consumer that pays, not the manufacturer, unless the US dips into recession. This is at the heart of the market's current uptrend. If tariffs cause a short recessionary shock, then that's fine as interest rates will fall. Interest rates go down, markets go up. With earnings growth now back into a normal uptrend and US interest rates now forecast to be cut next month, it is only inflation that might cause a concern for markets. With valuations low and for all three of the key drivers currently positive, the market uptrend seems well supported. The summer months are always volatile, and markets will be wary of a post-tariff hangover. Much will depend on the inflation news will it be enough to choke off the "animal spirits"?

August 2025

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