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FINANCIAL MANAGEMENT

REFLECTING ON 2025 & PLANNING FOR 2026

Our thoughts on the markets

A look back at 2025

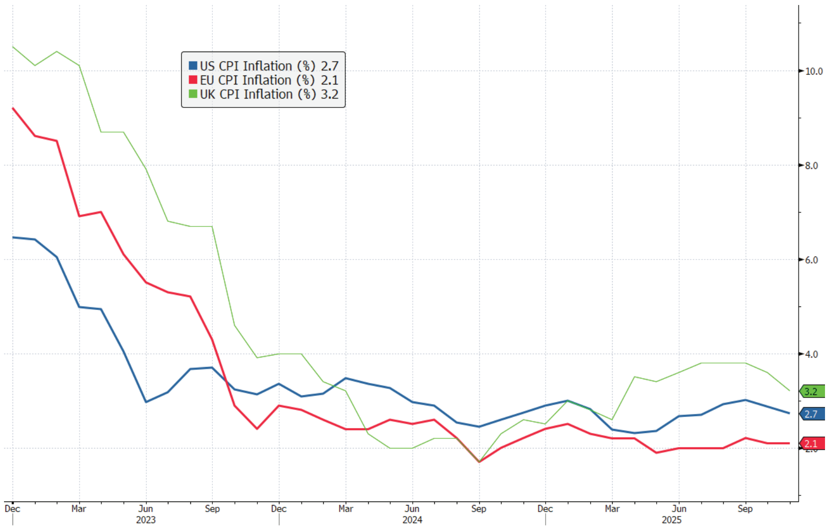
Looking back on 2025, it was pleasing to see investment returns defy a near-constant barrage of political and economic noise. Throughout the year, investors were asked to contend with concerns over government spending, the durability of economic growth, the impact of military flare-ups across the world, and persistent warnings of asset market bubbles. Despite these uncertainties, markets proved remarkably resilient, and major equity indices ended the year strongly higher, with the fourth quarter doing little to interrupt the gains already achieved. Investors appear to have understood that while geopolitical hostilities dominate the headlines, other, more positive forces are also at play.

A defining political development during the year was the return of Donald Trump to the US presidency, which reintroduced uncertainty around trade, regulation, and fiscal policy. Early rhetoric around tariffs raised concerns that protectionist measures could reignite inflationary pressures and weigh on global growth. These fears came to the fore in the first half of the year as US tariff rates rose to levels not seen since the 1930s, triggering a sharp sell-off in developed market equities in early April. Political dysfunction also came into focus during the year, with the US experiencing the longest government shutdown on record. However, as the year progressed, the anticipated economic fallout failed to materialise. Markets ultimately shifted their focus toward the supportive effects of fiscal and monetary stimulus, and risk appetite recovered strongly.

Inflation remained a persistent theme driving markets. Globally, inflation continued to moderate over the course of the year, although it remained above central bank targets in many economies. This gradual cooling in price pressures provided policymakers with greater flexibility and helped anchor market expectations, even as investors remained alert to the risk of renewed inflation stemming from tariffs, fiscal expansion, or supply-side disruptions.

Global Inflation Rate (CPI % year on year)

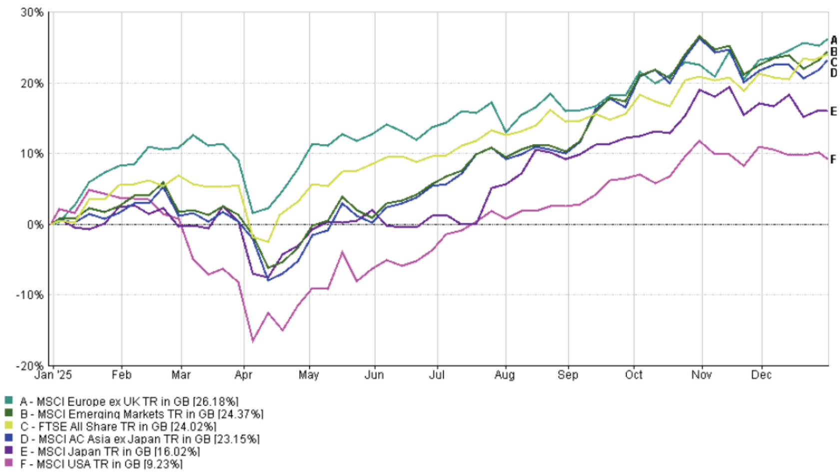
Source: Bloomberg



By year-end, developed market equities had delivered a robust performance, with the MSCI World Equity Index returning 13% in sterling terms. The second half of the year was characterised by a broad-based "risk-on" environment, and 2025 became the first year since the pandemic in which all major asset classes posted positive returns. In recent years, the concentration of market returns has increased, particularly within US equity markets and the technology sector. We remain mindful that valuations for many of the largest index constituents now appear demanding and, in some cases, difficult to justify on fundamentals alone, making diversification increasingly important.

Global Equity Market Performance in 2025, rebased to 100

Source: FE Analytics

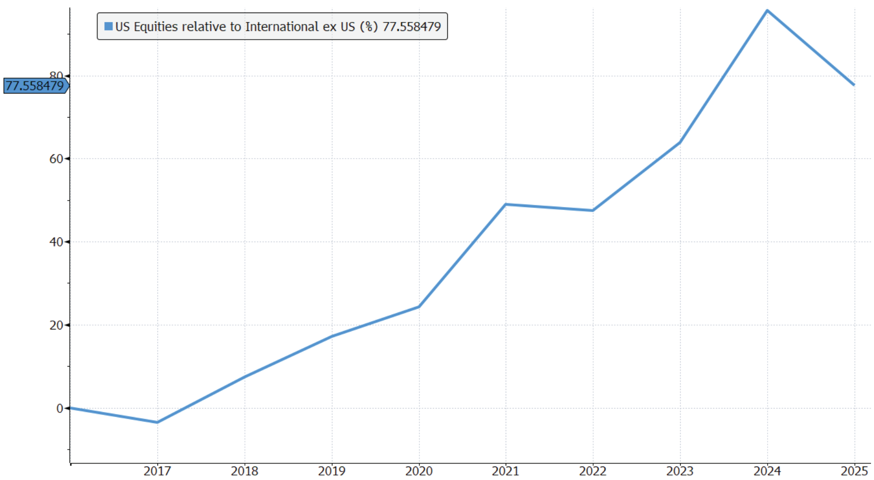


Artificial intelligence remained the dominant thematic driver of US equity markets, extending a trend that began with the mainstream release of ChatGPT in late 2022. The information technology and communication services sectors significantly outperformed the broader market. However, as investors became more discerning about which companies would ultimately benefit from AI investment, leadership narrowed: only two of the so-called “Magnificent Seven” technology companies outperformed the S&P 500 over the year. At the same time, rising questions emerged around the profitability of AI, given the hundreds of billions of dollars invested in what has become a highly circular ecosystem among leading technology firms. Consumer-facing sectors struggled, as sluggish job growth weighed on confidence and companies remained reluctant to pass on higher tariff-related costs. While this caution helped avoid a renewed inflation spike, it dampened returns in more cyclical areas of the market.

US equities ended up delivering returns of 17% in local currency terms, but these gains were eroded for overseas investors by a sharp decline in the US dollar. The trade-weighted dollar fell by 7.0% over the year, its steepest decline since 2009. As a result, US equities were ultimately outshone by other regions (see chart below), and 2025 marked the first time in two decades that the S&P 500 was the worst-performing major equity market.

US equities relative to International ex US over past 10 years

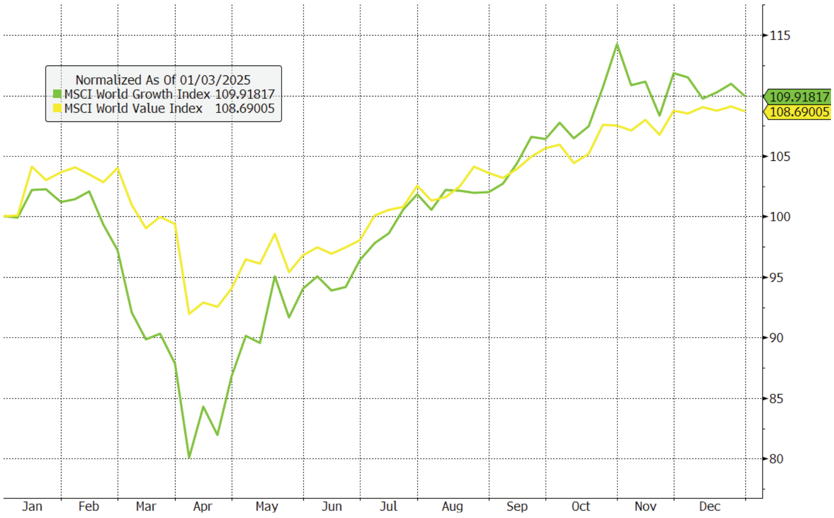
Source: Bloomberg



Equity leadership shifted meaningfully during the year. Emerging market equities outperformed developed markets, with the MSCI Emerging Markets Index returning 24% in sterling terms, reflecting both improved fundamentals and favourable currency dynamics. Within developed markets, growth stocks continued to outperform in the US, while value stocks led in most other regions. As a result, growth and value styles delivered broadly similar returns at the global level, highlighting the extent to which performance became more balanced as the year unfolded.

MSCI World Growth vs MSCI World Value during 2025 (rebased to 100)

Source: Bloomberg



Emerging market equity performance was broad-based, with all regions posting strong returns. Chinese equities performed particularly strongly. Advances in domestically developed AI technology supported the Chinese technology sector, while efforts to diversify trade relationships helped ensure export resilience despite higher US tariffs. In Japan, hopes for continued reflation were reinforced by the election of Prime Minister Takaichi, with markets pricing in greater government spending. Japanese equities returned 16% over the year.

European equities emerged as the top-performing major region, delivering returns of 26% in sterling terms. UK equities followed closely behind, ending the year at an all-time high and within touching distance of the 10,000 milestone, despite the domestic economy stalling ahead of November's budget. This served as a useful reminder that the performance of the UK economy does not necessarily mirror that of the UK stock market, particularly for large-cap indices where a substantial proportion of revenues and earnings are generated overseas. The FTSE 100's sector composition proved increasingly attractive to investors wary of high valuations in technology stocks and seeking exposure to more traditional, undervalued industries, with mining companies in particular benefiting from this rotation. With UK equities still trading at relatively modest valuations, this trend has the potential to extend into 2026.

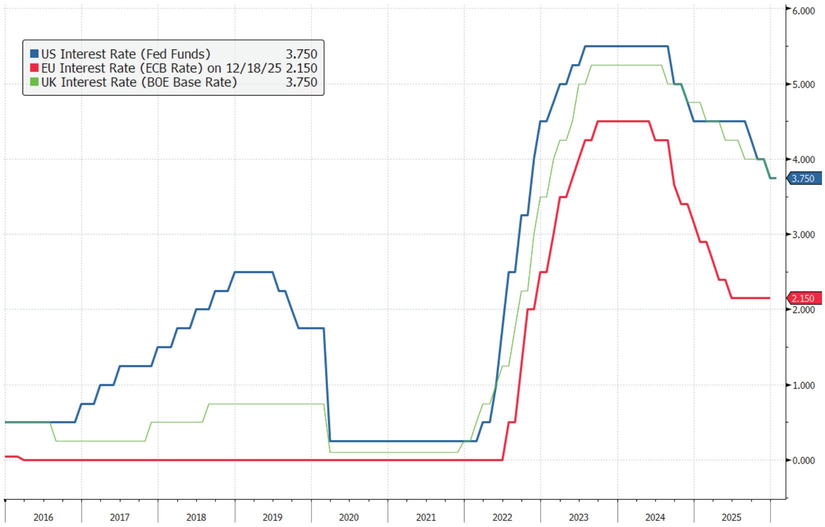
The rally in risk assets was not confined to equities. Fixed income markets also delivered positive returns, supported by declining interest rates, attractive starting yields, and a weaker US dollar. The Bloomberg Global Aggregate Bond Index (£ hedged) returned 5% over the year. Credit spreads compressed across the board, meaning that higher-risk bonds outperformed as investors demanded a smaller premium for taking on credit risk. Emerging market debt was the strongest-performing fixed income segment, buoyed by solid economic fundamentals, strong investor demand, and the weaker dollar.

Global credit returned 7% in sterling hedged terms. While default rates in both US and European high-yield markets edged higher, corporate balance sheets generally remained robust. The private sector has demonstrated a remarkable ability to absorb economic shocks, in our view, supported by healthy corporate and household balance sheets, limited leverage, and excess savings built up in earlier years. This resilience helped contain broader financial stress, despite some well-publicised defaults within private credit.

Government bond markets reflected diverging fiscal and policy dynamics. Fiscal concerns continued to weigh on sovereign curves, which steepened across major markets as yields on shorter-dated bonds fell more than those at the long end. In the US, despite growing unease over the longer-term implications of the “One Big Beautiful Bill” for debt sustainability, Treasuries performed relatively well. The feared tariff-driven inflation surge failed to materialise, and increasing concern over labour market conditions prompted the US Federal Reserve (Fed) to cut interest rates by a total of 0.75% in the second half of the year.

Major Central Bank Interest rates over the past 10 years (%)

Source: Bloomberg



UK gilts also delivered solid returns. Although inflation remained above target, a weakening labour market and cooling wage pressures allowed the Bank of England to cut interest rates by a total of 1% over the year. Combined with high starting yields and an autumn budget that ultimately avoided major disruption, this supported gilt performance. While the yield on 10-year UK government bonds fell by only 0.1% to 4.5% by year-end, this translated into an annual total return of around 5%.

In contrast, German government bonds delivered negative returns. After more than a decade of fiscal restraint, Germany signalled a decisive shift toward higher spending on defence and infrastructure, driven by geopolitical pressures and the need to revitalise a sluggish economy. Markets reacted accordingly, pushing yields higher and prices lower.

Overall, 2025 was a positive year for investors and a timely reminder of the importance of diversification across asset classes, regions, and currencies. After a decade defined by US exceptionalism, concentrated technology leadership, and a strengthening US dollar, the past year saw returns broaden meaningfully across global markets.

The next section of this review provides a summary of how markets evolved through each quarter of 2025, before concluding with our thoughts as we look ahead to 2026.

1st Quarter 2025

As we entered 2025, markets were mindful that early policy signals from the new Trump administration could pose risks. Campaign rhetoric emphasised trade tariffs, raising concerns that protectionist measures could reignite inflationary pressures and weigh on global growth. Many investors initially remained reassured, though, believing a Republican-led government would reinforce the theme of US exceptionalism.

Rising policy uncertainty quickly dented sentiment and renewed fears of a US recession. By contrast, Europe saw a significant uplift in confidence, as Germany's shift toward a more expansive fiscal regime marked a turning point. This divergence triggered a notable decoupling in global equity and bond markets.

US equities initially gained momentum, with the S&P 500 reaching an all-time high in February, but growth stocks then reversed course, and many strong performers from 2024 saw sharp declines. Tariff concerns resurfaced, casting a shadow over sentiment. US bonds rallied, as concerns about slowing growth outweighed persistent inflation. The Fed held rates steady over the quarter, but signalled that future rate cuts remained possible.
In China, January's breakthrough in artificial intelligence by DeepSeek prompted a reassessment of US large-cap technology positioning by investors. They rotated into underappreciated areas, while concerns grew about potential trade tariffs and public sector job cuts. The Fed lowered its 2025 growth forecast from 2.1% to 1.7% while nudging its inflation outlook to 2.7%.

European policymakers surprised markets with coordinated fiscal stimulus. Germany proposed a €500 billion infrastructure plan and relaxed fiscal rules for defence spending, while the European Commission unveiled an €800 billion defence initiative, lifting equities. However, bond returns were held back by expectations of increased issuance, even after two ECB rate cuts.

In the UK, large-cap equities posted solid gains despite a narrow avoidance of a technical recession for the UK at the end of 2024, while small- and mid-caps struggled amid fiscal and economic concerns.

UK GDP Growth (% YOY)

Source: Bloomberg

Corporate earnings remained robust across regions. US manufacturing and consumer spending showed resilience, and companies continued to invest in productivity-enhancing technologies, including AI.

2nd Quarter 2025

The second quarter of 2025 was marked by heightened volatility, driven by geopolitical uncertainty and US trade policy. President Trump's April "Liberation Day" tariff announcement initially triggered sharp equity and bond sell-offs. The VIX Index, which is frequently described as the market's fear gauge, briefly spiked above 50, reflecting extreme market anxiety. However, sentiment recovered after the administration softened its stance and announced a framework for US–China negotiations.

Chart of VIX Index

Source: Bloomberg

During the quarter, earnings reports covering Q1 surprised positively, growing 13%, with firms continuing AI investments to support long-term productivity. The 'Magnificent 7' tech stocks outperformed despite their high valuations, after lagging in Q1. European equities continued to perform well, supported by investor inflows away from the US, while UK equities lagged due to energy and healthcare sector weakness.

A brief geopolitical spike from tensions in Iran and Israel affected oil prices but had limited market impact, as Saudi Arabia increased production. This helped to reduce inflationary pressures. Currency movements were notable: the US dollar weakened a further 5.9% against Sterling, benefiting emerging markets and Asia but acting as a headwind for UK investors in US assets.

USD:GBP rate during first half of 2025

Source: Bloomberg

USD:GBP rate during first half of 2025

Central banks remained a key focus. The Fed held rates steady despite political pressure, the Bank of England cut rates to 4.25%, and the European Central Bank implemented two cuts while signalling fiscal support.

Late in the quarter, focus shifted to fiscal policy, with the US "One Big Beautiful Bill" raising concerns over national debt, leading Moody's to downgrade the US sovereign rating. Global growth remained positive but slower, with inflation sticky around 2.5–3%.

3rd Quarter 2025

The third quarter was significantly calmer, as early-year tariff volatility had a more muted impact than anticipated. The IMF raised global growth forecasts to 3.0% for 2025 and 3.1% for 2026, reflecting resilient US activity and stronger-than-expected corporate earnings.

Emerging markets, led by China, outperformed developed markets, supported by domestic policy stimulus, AI investment, and the continuation of the US–China trade truce. Japanese equities benefited from a weaker yen and the US–Japan trade deal. US equities rose 10% in sterling terms, though much of the gain was due to higher valuations rather than earnings growth. International markets continued to offer better value in our opinion, reinforcing the importance of global diversification. UK equities gained around 7%, boosted by stronger overseas earnings as a result of a weaker sterling.

Fixed income markets were mixed but ended slightly higher. US Treasury yields fell on softer labour market data while UK government bond yields rose on fiscal concerns, with the 30-year gilt yield climbing to its highest level since 1998. Corporate bonds outperformed as spreads continued to narrow.

UK government bond 30-year yield since 1998

Source: Bloomberg

Central banks diverged in tone. The Fed cut rates by 0.25% in September, signalling the start of a gradual easing cycle. The Bank of England also cut rates by 0.25% to 4.0%, but indicated that further reductions would be measured. Both US and UK labour markets showed signs of softening, which supported a modest easing of monetary policy.

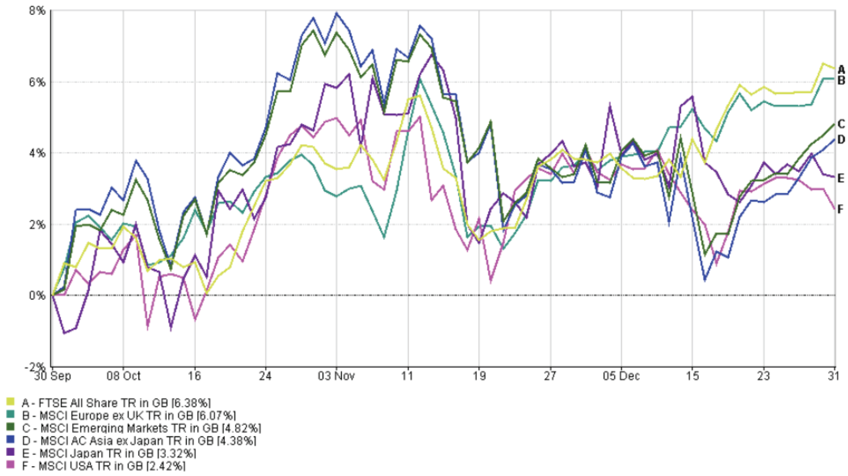
Momentum from AI investment and infrastructure spending continued to support growth. While cyclical tailwinds like capex and elevated job openings eased, earnings momentum remained strong, particularly in sectors benefiting from AI and global demand. The combination of steady growth, easing monetary policy, and relatively attractive valuations outside the US provided a constructive environment for diversified portfolios.

4th Quarter 2025

The final quarter of 2025 ended on a positive note for global markets, with all major equity regions finishing in positive territory. This outcome came despite a notable rise in volatility during October and November, marking the first sustained period of market turbulence since the "Liberation Day" tariff sell-off in April. Uncertainty was driven by a combination of political disruption in the US, renewed trade tensions between the US and China, and increased investor scrutiny of the scale and sustainability of investment in artificial intelligence.

Performance of major equities markets during Q4 2025 (rebased to 100)

Source: FE Analytics



Trade tensions escalated early in the quarter after the US threatened tariffs of up to 100% on Chinese imports, while China signalled potential restrictions on rare earth exports. Given China's dominant role in global rare earth supply and processing, these developments raised concerns over critical supply chains, particularly for semiconductors and AI infrastructure. The prospect of tighter controls triggered the sharpest single-day decline in global equity markets since April.

Market sentiment improved relatively quickly as the White House adopted a more measured tone. A meeting between Presidents Trump and Xi later in October helped stabilise conditions, with both sides agreeing to a one-year framework aimed at de-escalating tensions. While not a comprehensive trade agreement, the framework included steps to scale back tariffs and ease pressure on rare earth supply chains, supporting a swift recovery in markets.

Volatility resurfaced in November as investors reassessed elevated valuations in AI-related stocks and questioned the timing of further US interest rate cuts. Political uncertainty also intensified following the longest federal government shutdown in US history, after Congress failed to pass full-year funding. The shutdown was resolved mid-month, helping to restore confidence. Although some official US economic data were delayed, alternative indicators pointed to a slowdown in job creation during the quarter. This contributed to the Fed delivering two 0.25% interest rate cuts over the period.

In the UK, government bond markets began the quarter under pressure amid uncertainty surrounding the Autumn Budget. The Budget itself proved relatively subdued, while subsequent guidance pointing to reduced gilt issuance provided some support. A further 0.25% rate cut from the Bank of England also helped ease pressure, with 10-year gilt yields falling from 4.7% to 4.5% by quarter-end.

Corporate earnings remained a key support for markets. In the US, around 80% of large-cap companies exceeded expectations during the Q3 reporting season, with double-digit year-on-year earnings growth. Despite this, US equities underperformed overseas markets, continuing the theme from earlier in the year. This likely reflects the high expectations already priced into their largest stocks. The S&P 500 still gained 2.7% in sterling terms, but this lagged gains of over 6% in UK and European equities, with emerging markets close behind.

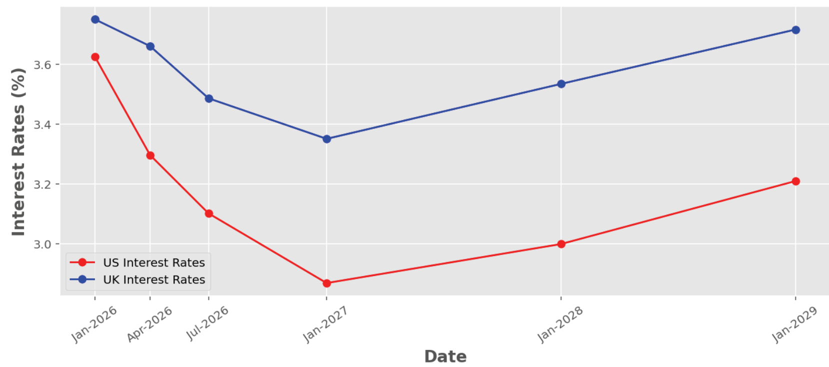
Looking Ahead

As we enter 2026, global markets remain resilient despite geopolitical noise, supported by fiscal and monetary stimulus across the US, Europe, and Asia. We expect economic activity to broaden across regions, building on momentum from 2025.

In the US, households are poised to benefit from fiscal stimulus, including tax rebates under the “One Big Beautiful Bill,” while strong stock and housing wealth continue to support consumption. Businesses are investing heavily, particularly in technology and AI infrastructure, providing potential for long-term earnings growth. The Fed will be closely scrutinised in 2026, with Jerome Powell’s replacement likely to be announced early in the year. This transition may increase the pressure on the Fed to consider further rate cuts to support markets. The futures market is currently pricing in three rate cuts in the US next year.

Market implied path of UK and US base interest rates (%)

Source: Bloomberg



Europe is set for a pickup in activity, aided by Germany’s fiscal stimulus targeting defence, transport, and industrial projects. Broader EU commitments to increase military budgets to 3.5% of GDP by 2035 underpin this trend. In the UK, near-term growth may be constrained by limited fiscal and monetary flexibility, but slower activity could ease inflation, allowing the Bank of England to adopt a more accommodative stance over time.

Asia continues to provide monetary and fiscal support. Japan’s pro-growth government maintains accommodative policy, while China shows improving confidence from stabilising property prices, targeted stimulus, and optimism around innovation, particularly in AI, supporting broader market sentiment.

Key risks remain. Inflation could re-emerge, particularly if labour markets tighten, challenging central banks' ability to ease policy. Elevated valuations in parts of the equity market, particularly technology, warrant caution. Government debt levels, notably in the US, continue to rise faster than economic output, with bond markets likely to signal investor sensitivity.

Against this backdrop, diversification remains crucial. Investors are advised to maintain balanced portfolios, with a focus on global opportunities and earnings momentum. We believe that active management is likely to outperform passive strategies in 2026, given the uneven distribution of growth and value opportunities across sectors and regions. Investors will be closely monitoring corporate earnings, AI-driven investment returns, and broader participation outside mega-cap tech.

We believe a balanced, disciplined approach is appropriate. With the US dollar under pressure, and arguably still overvalued despite its falls over 2025, a less US-centric allocation and exposure to regions benefiting from fiscal and monetary support offer the potential for attractive returns. Cash reserves, strong corporate fundamentals, and ongoing business investment provide further resilience and gives us cause for optimism that the healthy returns enjoyed by markets over the past three years can continue into 2026.

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