



## Newsletter – June/July 2025

The summer lull has seen some developments in the financial world that will be important for the rest of the year and into 2026. On 30 July the USA central bank decided to hold interest rates level despite two members pushing for a cut. This is the first time two governors have dissented on monetary policy decisions since 1993. Mr Trump has also been wanting cuts and was putting pressure on the chairman Powell but to no avail. Then a few days later the US employment report was weak and revisions lower to earlier reports made it all but certain that cuts will come at the next meeting in mid September. This is just following the other central banks lower with the ECB down to 2% and the Swiss central bank down to zero! The rapid rise in rates after the CV19 lockdowns are being reversed lower and likely to stay low for some time.

The theory is that lower rates will encourage more economic activity and employment however the link is not strong in the short term. Big corporations are unlikely to invest millions in new plant and people if the central banks lowers rates by 0.25%. The moves have to be significant and sustained so I expect little economic impact this year. What cuts can impact are financial assets.

Lower rates support a higher gold price and support bonds. They may support stock markets for a while, but remember that lower levels are in response to a poor economy. Companies need customers to spend money so they can generate profits and sustain higher share prices. But profits and share prices seem to have disconnected for many companies. Consider the following :

The most valuable company in the USA is now Nvidia at \$ 4 trillion. The AI company trades on a price earning ratio of 58 which means investors are happy to buy the shares at 58 times the income generated. A payback period, at today's earnings, of 58 years. Looking at the price to sales ratio which stands today at 30 it means that if the CEO decided to give all the revenue to shareholders, none for expenses eg. salaries, rents, taxes etc. the payback period would be 30 years, clearly impossible. These very high valuations have persisted for 3 years and I mentioned them in my July 2023 report. I also mentioned in my August 2023 report how Sun Microsystems got to a price to sales ratio of 10 before the dotcom bubble burst and the company's shares collapsed 80% and they were taken over. ( See old reports at <https://timunderwood.com/newsletter/> ) Clearly if a company's growth story is popular these classic valuation measures are ignored and those using index tracking funds will be fully invested in such companies.

As well as such valuations also of note is the continual geopolitical risk and in particular the war in Ukraine. It has been going on for over 3 years and the death toll on the battlefield is huge. I cannot see the two sides simply shaking hands and making peace after such a terrible war. Now it looks like the deadlock is coming to an end and at times like this, the risk of escalation into the rest of Europe rises. It's an unknown, but the risk is certain. Fund managers do not concern themselves with geopolitical risk. Maybe they should?

Best wishes

Tim Underwood

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