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MARKET INSIGHT

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Overall, August was a broadly positive month for financial markets and saw fairly solid returns across most major asset classes.

Global equity markets are still benefiting from a tailwind. Economic growth is moderating but sufficient to allow 5-10% profits growth, more so for larger companies, for multi-nationals, and the all-important tech sector. Monetary policy is not restrictive, fiscal policy is supportive, companies can cope with Trump's existing deals on tariffs, and bond investors are not yet worried about future debt issuance.

The key economic data over the month was the release of US non-farm payrolls for July, which suggested the US labour market was slowing.

The economic picture

Starting with the economic picture, the global economy is in a 'Goldilocks' environment for investors, neither too hot nor cold. Consumer sentiment remains weak and many companies are wary of investing, but household spending is sustained by strong balance sheets, unemployment has only edged up, and debt servicing costs remain relatively low. The latest ISM/PMI business surveys support such a moderate expansionary view; these remain about 48-50 for manufacturing (i.e. stagnation) and 50-52 for service sectors (i.e. slow expansion) in most of the major economies. Averaging out volatile

quarterly data, US GDP growth was 1.2% annualised in the first half of the year, and looks set to be 1-2% into Q3 as well.

The key economic data over the month was the release of US non-farm payrolls for July, which suggested the US labour market was slowing. At Jackson Hole – the Federal Reserve's (Fed's) annual get-together for central bankers – Fed chair Jerome Powell indicated the balance of economic risks had changed based on this release, potentially justifying an alteration to the Fed's current policy position. As a result, markets are now pricing in that the Fed will reduce the fed funds rate by 0.25% at its September meeting. At the same time, the White House is applying considerable pressure on the Federal Reserve, both for larger rate cuts (Treasury Secretary Bessent argues that rates should be at least 1.5% lower) and also for new personnel on the Board (calls for Powell and Cook to resign).

Inflation

A mixture of tariff effects, food prices driven by climate change, and wage gains from tight labour markets, have all ensured that inflation in most of the major economies either remains higher or looks to be trending upwards more than central banks would like to see.

Policy makers can only envisage future interest rate cuts by forecasting that one-off factors will fall away, and labour markets will ease, allowing inflation to return towards target. The UK continues to have an inflation problem. Headline and core inflation at 3.8% a year are well away from MPC targets and look to worsen modestly into the autumn, reflecting, for example, energy prices. Headline and core inflation at 3.8% a year are well away from MPC targets and look to worsen modestly into the autumn reflecting for example, energy prices. This has led investors to temper their expectations for Bank of England (BoE) rate cuts over the rest of 2025, despite a waning UK jobs market. Eurozone inflation at 2% gives the European Central Bank (ECB) time to monitor the impact of the US-EU trade deal on economic activity and whether to move again.

The annual amount of tariff revenue is running about \$300bn, the majority of which is in essence a regressive tax worth some 2% of GDP on US lower income households and businesses which import. Goldman Sachs estimates that overseas firms are currently taking about 25% of the tariff burden, US consumers about 15%, meaning about 60% currently rests on US companies.

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Assets and factor performance

Turning to growth assets, Japan was the best performer in local currency terms, helped by the US-Japan trade deal agreed towards the end of July and supportive economic data. US gains were supported by solid second quarter earnings: with most firms now having reported, around three-quarters of the major US index beat forecasts, by the largest amount since 2021. Nvidia – the most prominent company reporting – beat overall sales and earnings estimates but missing data centre revenue forecasts. Concentration risk however remains a theme. The \$4 trillion market caps of Nvidia and Microsoft are both not far away from that of the whole blue chip Eurozone index.

The UK underperformed in relative terms in August, with Britain's domestic backdrop looking challenging. However, the UK continues to benefit from its status as a high dividend paying market. Computershare's Dividend Monitor forecasts that regular dividends paid by UK companies will reach £85bn this year, about 3% higher than a year earlier.

Turning to factor performance, smaller cap outperformed their large cap counterparts in August, driven by fairly resilient global activity data and, for US smaller firms, rising expectations for near-term rate cuts by the Fed. Momentum was the relative laggard over the month, but this factor still produced a positive return.

In terms of defensive assets, US Treasuries ended the month up just under 1%. Fed Chair Jay Powell's Jackson Hole speech was the main driver for this. UK Gilts came under further pressure following another upside surprise to UK inflation in July. In response, investors reduced their expectations for rate cuts by the BoE, which raised short-end Gilt yields. Longer-dated Gilts also underperformed, with the UK 30-year government bond yield reaching 5.6% (its highest level since 1998) driven by thin liquidity and ongoing concern about UK fiscal sustainability.

Summary

In summary, a supportive outlook is already reflected in growth asset valuations, which roughly sit above their long-run averages, notably in the US. Thus, investors should ensure their portfolios continue to be well-diversified across both regions and assets, to help protect against the chance of a delayed, trade-related slowdown, as well as against any re-emergence of inflationary pressures, as the impact of tariffs feed through to consumer prices.

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