

The Fiscal (Milk)shake-Up

The much-awaited UK Budget was delivered at the end of the month, with higher spending now and looming tax rises down the road. The Chancellor is taking some fire for being too gloomy before her speech, but markets, especially bonds, were fairly sanguine. In the US, the federal government shutdown is finally over, though it will have had a negative impact on growth.

Budget day is over, and it was one that brought with it, if not outright fear, then at least a mild case of the heebie-jeebies. Not only because of potential tax rises, which are to few people's liking, but also because the run-up saw Labour launch so many proposals that Heathrow might have had to open an overflow runway.

In the end, we saw a myriad of taxes being tweaked, raised or implemented, including a new Mansion Tax and a limit on pension salary sacrifice; not even milkshakes were safe. Given most of these changes will not come in immediately, it is hard to unpack how this will pan out, but the nation's tax advisers should eat well for the next few Christmases.

While the Chancellor did not touch the major taxes outright, the spirit of this has been debated, as income tax thresholds have been frozen for an extra three years beyond 2028. This will push millions into paying higher taxes as their pay rises. One risk to this narrative is that behaviours change and some taxes are avoided, but that is a problem for another day.

The Budget was framed as necessary to increase the limited fiscal headroom available, essentially the money left after core costs. The Chancellor has since been accused of exaggerating the state of play to raise welfare spending and appease noisy backbenchers. Borrowing and spending will rise in the near term, helped along by the scrapping of the two-child benefit cap from April 2026 and the mostly reinstated winter fuel allowance.

Financial markets, especially UK government bonds, took the Budget calmly, as the extra borrowing is offset by larger tax takes later on. A surprise to some, but the UK stock market has performed well so far in 2025, more on this in the questions below. Overall, it did not feel like a growth focused Budget, which is notable given how loudly Labour campaigned on growth in the 2024 election.

Elsewhere, the shutdown of the US federal government ended after 43 days, the longest in US history. One consequence was a delay in releasing economic data such as inflation and employment. Aside from impacting the economist wizarding realm, it had wider muggle implications by slowing the information used for interest rate decisions. More importantly, it reduced economic output and left millions furloughed or working without pay.

Bottom Line

The Budget delivered numerous tax rises but little upheaval. More broadly, markets remain resilient, though some, notably the US, look expensive and policy uncertainty lingers. Everything technology related is back in vogue, though we would temper enthusiasm and point to other markets where less good news is priced in.

Month by numbers

Change in various markets over the month:

Asset	Change
	Value

Equities

UK	↑	0.54%
Europe	↑	0.93%
US	—	0.00%
Emerging Markets	↓	-1.60%
Japan	↑	0.59%

Bonds / Rates

* Absolute change (%)

UK Base Rates	—	0.00%
		4.00%
Fed Funds Rate	—	0.00%
		4.00%
UK 10-Year Yield	↑	0.03%
		4.44
US 10-Year Yield	↓	-0.08%
		4.02

Currencies

GBP / USD	↑	0.86%
		\$1.33
GBP / EUR	↑	0.29%
		€1.14
DXY (USD Index)	↓	-0.35%
		99.46

Commodities

Gold	↑	5.71%
		\$4230.63
Oil (Brent)	↓	-2.87%
		\$63.2

Noteworthy

Alphabet (Google)	↑	19.26%
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Q&A

What's on your mind?

Why are UK equities doing so well in 2025?

In recent years the backdrop for UK equities has been gloomy. Persistent outflows, heightened political noise, and a sluggish domestic economy, have fuelled uncertainty, while rising tax and regulatory pressures this year further dampened sentiment. As a result, investor attention has largely shifted towards markets seen as more exciting, particularly those linked to the AI theme.

However, despite this challenging environment, UK equities have performed strongly. The FTSE 100 has hit multiple record highs in 2025 and outperformed many global markets, driven largely by the financial, healthcare, energy and defence sectors. This year has also seen international investor interest return, as concerns over concentration and high share prices in the US encourage diversification. The UK is home to numerous global champions, as well as smaller more domestically focused businesses, which trade at attractive price levels relative to global peers. The UK also continues to offer high and reliable dividend income. While risks remain, notably political and fiscal uncertainty, 2025 has highlighted the resilience of UK equities and their ability to deliver strong performance.

Why are technology companies spending so much?

It may feel like every financial article you read focuses on big spending in AI and tech, and understandably so, given how dominant these companies have become globally. Recent industry estimates suggest that leading firms such as Meta, Alphabet (Google), Amazon, and Microsoft collectively appear on track to spend between \$350 and \$400 billion for 2025, much of it directed towards building data centres and acquiring the hardware that underpins AI applications.

AI is widely regarded as the technology driving the next industrial revolution, prompting companies to engage in an "AI arms race." By investing heavily now, these firms aim to create structural barriers to entry, making it difficult for competition to easily enter the space. Many of these big spenders have long been market leaders and, as a result, benefit from large cash reserves, stable revenue streams, and access to low-cost capital. This gives them the flexibility to support high spending levels without adding excess risk to their core operations. However, caution among investors remains high, with concerns raised about an "AI bubble" if monetary and productivity gains underwhelm against expectations.

What is a "Santa Rally"?

A "Santa Rally" is a stock market phenomenon referring to a rise in equities during the final trading week of December and the first two trading days of January. The concept was first noted in 1972 and has since attracted attention from analysts, commentators, and investors.

For those hoping for an easy return, we're afraid to say this is not a guaranteed occurrence. From 1995 to 2024, UK stocks have gained during this period around 80% of the time, while US stocks have gained roughly 73% of the time. Some commonly cited explanations include: "Christmas spirit" boosting sentiment, lower trading volumes as investors take time off work, and portfolio "window dressing," where fund managers buy stocks with positive momentum to improve their performance before year-end.

We would caution that the existence of a pattern does not imply the existence of a rule. For long-term investors, a Santa Rally should be viewed as a market quirk rather than a basis for investment decisions. Staying invested across cycles with a well-constructed portfolio should remain the focus, and with any luck markets will avoid giving us a lump of coal this Christmas!

For more information, please contact your adviser.

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