When the Good News Runs Out

13th October 2025

- Markets were vulnerable given recent low volatility.
- The US’s threat of 100% tariffs on China was seen as playing with fire, but there are early signs of a potential backdown.
- The world will remain vulnerable to China's virtual monopoly on rare earth production.
- Global growth looks to be waning as capital investment growth starts to mean revert.

For some time now, we have been pointing out that complacency has been creeping into the markets. Friday's flash market crash significantly disrupted that complacency. After witnessing months of low volatility and steady gains, markets finally reversed course. The S&P 500 fell about 2.4% for the week, while the Nasdaq slid 3.6%, led by semiconductor and AI-related names. The trigger for the decline came from Beijing. China's announcement to impose tighter controls on exports of rare earths and refining technologies was a de facto escalation of a long-simmering resource confrontation that the tariffs have only exacerbated. President Trump's retaliatory threat of 100% tariffs on all Chinese goods from 1 November turned a policy dispute into an outright trade war. Markets abruptly repriced the risk that the US-China economic conflict could reignite just as global growth momentum weakens.

Chart 1: Friday Was a Tough Day for the S&P500
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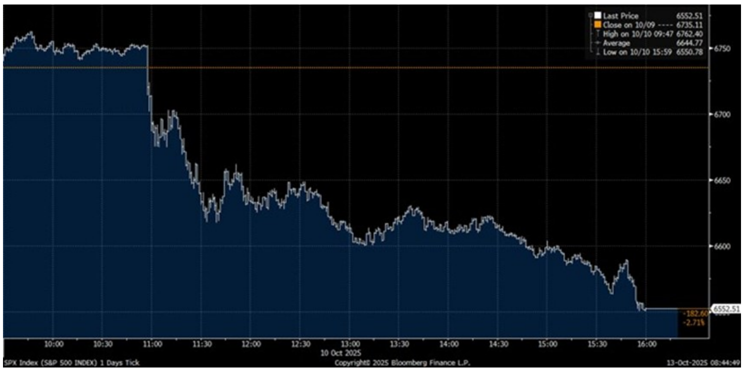

Source: Bloomberg

Rare Earths: The Strategic Choke Point Exposed

China controls roughly 70% of global rare-earth mining and nearly 90% of refining - a stranglehold over the inputs that power high-end electronics, EVs, and defence systems. The new export-licensing rules tighten control over heavy elements such as dysprosium and terbium. Washington's reaction has been reactive: the Pentagon plans a $1 billion stockpile of critical minerals. But Beijing has been preparing for this moment for more than a decade, diversifying away from US demand, securing long-term contracts, and deepening partnerships across Africa and Southeast Asia. The West, fixated on quarterly earnings, has ignored the strategic fragility of its supply chain.

Trump, China, and Strategic Misalignment

The escalation via tariffs exposes a deeper failure of strategy. Trump's tariffs are a political weapon without an industrial plan. Confrontation has replaced coalition-building; allies remain unengaged. China, meanwhile, has been patient and pragmatic, cutting reliance on US soybeans, cultivating Indian partnerships, and accelerating domestic semiconductor and rare-earth capacity. The contrast is stark: China's long game versus the West's reactive populism.

Beyond Tariffs: The Economic Setup Was Fragile

Much of 2025's growth surprise reflected a surge in front-loaded capital investment - now fading fast. The US Logistics Managers Index for September showed Transportation Utilisation collapsing to 50.0, its weakest reading on record versus an eight-year average of 65.1. This should be peak freight season; instead, warehouses are full and shipments have stalled. Warehousing Capacity remains tight at 50.8, signalling an inventory glut rather than vibrant demand. The front-loading of imports earlier in the year to beat tariffs has flipped into payback: full warehouses, weak shipments, and falling consumption. Retail data echo the same story. The CNBC/NRF survey for September reported retail sales −0.66% month-on-month, with seven of eleven sectors declining, notably furniture (−1.9%) and clothing (−1.1%), both tariff-sensitive. Job indicators are softening, ADP −32k in September, ISM Services below 50, and confidence surveys rolling over. The slowdown is already under way.

Q3 Corporate Earnings: Good Numbers, Gloomy Guidance

Earnings season may still deliver respectable backward-looking results, but guidance will matter far more. Corporates are likely to sound cautious. Inventory drawdowns, weak logistics, and softer spending point to margin pressure ahead. The danger is that a market priced for perfection faces a wall of unremarkable guidance, prompting multiple compression even without an earnings collapse.

Economics by Ego

The Fed minutes confirmed that another rate cut is coming; the only debate is timing. The cautious camp still clings to inflation fears, but Friday's turmoil, tariff brinkmanship, market stress, and geopolitical theatrics, strengthens the case for easier policy. Yet, the larger absurdity lies in Washington, where economic strategy is now dictated by ego rather than economics. A 100% tariff on Chinese goods is not policy; it is vandalism. The result is predictable: growth slows long before inflation falls.

Inflation Risk: What the Markets Would Prefer Not to Discount

If the markets were to take President Trump at his word, we would have much more serious downside for financial markets. A blanket 100% tariff on Chinese imports would almost certainly:

- Add 2–3 percentage points to US headline inflation within a year.
- Lift core goods inflation by 5–7 points temporarily.
- Shave approximately 0.5–1% off real GDP, producing a stagflationary shock.
- Force the Fed into a policy dilemma: fight inflation or cushion recession.

In practical terms, it would replay the 1970s-style dilemma of cost-push inflation amid weakening growth - the exact mix that markets fear most.

Over the weekend, the rhetoric between Washington and Beijing shifted subtly but importantly. Chinese officials defended their new rare earth export restrictions as a national-security measure, framing them as a response to the US decision to tighten controls on advanced chip exports, a move that Beijing views as breaking the spirit of earlier trade understandings. The sequence makes clear that China's measures were retaliatory, not provocative. In turn, President Trump appeared to temper his tone, suggesting that talks could resume and that "China will be fine," signalling a desire to calm markets after Friday's rout. **For investors, the weekend reinforced two points: that the trade conflict is now as much about technology sovereignty as tariffs, and that Washington's economic posture can still pivot quickly when financial markets deliver a warning shot.**

Remember April - a lesson in not over-reacting before the dust settles. TACO (Trump Always Changes Opinion) still applies. The sell-off, though sharp, was modest in context. The hardest hit were the speculative pockets with a thin investor base. Crypto bore the brunt: Bitcoin down 12%, Ethereum down heavily, and around $19 billion in value erased in the cryptomarket as leveraged traders were flushed out.

Gold and Silver for All Seasons?

Whatever the outcome of the US–China spat, gold continues to appear as a key asset. A hostile outcome could bring geopolitical tension and inflation; a compromise may still leave China aiming to reduce dollar dependence. Beijing is likely to continue accumulating physical gold to support trade settlement. In this environment, gold and silver remain relevant across all seasons.

Chart 2: Gold and Silver Continue to Rally

Source: Bloomberg

Non-US Equities – The Value Play?

The significant valuation premium in US equities leaves limited room for disappointment. Europe trades at roughly a 10-point P/E discount, while Asia shows relatively stronger growth prospects and potential scope for further rate cuts. Together, these regions present a mix of value and monetary flexibility, a notable contrast to the US.

Technology – Separate Signal from Noise

The sell-off in tech highlights potential openings in core franchises with resilient cash flow and supply-chain strength, rather than in speculative AI-story names. Selectivity remains important; structural tech appears durable, while hype may not be.

Final Thoughts

The week's turmoil was not random; it reflected the market's response to policy shaped more by impulse than by design. The era of good news being priced in may be coming to an end. What follows could highlight the importance of positioning for volatility, value, and realism.

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Falco Model Performance (as of 30 September)

Falco Models	1 Month	2025 YTD	2024	2023	2022	2021	2020	2019	IRR Since Inc
FPW Cautious	+2.27%	+6.52%	+6.89%	+6.86%	-10.14%	+3.44%	+10.80%	+12.30%	+5.26%
FPW Balanced	+2.53%	+8.44%	+9.56%	+6.51%	-9.75%	+5.10%	+11.10%	+14.90%	+6.61%
FPW Speculative	+3.10%	+11.96%	+11.72%	+7.88%	-10.06%	+9.42%	+13.60%	+18.50%	+9.10%
FPW 100% Equity	+2.99%	+11.50%	+15.74%	+15.82%	-7.19%	+18.05%	+9.36%	+21.34%	+11.85%

Low-Coupon Gilt Summary (as of 13 October)

Holding	Coupon	Maturity Date	Price	Yield to Maturity
0.125% Treasury Gilt 2026 (T26)	0.125%	30/01/2026	£99.08	3.27%
0.375% Treasury Gilt 2026 (T26A)	0.375%	22/10/2026	£96.67	3.72%
0.125% Treasury Gilt 2028 (TN28)	0.125%	31/01/2028	£92.13	3.73%
0.50% Treasury Gilt 2029 (TG29)	0.50%	31/01/2029	£89.64	3.88%
0.375% Treasury Gilt 2030 (TG30)	0.375%	22/10/2030	£83.68	3.99%
0.25% Treasury Gilt 2031 (TG31)	0.25%	31/07/2031	£80.40	4.08%
0.50% Treasury Gilt 2061 (TG61)	0.50%	22/10/2061	£24.61	5.08%

Example Cash Deposits (as of 13 October)

Holding	Interest Rate	Max Deposit	FSCS Protection
Instant Access Deposit *	4.04%	£2,000,000	Yes
95 Day Notice Account	3.82%	£2,000,000	Yes
1 Year Fixed Term Deposit	4.00%	£3,000,000	Yes
2 Year Fixed Term Deposit	4.15%	£2,000,000	Yes
5 Year Term Deposit	4.25%	£2,000,000	Yes

* Exclusive rate for new customers

Yield Enhancement Examples (as of 10 October)

Holding	Structure	Liquidity	Average Maturity	Yield to Maturity
GBP Liquidity Fund	UK OEIC	Daily	48 days	3.93%
USD Liquidity Fund	Lux SICAV	Daily	54 days	4.08%
Example Short Duration Investment Grade ETF	ETF	Intra-day	2.3 years	4.14%
Example Short Duration High Yield ETF	ETF	Intra-day	2.6 years	6.21%
Example Fixed Income ETF Portfolio	ETF	Intra-day	6 years	5.60%
Asset-Backed Mortgage Bond (GBP and USD)	Bond	Daily	2 years	10.50%