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MARKETS UNWRAPPED

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Market review: bonds, AI spending and what October meant for investors

Markets delivered a mixed picture in October. UK equities performed positively, while some overseas markets experienced a more challenging month, particularly areas with greater exposure to large technology companies. Bond markets, meanwhile, strengthened as yields eased from recent highs.

Behind these movements were several important themes for investors. Corporate earnings remained relatively resilient, but questions around the significant sums being invested in artificial intelligence (AI) created volatility among some of the world's largest technology companies. Changing expectations for inflation and interest rates also continued to influence bond markets.

Together, these developments demonstrate why it can be useful to look beyond whether markets have simply risen or fallen and consider what is driving those movements.

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Bond markets find some support

Bond markets had a more positive October following periods of volatility earlier in the year. Government bond yields fell modestly during the month, supporting bond prices. Bond prices and yields move in opposite directions. When bond prices rise, their yields fall, and vice versa.

One factor supporting demand is that government bond yields remain relatively high compared with much of the past few decades, potentially making them more attractive to investors seeking income.

There is still uncertainty about what happens next. Higher oil prices have added to inflationary pressures, while investors continue to assess how central banks could respond. However, financial markets are forward-looking. Bond prices reflect not only what is happening today, but also expectations for inflation and interest rates in the months and years ahead.

What did the UK Budget mean for markets?

The Budget attracted considerable attention, but its immediate impact on financial markets was relatively limited. Changes included higher taxation on banks, although the increase was less significant than some investors had anticipated. While banking shares initially reacted to the announcement, there were no substantial movements across the wider UK equity market. Government bonds also remained relatively stable, with investors appearing reassured by the government's commitment to its fiscal rules.

For long-term investors, this is a useful reminder that major political events do not always have a meaningful impact on financial markets. Ultimately, what can matter more is how policies affect economic growth, company profits, inflation and government borrowing over time.

AI investment comes under greater scrutiny

Artificial intelligence remains an important influence on global equity markets. However, attention is increasingly shifting from how much companies are investing in AI to whether that investment will ultimately generate sufficient returns.

Some of the world's largest technology companies are spending substantial sums on data centres, computing power and other AI infrastructure. While this investment has supported expectations for future growth, it has also raised questions over how quickly that spending will translate into additional revenue and profits.

October's company results highlighted this tension. Some technology companies reported positive underlying results but still experienced share-price falls as investors focused on rising AI expenditure and questioned the potential future returns.

It is an important distinction for investors. A company can continue to grow and report healthy profits, but its share price can still fall if its results or outlook do not meet the expectations already reflected in its valuation.

Opportunities beyond the largest technology companies

Although AI continues to dominate many market headlines, October also demonstrated that the investment landscape extends well beyond the largest US technology businesses. Corporate earnings outside the biggest technology companies remained relatively positive, supported by resilient economic conditions in areas including the US and UK.

This is particularly relevant after a period in which a relatively small number of large technology companies have had a significant influence on global equity market returns. Holding a diversified portfolio across different regions, sectors, companies and asset classes can help reduce reliance on any single company, market or investment theme.

US politics returns to the spotlight

Attention is also turning towards the US midterm elections and what the outcome could mean for future policymaking.

The US political system requires the president to work with Congress, which consists of the House of Representatives and the Senate, to pass many forms of legislation. When different political parties control these institutions, it can become more difficult to introduce significant policy changes, a situation sometimes referred to as political gridlock.

From an investment perspective, history provides limited evidence that one political configuration is consistently better for markets. Political developments can influence sentiment in the short term, but they remain only one of many factors affecting investment returns.

Looking ahead

Several themes are likely to remain important for investors as we move through November:

- Corporate earnings and whether companies can continue to deliver profit growth.
- AI investment and whether higher spending begins to translate into revenues and profits.
- Inflation, including the impact of oil prices.
- Interest rate expectations in the UK and US.
- Government bond yields and whether recent stability continues.
- The US midterm elections and the implications for future policymaking.

Corporate earnings outside the biggest technology companies remained relatively positive supported by economic conditions

While the largest technology companies will remain firmly in focus, results from businesses elsewhere in the market should also provide useful insight into the health of the wider economy.

In summary

October provided a reminder that markets do not always move together. While some equity markets and technology companies experienced volatility, bonds had a more positive month and corporate earnings outside the largest AI-related businesses remained relatively resilient.

For bonds, higher starting yields have made the asset class more attractive to some investors, although inflation and interest rate expectations will continue to influence performance.

For equities, investors are increasingly asking whether the significant amounts being spent on AI can generate sufficient long-term returns. At the same time, positive earnings elsewhere in the market reinforce the importance of looking beyond the largest technology companies.

For long-term investors, diversification remains important. Spreading investments across different asset classes, regions, sectors and companies can reduce dependence on any single outcome, while helping investors remain focused on their longer-term objectives rather than short-term market headlines.

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