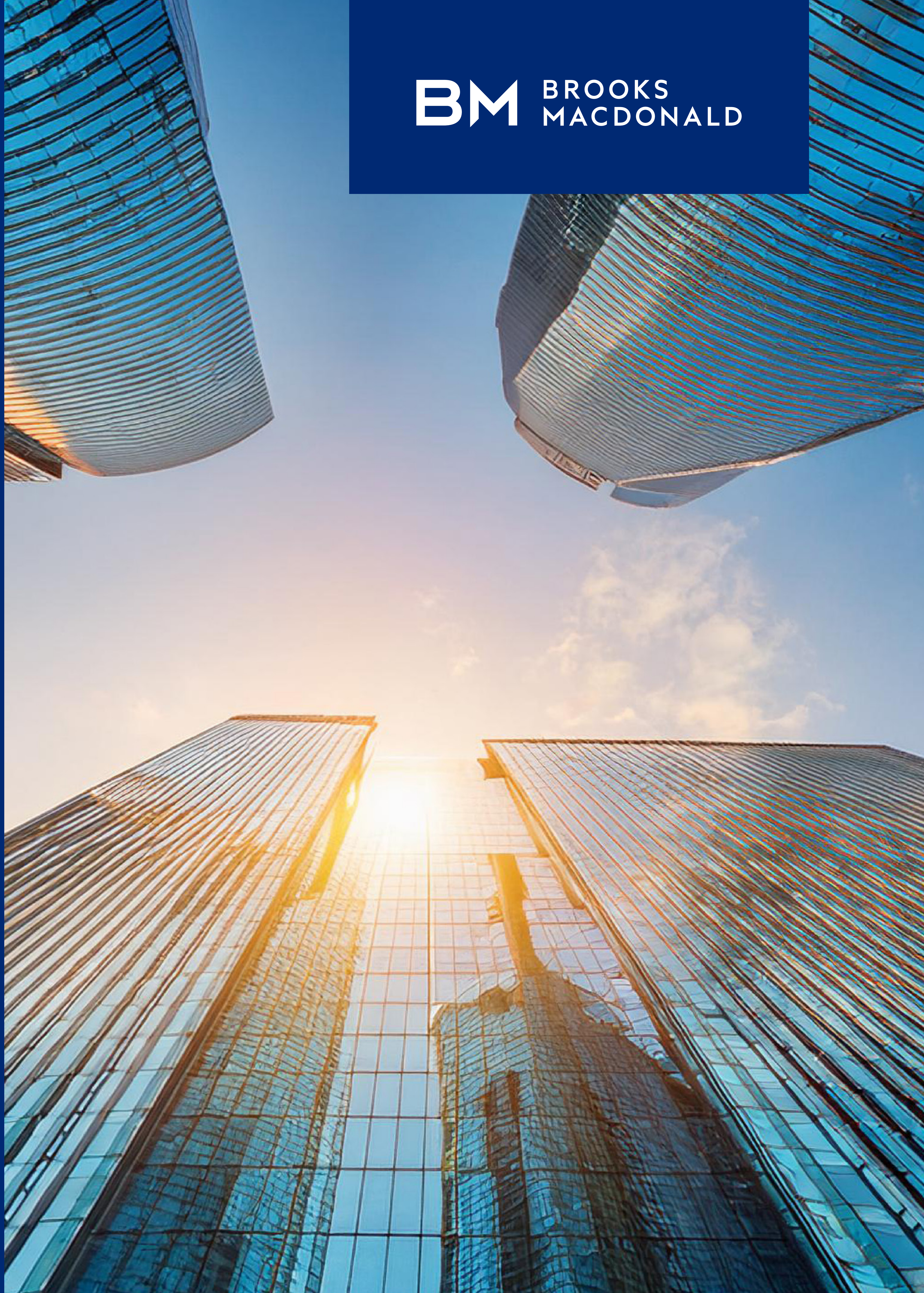
FOR PROFESSIONAL ADVISERS ONLY

Asset *Allocation* Overview

Q1 2025



Investors weigh up tariff risks for economies and markets

– US President Trump's tariff plans force investors to reassess potential impact on economies and markets
– Megacap technology leadership is challenged, highlighting the importance of avoiding concentration risks
– A mixed economic and market backdrop reinforces our selective equity and short-duration bond allocation

Outlook summary

Views correct as of 31 March 2025

After a strong backdrop for equity market returns last year, global equities delivered a more challenged return picture in Q1, falling in sterling total return terms, and underperforming fixed-income benchmarks. But look beneath the surface, and there have been some notable divergences across equity regions, countries, sectors, and investment styles. Q1 appears be shaping the year ahead in which economic and geopolitical decisions taken by the US Trump administration are already having far-reaching consequences for the rest of the world. With fears during Q1 that Trumps' tariffs might curb economic growth yet stoke inflation pressures, equity share prices came under pressure.

There were at times dramatic headlines during the quarter: from constantly evolving US tariff news, to geopolitics and a rapid reassessment of Europe's defence spending needs, to changing fortunes for megacap technology stocks, and even a rethinking of US economic and stock market exceptionalism. Throughout however, across the investment outlook, from compound earnings growth through to hopes for falling interest rates, fundamentals during Q1 had continued to support a constructive investment position in aggregate. Specifically, as we ended March, we believed that on balance a US recession was unlikely, that global economic growth would largely weather those tariffs thus far disclosed, and that inflation could continue to ease. In the case of the world's biggest economy, jobs and wage growth have clearly moderated but there is still an expectation of tax cuts alongside a likelihood of lower interest rates later this year. The greatest risk to this central view, however, is the outlook for tariffs, outlined below – Trump's reciprocal tariffs are due to be announced early April (after this document goes to print) - should those tariffs prove worse than expected, this could dramatically upend the aforementioned investment outlook.

As regards US megacap technology, share price weakness triggered midway through the quarter by a start-up Chinese start-up AI competitor is a timely reminder that asset allocation is not just a US-only or a megacap-tech only exercise. Having driven gains across US and global equity markets in recent years, a handful of technology giant-sized companies command an uncomfortable degree of concentration within broader equity indices. As such, the ability of megacap technology stocks to move markets is something we have been mindful of for some time. While Technology is one of our two key global equity themes (alongside Healthcare), given our preference for diversification we continue to be underweight the 'Magnificent Seven' group of stocks relative to our industry benchmarks.

As we look forward, we have a constructive stance on equities in aggregate but spread across regions and countries, helping to deliver diversification across investment styles. For bonds, we prefer those of a higher quality and shorter maturity, helping to balance the risks we take elsewhere by offering relatively attractive yields while limiting sensitivity to unexpected volatility around interest rates, economic growth, and inflation. For our alternative investments, such as structured return products, these can offer expected returns and yields that do not always move in the same direction as stocks and bonds, also reducing overall risk and balancing portfolios. Our focus continues to be on keeping a balanced and diversified approach, aiming to position our asset allocation choices to weather economic uncertainties effectively, and focused on a long-term investment strategy that is adaptable yet grounded in sound principles. Overall, our diversified approach aims to position portfolios to effectively navigate the economic uncertainties that lie ahead.

Our top three investment risks

- **Tariff risks.** With the US administration trade tariff policy, including plans for reciprocal tariffs globally, this carries significant risks, both for lower economic growth and higher inflation pressures, and which would present a major significant challenge for risk assets.
- **Geopolitical risk.** Any escalation in either the current theatres of conflict (Middle East and Russia-Ukraine), or indeed future risks of potential conflict (China-Taiwan), could have a significant impact on the global economic and investment outlooks.
- **Policy error.** Governments and central banks continue to face the risk of unintended policy errors, with fiscal policy in particular a risk as governments attempt to navigate calls for continued deficit spending while hoping to keep financial markets onside.

Asset class	Outlook	Change since previous quarter	Rationale
Equities			
UK	🟢	No change	The UK equity market index earns about three-quarters of its revenues from outside the UK, making it sensitive to global trends. UK equities are a key part of our investment strategy, including shares of companies in 'value' sectors such as resources and financials; these stocks might be considered undervalued on a price to earnings ratio or dividend yield basis, for example. These sectors can help balance our growth investments in other regions and asset classes.
US	🟠	Down	The latest round of US corporate results has largely reflected a constructive picture although there has been some market fatigue in evidence more recently. More interest rate cuts are expected later this year with the US Federal Reserve judging tariff inflation risks as "transitory" and supporting the outlook for smaller and mid-sized companies which we own. Against this, US tariff policies have introduced unwelcome uncertainty for an equity market which is relatively highly rated. Given the balance of risks, not least, further tariff announcements to come, the outlook for US equities was lowered from positive to neutral in March.
Developed Europe (excluding UK)	🟠	No change	Continental European equity performance in Q1 was boosted by increased government spending and led by a huge increase in defence commitments by the region's largest economy, Germany. However, while Germany has the debt-to-GDP ratio headroom to allow for a huge ramp up in fiscal spending, the same cannot be said of the other major European countries. Meanwhile, there are still significant headwinds for the region, including US tariff risks and increased export competition from China.
Japan	🟠	No change	In recent years, the Tokyo Stock Exchange has been working to help companies manage their finances better. Along with the return of inflation after years of stagnation, this has improved the outlook for Japan's financial markets and shareholder return expectations. However, Japan still faces significant challenges. High public debt levels and an ageing population in particular make it hard for the Bank of Japan to pull away from its long-standing low-interest rate monetary policy.
Asia Pacific (excluding Japan)	🟠	No change	The region's dominant economy, China, continues to face significant economic challenges. Structural imbalances, including a heavily indebted property sector, high youth unemployment, and febrile consumer sentiment will take time to resolve. While China's policy makers continued to promise support for the economy, renewing investor interest during Q1, the country is still at risk of being stuck in a deflationary spiral, while US-China tariffs create unwelcome headlines for export growth and business sentiment.
Emerging markets	🔴	No change	China is a major buyer of global commodities from emerging markets. However, despite promises of increased government spending, China's leaders appear reluctant to rely heavily on their tried-and-tested past model of aggressive infrastructure expansion. Those risks dampen the export hopes of emerging markets more broadly. Additionally, emerging market countries with debt in US dollars are particularly sensitive to US dollar exchange rate volatility and at times this can challenge global investment flows into emerging markets.

🟢 POSITIVE 🟠 NEUTRAL 🔴 NEGATIVE

Asset class	Outlook	Change since previous quarter	Rationale
Equity Themes			
Technology	●	No change	With a focus on profitable, cash generative technology exposures, we see long-term growth from technology's ability to identify, enter and disrupt new markets, creating new revenue streams and barriers to entry. More recently, generative Artificial Intelligence (AI) has catalysed revenue and earnings forecasts for the sector as companies seek to lift their productivity. Across our technology exposures, we are mindful of concentration risks given the size of the US 'Magnificent Seven' megacap technology stocks, where we are underweight relative to our asset allocation industry benchmarks.
Healthcare	●	No change	Western health-care systems are geared toward long-term elective care and demographic tailwinds, where growth in appetite-suppressant drugs is the latest example. Highlighting the overlap between our Healthcare and Technology themes, generative AI has the potential value across drug discovery, clinical trial design, and customer engagement.
Fixed Income			
UK sovereign	●	No change	Higher yields on gilts, reflecting the current interest rate environment, can mean this asset class can play a more constructive role in asset allocation. Recognising inflation and interest rate uncertainty, including timing of further rate cuts and the eventual 'landing zone' for interest rates longer-term, we prefer shorter-dated bonds to manage interest rate sensitivity.
UK Credit	●	No change	We have a positive outlook on UK corporate debt, in part given the expected yield pick-up available and versus yields elsewhere globally. Within corporate debt, we prefer investment grade over high yield debt, where the latter is more vulnerable to any weakening in the economic outlook as well as greater sensitivity to adverse liquidity and market stress events.
International sovereign	●	No change	Our neutral outlook disguises a more cautious outlook towards conventional US Treasury bonds, where as a result of the US administration's tariff policies in particular, we see a risk that yields could move higher across the curve. Balancing this risk of a re-emergence in inflationary pressures, we have a positive view on US Treasury Inflation Protected securities.
International	●	No change	Credit spreads versus sovereigns are some way below past episodes of significant market stress. Corporate balance sheets are relatively well-capitalised, but we prefer investment grade over high yield debt, where the latter can prove more sensitive to changes in the economic outlook as well as relatively weaker liquidity characteristics.

● POSITIVE ● NEUTRAL ● NEGATIVE

Asset class	Outlook	Change since previous quarter	Rationale
Alternatives			
Alternatives	●	No change	Within the Alternatives asset class, we have allocations (dependent on the risk band in question), to Directional Multi-Asset funds, and/or Alternative Income, and/or Uncorrelated Assets. These assets can be expected to provide a degree of counterbalance to more directional risk exposures elsewhere in our asset allocation.
Property	●	No change	The inflation / interest rate outlook has generally continued to moderate, lifting sentiment, though central bank policy is still in restrictive territory. Longer-term, the sector offers both generalist and specialist investment opportunities, while valuation discounts to net asset value provide some cushion against any downward estimate revisions.
Structured investments	●	No change	While structured investments have at times historically provided relatively attractive returns, performance can become more correlated with equities if markets suffer a significant correction. In addition, pricing of structured return products can vary at times, in part given issuer appetite as well as expected market volatility levels going forward.

● POSITIVE ● NEUTRAL ● NEGATIVE

Important information

More information about the Brooks Macdonald Group can be found at
brooksmacdonald.com

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