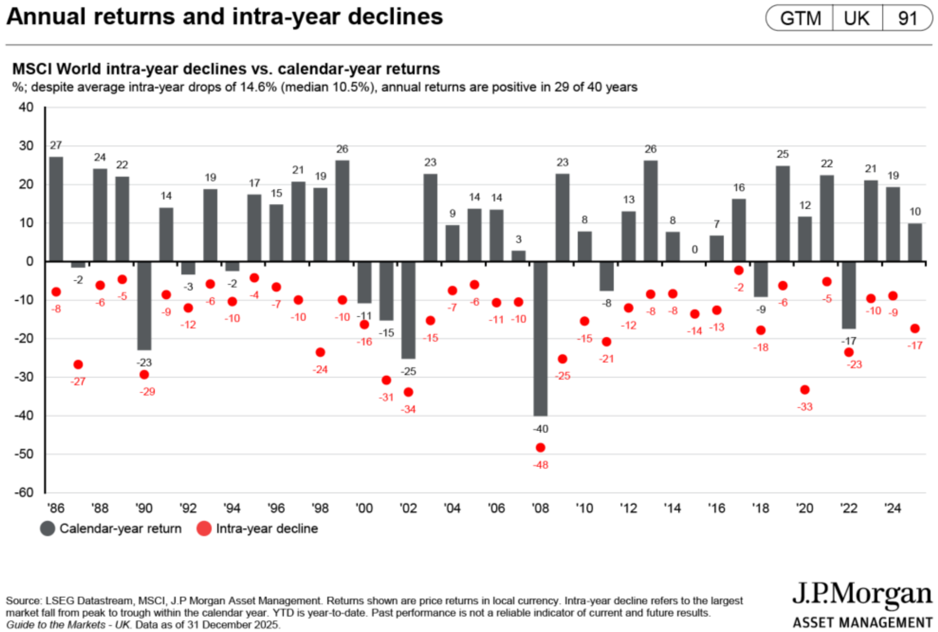
Q4 2025 Market Commentary

The fourth quarter of the year brought steady returns from most equity markets with some reaching record highs. Easing trade tensions and loosening monetary policy aided returns which allowed for some profit taking, and rotation from US names that benefited broader international markets. We remain watchful on tariffs and continue to engage with our underlying managers on how this increased cost is being addressed, for example being passed through to the end consumer or absorbed within the company at this stage. In other asset classes precious metals continued to have a strong run to the end of the year as gold prices remained elevated. Fixed income markets also had a positive quarter with gilts being a strong performer as the budget was well received by the markets.

Government debt levels in developed markets remain at higher levels. Over the year, Germany also increasing the debt ceiling to boost growth. Other countries including Japan may also increase their debt level to increase government support. We remain watchful on government debt levels moving forward and continue to engage with our active managers. Corporate balance sheets on the whole continue to be resilient and the income levels continue to be attractive at this stage.

Geopolitical events are generally unwelcome in markets. Investors have seen many events over the past five years. In general, markets tend to react, absorb the information and then recover quite quickly. We feel it is important to not make short term reactionary moves. The chart on the right shows that intra year declines are often surpassed by a positive return over the calendar year. Often these periods provide opportunity for active stock selection over investment time frame, we remain focused on strategies and the underlying companies as and when details become clearer.



Equities

Equity markets were generally higher recovering sharply from their initial falls, with a combination of easing trade tension and strong earnings boosting the market. It should be noted that on the whole corporates are benefiting from earnings progression and the consumer remains confident at this stage.

The UK market as measured by the MSCI UK IMI index was up by 5.55% over the quarter. Corporate earnings overall remain resilient, whilst merger and acquisitions have picked up this year. The pickup in M&A, on account of increased investor sentiment has been led by domestic and international sources of capital. The speculation and run up to the budget impacted markets over the quarter. The market reaction was muted as nothing too severe was announced and provide the market some clarity looking forward now. The consumer remains in a reasonably resilient place and should inflation and bank rates fall this may be a further positive for markets in the year ahead. We continue to actively engage with fund groups on the implications of the national insurance rise and minimum wage increases and how they are adapting to this. As ever, there is a variation in approach and remain watchful of wider risk concerns.

The US market had with a good quarter despite the government entering the longest shut down in history, risking the jobs of those in public employment. The market remained fairy concentrated in the communications and technology sectors, although there are some signs of a broadening market. Optimism around further rates cuts and the tax cuts extensions announced (from Jan 2026), may be helpful for markets moving forward. We remain mindful of valuations in some areas and the levels of investment moving forward alongside a watchful eye on inflation numbers.

In Japan equity markets appreciated as market sentiment and the combination of US rate cuts, domestic political developments and a weaker Yen helped market returns. The new Prime Minister Sanae Takaichi announced a $135 billion stimulus plan from April 2026 to further boost the economy. Corporate governance reforms continue, and companies are buying back shares at a greater pace, alongside increasing dividends and earnings which continue to be robust, look supportive moving forward.

In Europe, shares were strong over the quarter particularly in the areas of financials and healthcare. Within the banking sector strong earnings and rate cuts in the US were supportive. Markets will continue to look favourable with increasing fiscal spending, falling inflation as well as easing monetary policy. The economic picture across the group remains mixed with services continuing to be strong and manufacturing especially contracting at this point. We will monitor the potential trade tariffs and the implications of these for the strategies we hold. It should also be noted that whilst a European business may suffer US tax on exports to the US, companies with factories in the US will not and shifting production may become the norm. The ECB increased their growth forecast slightly for 2026 with labour markets being resilient and bank lending slowly picking up helped boost confidence.

Emerging Markets and Asian markets were also strong over the quarter as dollar weakness and easing trade tariff sentiment helped returns. The technology theme was evident in markets, with the AI focus in the region offering strong returns for investors similar to those in the US. China which had performed well all year had some profit taking over the last quarter as investors took gains. India performed in line with expectation as some improving macroeconomic data and an interest rate cut supported markets. There is a clear focus on the domestic Asian economy, and some target policies provided stimulus and support into the year end.

Fixed Income

The FED cut rates by 25 basis points (bps) during the quarter as a slightly weaker jobs markets gave scope to cut as the dual mandate remains the for the inflation rate to be at 2% over the longer term and achieve maximum employment. They have scope to cut rates further if required. Inflation has moved up and the committee remain cautious on tariff implications which haven't yet fully filtered through, as such they will continue to remain data dependent moving forward when making rate decisions.

The Bank of England cut rates by 25bps over the quarter with growth remaining weak over the quarter, inflation remains above target with an easing in wage inflation albeit still relatively high being slightly offset again with an increase in energy and food inflation. The annual Consumer Price Index (CPI) inflation rate has started to fall back again to 3.2% with expectations it will get back to the 2% target quicker than forecast moving forward. Corporate debt continues to offer attractive income with defaults continuing to be low and balance sheet remain robust at this stage.

The ECB kept interest rates on hold with inflation very close to targets. Inflation has continued to fall as expected and is very close to the 2% target, as a slight increase in energy inflation was offset by decreasing food price inflation and moderating labour costs. The growth expectations have been revised up to 1.4% for 2025, before decreasing slightly to 1.2% for 2026 as a combination of the appreciation of the euro and weaker foreign demand from tariff impact. Unemployment remains low at 6.4% although demand for labour has weakened.

Outlook

Looking at the investment outlook for the long term, we continue to focus on fundamentals and what drives investment returns over investment time frames. Over the last twelve months we have seen indiscriminate moves across markets, sectors, and individual companies which are short term and lacking fundamental support. In the West, rates are now being cut as inflationary pressures ease providing greater stability. Many short-term markets movements are sentimental and reactionary without long term consideration of how individual companies are performing and adapting to the economic environment. The dislocation in markets presents opportunities for active management.

Corporate earnings for now remain supported and the US consumer remains in good shape with a tight job market. The outlook is mixed with a possible slowdown ahead of a slight pickup in unemployment. We do not envisage a deep recession in the US but will continue to keep a close eye on economic developments. We continue to focus on what drives asset class returns over investment time frames.

We continue to actively engage with all our fund managers on both a routine and ad-hoc basis to monitor how they are positioned and how the underlying companies are doing against wider media headlines, and they are changing to political changes if, and when, these get implemented. We remain overweight equities favouring active managers, who have been trimming and adding to positions when opportunities arise.

We remain overweight in a pool of diversified real asset funds. Some of the underlying investments in the funds are assets with inflation linked contractual payments often backed by governments. The more rate sensitive areas in this space such as Infrastructure and Real Estate should start to benefit as start to come down, with many attractively valued offering a good level of income and many now also buying back shares to further add value.
Our portfolios remain blended and diversified throughout regions/sectors and asset types and will perform different roles in the portfolios over investment time frames. We continue to focus on longer term drivers of asset class return and not trying to second guess short term sentiment or be too reactive to macro/geopolitical events.

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