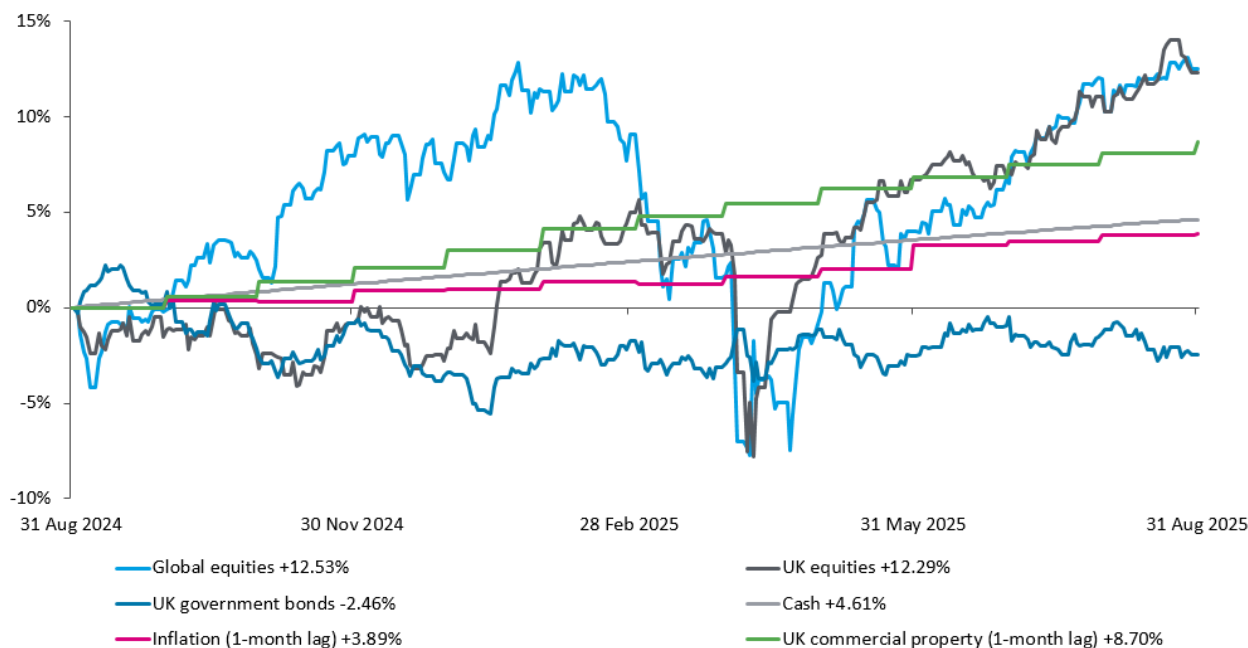


# Market report

## The headlines

- ▶ **Share prices posted modest gains in August, as more US tariffs came into effect but stock market volatility fell.**
- ▶ **The Federal Reserve now appears more likely to start cutting rates in September, but the Bank of England seems nearer the end of its rate cuts than previously thought.**
- ▶ **Stock market gains have become more concentrated among fewer shares since early 2025, so managing idiosyncratic risk in portfolios has become more important.**

### Market returns: Share prices posted modest gains in August, and volatility fell.



Sources: Bloomberg, in pound sterling, as of 31 August 2025. Daily data, except for inflation and UK commercial property, shown monthly. UK government bond returns as per Markit iBoxx £ Gilts Index. UK inflation index (31 August 2024=0%) as per the Office of National Statistics' Consumer Prices Index, with a one-month lag. UK commercial property as per MSCI UK Monthly Property Index, estimated for the most recent month. Cash returns as per Sterling Overnight Index Average (SONIA). Global and UK equity returns as per MSCI World Index and MSCI UK IMI Index, respectively. **Past performance is not a reliable indicator of future results.**

## Economics and markets news

World share prices rose 0.5% in August, in pounds sterling, as a September interest rate cut by the US Federal Reserve ('the Fed') became more likely.<sup>(1)</sup>

US share prices rose 1.9% during the month, in US dollars. But the dollar weakened more than 2% versus the pound in August. So, despite *loca* records in US shares, US share prices fell 0.2% in pounds sterling. By

comparison, UK share prices rose 1.1% and eurozone shares 0.4% during the month.

Bond yields fell in the US, as the Fed became more likely to cut interest rates in September.<sup>(2)</sup> By contrast, yields rose in the UK and the eurozone, where central banks are near or at the end of their rate cutting cycles.

## United States

A range of US tariffs came into effect in August. But tariffs didn't dominate the stock market narrative as much as they had in previous months.

Instead, US share prices rose to new record highs during August, in dollar terms. (The dollar itself, however, weakened more than 2% in August, relative to the pound sterling. So, in pound terms, US share prices fell.)

US share prices mainly rose after Fed chair Jay Powell suggested that America's slowing labour market might warrant a rate cut. His statement was bolder than investors had expected.

US inflation increased from 2.8% in June, year on year (yoy) to 2.9% in July, on the Fed's preferred measure, core PCE (Personal Consumption Expenditure) inflation. This was the highest inflation reading since March.

But only 73,000 non-farm jobs were created in July, and previous months' earlier numbers were revised down. Unlike the Bank of England, the Fed has a 'dual' mandate. Next to controlling inflation, it aims to promote maximum employment, so lower jobs numbers could trigger a rate cut.

However, some economists saw signs of a slowdown in these jobs numbers, mainly due to President Trump's many policy announcements. And Trump's reactions in August also raised concerns. He fired the civil servant in charge of labour statistics after her department published the July numbers. In addition, Trump tried to remove Fed governor Lisa Cook, while pressuring Fed chair Jay Powell to lower interest rates. If the US President continues to undermine the Fed's independence, he might make it more difficult for the Fed to control inflation.

Despite Trump's attempts to interfere, the Fed might cut interest rates in September, especially if August job numbers turn out to be weak. As a result, two-year US Treasury (government bond) yields fell from 3.94% at the end of July to 3.59% at the end of August. Ten-year Treasury yields fell from 4.37% to 4.23% over that time.

In the stock market, the chemicals, health care and communications sectors were the best performers during the month. Shares of microchip maker Intel were among the biggest gainers, as the US government acquired a 10% stake in the company.

Share prices of the so-called Magnificent 7<sup>(3)</sup> gained a modest 1.8% during the month. Apart from Tesla, most of the Mag 7's second-quarter results were solid. However, even small disappointments resulted in price falls. Microchip maker NVIDIA, for example, reported steady revenues on 27 August, but signalled uncertainty over its sales in China. As a result, the company's share price fell more than 4% over the last three days of August.

## United Kingdom

UK share prices rose 1.10% during August, led by mining company Fresnillo, medical device maker Smith & Nephew and pumps business Spirax.

The pound sterling strengthened against the US dollar during August, which reduced returns on dollar-denominated assets. The stronger pound mainly resulted from the Fed's more dovish stance, rather than what happened in the UK.

In early August, the Bank of England (BoE) cut its main interest rate from 4.25% to 4.00%, even though UK consumer prices (CPI) inflation rose from 3.6% yoy in June to 3.8% in July.

Inflation mainly rose because of airfares and food prices, and because fuel prices fell less in the 12 months to July 2025 than in the preceding year. The Bank also remarked on a cooling in the jobs market. It therefore does not expect inflation to become entrenched, but to peak at 4.0% in September and fall back to its 2% target by mid-2027.

Remarkably, the BoE's August decision took an unprecedented second round, with a narrow 5-4 decision in favour of a rate cut. Many analysts therefore believe that the end of this rate-cutting cycle is nearer than previously thought.

As a result, yields on two-year UK government bonds ('gilts') rose from 3.70% at the end of July to 3.79% at the end of August. That's mainly because of the higher inflation described above, and because investors now expect fewer rate cuts.

Ten-year gilt yields rose from 4.60% to 4.77% over the month. An important reason was the record borrowing by developed countries, all chasing the same global pool of investible liquidity. In addition, the UK government increased its borrowing over the last year. Its autumn budget, announced for 26 November, is expected to include a combination of spending cuts and tax rises.

## Other markets

**Eurozone** share prices rose 0.4%, in euros, and the euro strengthened versus the pound. August is traditionally the weakest month for eurozone shares. This August's positive outcome, however, was helped by a rally in banking shares in early August (Banks are relatively insulated against tariffs.) and a rebound in industrial and pharmaceutical companies, such as Novo Nordisk.

The European Central Bank did not meet to set rates in August. Eurozone inflation was 2.0% in July, yoy. This reinforced analysts' views that the Bank will leave interest rates unchanged in the foreseeable future.

Share prices in **China** rose 4.2% in August. Chinese interest rates have drifted lower this year, making shares more attractive by comparison. In addition, China's government relaxed its rules for state funds to invest in the stock market and the shares of Chinese tech companies gained in popularity.

Despite its rising stock market, China continued to suffer from deflation, as producer prices fell 3.6%, yoy, in July. Falling prices hold back the nominal value of the country's gross domestic product (GDP).

**Japanese** shares advanced 4.3% during August. The domestic economic outlook improved, as GDP was reported to have grown an annualised 1.0% in the second quarter, up from 0.6% in the first.

Japan's central bank reiterated that it would raise interest rates when conditions allow. But the absence of a specific timeline weakened the Japanese yen somewhat. Japan's inflation rate decreased from 3.30% in June to 3.10% in July. The central bank aims to raise its main policy rate from its current, 0.5% level. But it is careful to avoid returning the country to the chronic deflation that plagued it from the 1990s until 2023.

<sup>(1)</sup> Source: MSCI (net total return in local currency), except where stated

<sup>(2)</sup> Sources: US Federal Reserve, Bank of England, European Central Bank

<sup>(3)</sup> The 'Magnificent 7' or 'Mag 7' are seven of the world's biggest tech companies: Apple, Amazon, Google parent Alphabet, Meta Platforms, Microsoft, NVIDIA and Tesla.

## Looking ahead

Market chatter about tariffs subsided in August, so now is a good time to highlight the stock market's increasing concentration, a key characteristic that we've continued to watch.

By market capitalisation, the 10 largest shares in the S&P500 index made up nearly 40% of the index at the end of August, a new high. Compared to the dotcom bubble of the early 2000s, we don't consider all the largest stocks overvalued at this time. That's because, for example, earnings growth for the Magnificent 7 was an impressive 27% in the second quarter of 2025, yoy.

And broader statistics appear supportive of shares as well. US consumers' and US companies' balance sheets remain strong, in aggregate. The Fed appears on the cusp of cutting interest rates for the first time since 2024. And the worst of US trade policy news seems to be behind us.

However, the Magnificent 7's cash flow as a percentage of their share price (their 'cash flow yield') has been falling lately. That's mainly because IT businesses used

to be capital-light, while the current AI boom requires massive investment in data centres.

In addition, there are signs of a frothy stock market. Zero-day options, which 'day traders' use to speculate, now account for 61% of all options trading in the S&P500. The VIX index, a measure of market uncertainty, fell to its lowest level for the year in August. And shares in trading platform Robin Hood, have gone from \$8 to \$108 since December 2023.

### So, if we are near bubble territory, how do we invest?

Previous peaks in 2000, 2008 and 2020 ended with steep price falls. The world's largest companies at the time, such as Cisco, Nortel or General Electric, are now worth a fraction of their peak values then. So blindly buying the largest firms, or those whose share prices have risen most, is not the best strategy.

And even buying shares in proportion to their market capitalisation (so-called 'passive' investing) doesn't look attractive. It reduces diversification, when we know that some of the largest companies will fall out of that leading group at some point.

Instead, we continue to focus on quality shares to see us through this frothy stock market. Those are shares of companies with high returns on equity, stable year-on-year earnings growth and low debt levels.

Inevitably, this strategy may temporarily lag some market segments, such as growth stocks in the current environment. But, historically, quality shares have outperformed in the long run. And they have been more stable than growth stocks in a downturn. As before, therefore, we continue to focus on the longer time horizons over which our clients expect us to serve them, not the short run.

## Glossary

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