Courtville Partners – Investment Outlook, October 2025

Summary of the key points in this quarter's Investment Outlook:

- Wall Street's AI boom is reminiscent of the dotcom era – but no one can predict when or how it will end.
- We think the odds remain against a US recession and so are not tempted by US treasuries at current yields.
- Other anti-fragile assets (e.g. gold and crypto) continue to replace government bonds as portfolio hedges against risk assets – a momentous change in the investment landscape.
- China's new policy to rein in excess manufacturing capacity, plus a weaker US dollar, could drive a new reflationary boom in the global economy.
- Our asset allocation stance is unchanged: equities over bonds and non-US equities over US equities (especially the mega-caps).

Perspective may not be everything, contrary to the adage, but it is important, certainly for investors. Take geographical bias, for example. The building blocks of the United States – civic, economic, political and religious – were imported from Europe. Americans still speak a close variant of our language. Yet for all their interwoven origin stories, have Europeans and Americans ever understood each other less? Answers to this question can only be subjective; but, seen through the lens of portfolio investment, the current level of estrangement seems to us noteworthy. At the risk of over-generalising, the US seems imbued with enormous optimism, even by the standards of a nation known for precisely this quality. By contrast, Europe feels mired in intractable social, political and above all economic problems.

We mention the disparity in the moods either side of the Atlantic because of its bearing on one of the biggest issues now facing investors: has the Artificial Intelligence boom pushed the US stock market into bubble territory? And, if so, what should investors do about it? We've addressed this subject before. After all, neither stretched US equity valuations nor the market's hyper-concentration ranks as news. We have stuck to our belief that investors should do two things: favour real assets over nominal assets (principally equities over bonds) and resist the temptation to time markets. As we'll argue later on, we don't share the view that a US recession is likely – both fiscal and monetary policy are too loose for that. Rather, we see a bigger undiscounted "risk" that the global economy embarks on a major reflationary boom. If that's the case, real assets stand to do very well, even after so many years of stock market strength. But what about Wall Street's AI mania?

We have to go back to the dotcom boom of the late 1990s to find similarly low levels for the equity risk premium (a measure of the value – or lack of it – offered by equities versus risk-free government bonds). The nagging worry is that, just as late-1990s investors came to believe collectively that the internet would change everything, including the foundational principles of company valuation, AI is now an irresistible lunar influence on the tide of share prices in the mid-2020s.

Taken in isolation, some of the numbers around AI's stock market clout are eye-popping. For example, chipmaker Nvidia is now capitalised at $4.3trn, which is 10% more than the entire UK stock market (and getting on for double the German market). And here's another one: in the three years since Chat GPT was released, the US market's capitalisation has ballooned from $40trn to $65trn. For context, this $25trn increase equates to over 80% of US GDP. There is no precedent in economic history for portfolio wealth creation on this scale.

AI optimists contend that this latest technological revolution will boost both productivity and corporate earnings enough to justify the valuations. They may be right; but no one can know. There are, however, grounds for caution. First, Big Tech is committed to a gargantuan AI-driven capital expenditure binge (approximately $400bn so far this year, equal to more than 1% of US GDP). But there is little evidence yet that these investments will do magical things for either productivity or profits – or that the returns on investment be good enough either to underpin the investing companies' share prices. And why does Nvidia feel the need to invest $100bn in OpenAI, which is its customer? Isn't this the vendor financing movie we've seen at previous cyclical peaks?

The mood-music was similar in the second half of the 1990s as the internet got going. That stock market boom was also a response to vast corporate capital expenditure, much of which failed to earn satisfactory returns (or any returns at all), at least for several years. Once this awkward truth became unavoidable, the valuations of internet-hype stocks duly collapsed, leaving equity investors to pick up the bill. Here in Autumn 2025, contemplating AI as an economic phenomenon, can we discern where we are in the cycle? To put it another way, is this 1996 or 1999? Are stock markets more likely to melt up or melt down from here? This is important: investors who pulled the valuation rip-cord in 1996 turned out to be walking away from enormous portfolio gains.

These AI-related thoughts come as we approach what one analyst has dubbed "the financial hurricane season" – a reference to the weird fact that almost every stock market implosion of the last hundred years has come in the three months between mid-August and mid-November. Although the future is unknowable (as we so often remind ourselves), gloomsters can point to many possible triggers for a crash, including impending US recession (which we rate as unlikely), sky-high equity valuations, unhealthy levels of share buying by retail investors, the delayed inflation impact of US tariffs, the US Government's continuing fiscal profligacy – and so on.

What we *can* say is that this year has already been a rollercoaster ride. By mid-April, the global equity index was down 12%, mainly in response to US tariffs ("Liberation Day" and all that), but has since recovered in style, rising 33% from the nadir – and is now showing a dollar gain of 18% for the year so far. More interesting to us is that the S&P 500 has *under*performed the MSCI All World Index (+15% vs +18%, both in dollars). For all the hullabaloo over AI, the strongest year-to-date market performances have been in Asia (China +39%, Asia-Pacific +29%) and Emerging Markets (+24%). Even Japan came roaring back in 3Q25, rising 12%. We won't repeat here what we wrote last time about the Valeriepieris circle. We would simply add that a European geographical perspective doesn't necessarily help investors who are on the look-out for secular growth opportunities. Europe is not where it's at; and we see little chance of that changing. Not for nothing is our Model Portfolio almost double-weighted in Asia and Emerging Markets (19.2% vs 10.5%).

Why have Chinese equities emerged from their multi-year deflationary slumber? Should investors be chasing this particular dragon? "Anti-involution" barely counts as English in our book, but has somehow become the accepted term for Beijing's latest economic policy – namely, the removal of widespread excess capacity in many industries. After years of trying to boost demand in various ways, the government hopes this will open up a second (supply-side) front in its war on deflation. We have no idea whether it will succeed. The enthusiastic reception by equity investors is a reminder that stock markets are discounting mechanisms. Nevertheless, if it does work, the knock-on effects could be hugely reflationary, especially when combined with a weaker (and weakening) US dollar. (By the way, who said Trump and Bessent needed a Mar-a-Lago Accord to drive down the dollar? The currency has fallen 10% this year all on its own.) It wouldn't be a surprise to see profit margins of industrial companies everywhere expanding suddenly. We might even be contemplating a *de facto* repeal of the long-standing economic law (as coined by Gavekal): when

China enters the room, profits walk out. The relative outperformance of industrial stocks around the world hints at just such a development.

A new policy diktat in China is not the only reason to argue that the global economy could be poised for a reflationary boom. Consider also the sheer laxity of both fiscal and monetary policy almost everywhere. Admittedly, Trump hasn't yet been granted his wish for aggressive rate cuts. But neither does the Federal Reserve show much appetite for taming inflation that is running at a headline rate of 4% if ISM and PMI surveys are to be believed. An unfazed market consensus expects 75bp of rate cuts by year-end and sees 150bp by the end of 2026 as probable.

If a lack of monetary rigour isn't enough to spook bond investors, the sight of budget deficits blowing out in almost all OECD countries ought to do it, surely. (Remember DOGE? No one does.) For now, however, the benchmark 10-year US treasury yield remains becalmed at just over 4%, which is low versus the 5-12% range considered normal from 1950 to 2008 and is probably explained by recession fears. We're not falling for it. Several generations of investors may have been able to rely on government bonds as hedges of portfolio risk; but this is no longer the case, as the strong correlations between equities and bonds have been suggesting for a while. It is hard to overstate what a seismic development this is. Why have government bonds lost their anti-fragile properties? Spendthrift politicians must bear some of the blame, of course. But the real villains of the piece are the central bankers whose pathological aversion to recession since the GFC of 2008 has caused capital to be misallocated on a biblical scale. The inventory of damage inflicted by 17 years of abnormally low interest rates includes – but is not limited to – an explosion in wealth inequality, increased risks of financial instability, stagnant productivity and a surge in populist politics.

The purpose of central bankers should be to ensure that an economy's available savings go into new productive assets, not into private sector leverage or even government bonds. When we survey the track record since the GFC, it is not an exaggeration to say that central bankers have failed wider society thanks to wrong-headed monetary policy. As yet we detect no signs of contrition. In our view, Trump is entitled to question the benefits of central bank independence. The irony – lost on the man himself, we assume – is that aggressive rate cuts are more likely to benefit Wall Street than Main Street.

Sensing that government bonds have been undermined either as stores of value or as hedges against risk assets, investors have long been voting with their feet by accumulating other non-correlated assets, including precious metals (gold above all) and cryptocurrencies. Over the last 20 years US equities have underperformed gold by 30%. Go figure indeed. Seen from this perspective, the early 21st century bull market in the US has been something of a monetary illusion. Until central bankers and governments rediscover monetary and fiscal rigour, respectively, this is likely to remain the case. Meanwhile, investors should stick to real assets to the extent they can – equities above all, but also precious metals – and spurn government IOUs (aka bonds); and they should tilt their portfolios towards that Valeriepieris circle.

The Model Portfolio is up 11% year-to-date. Outperformance of 2.6% versus its benchmark can be broken down between +4% owing to asset allocation and -1.4% from currency effects (the weaker dollar above all). Arguably the portfolio expresses only four views that matter: a large underweight position in bonds (and an EM bias within even that shrunken allocation); a modest tilt away from US equities, but a bigger tilt away from the Mag 7 mega-stocks (via the equal-weighted S&P 500 ETF); a near-double weighting in Asian/EM equities; and an outsize cash cushion (as a hedge against financial hurricanes). We are happy to stick to our guns.

Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	10.0	12.4
International Equities	57.0	51.0
Fixed Income	10.0	24.7
Alternatives	15.0	7.3
Commercial Property	1.0	0.1
Cash	7.0	4.5
Total	**100.0**	**100.0**

Courtville Partners Model Portfolio	ETF	Weight (%)	Changes this quarter	Weighted OMC (%)
UK Equities		**10**	**0**	
UK	VUKE LN	8	0	0.09
UK	VMID LN	2	0	0.10
International Equities		**56**	**0**	
Global	IWQU LN	2	0	0.30
US	VUSA LN	7	0	0.07
	XDPG LN	9	0	0.09
	EWSP LN	9	0	0.20
	IUVD LN	3	0	0.20
Euro	VERX LN	5	0	0.12
	XDAX LN	2	0	0.09
Japan	VJPN LN	4	0	0.19
Asia ex-Japan	VAPX LN	4	0	0.22
Emerging Markets	VFEM LN	9	0	0.25
Emerging Markets ex-China	EXCS LN	2	0	0.18
Fixed Income		**11**	**0**	
UK	IGLT LN	3	0	0.07
US	IDTM LN	2	0	0.17
EM	SEML LN	4	0	0.50
China	CNYB NA	1	0	0.35
US	CORP LN	1	0	0.20
Alternatives		**14**	**0**	
Gold	PHAU LN	4	0	0.39
Oil	WEL5 GY	2	0	0.18
Infrastructure	INFR LN	2	0	0.65
Uranium	NUCG LN	2	0	0.55
Water	IH20 LN	2	0	0.65
Carbon Allowances	CARB LN	2	0	0.35
Commercial Property		**1**	**0**	
Global	IWDP LN	1	0	0.59
Cash	XSTR LN	**8**	**0**	0.15
Total		**100**		**0.21%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2025 YTD	11.0%	8.4%	2.6%
Since inception(1/1/2015)	130.9%	116.5%	14.4%
CAGR	8.1%	7.4%	0.7%

The value of your investments can fall as well as rise. You may not get back all the money you invested.