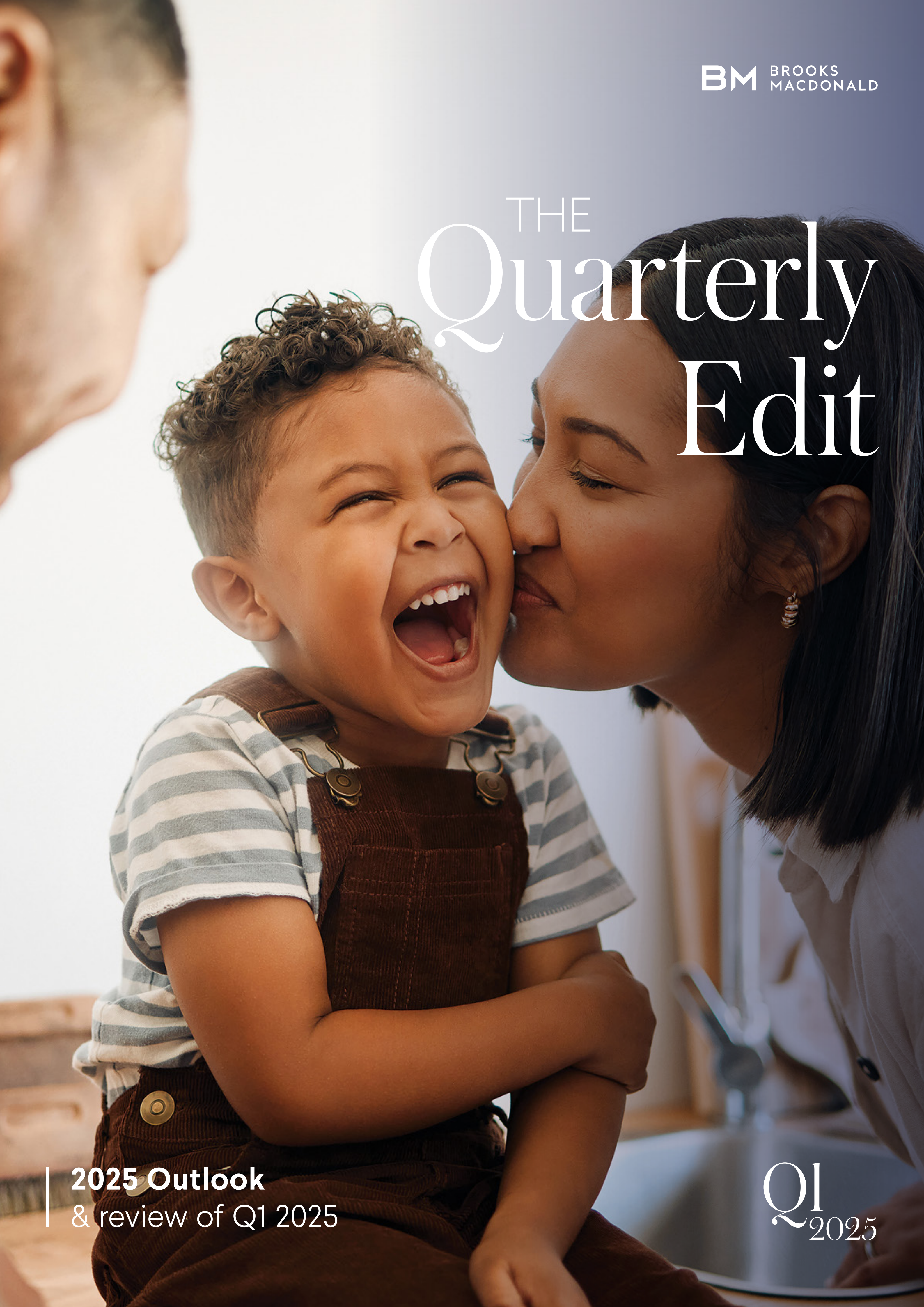

BROOKS MACDONALD

THE Quarterly Edit

2025 Outlook
& review of Q1 2025

Q1 2025

Quarter IN REVIEW

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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.

In our latest 'Quarterly Edit', we touch on six themes that we hope will provide you with an overview that supports informed decision-making and helps you understand some of the complexities in financial markets. These themes range across tariffs, geopolitics and inflation linkages, defence spending, megacap technology stocks, US economic and stock market exceptionalism, and last but by no means least, China.

Through it all, while there have been at times dramatic headlines during the quarter, fundamentals, from the outlook for compound earnings growth through to expectations of falling interest rates ahead, have continued to support a constructive investment position.

Our focus remains on maintaining 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.

We are grateful for the trust you place in us and we are committed in targeting the highest level of service and performance. Together, we look forward to navigating the market's complexities and helping you to work towards achieving your financial goals.

Global investors face tariff uncertainty as US President Trump puts America first

The first quarter was filled with tariff headlines, causing confusion for markets. Investors at times struggled to keep pace with trade policy-pivots from US President Trump, taking place often in the space of hours, let alone days. That degree of tariff uncertainty left open the question as to whether Trump's tariffs were transactional or ideological. The implication for markets is that Trump's well-referred-to tactic of 'the art of the deal' means that investors might yet hope to be able to look through much of the tariff headlines as noise, and if anything, see opportunities for longer-term positioning.

Geopolitics makes headlines, but markets see hopes for lower energy prices

Geopolitics saw established diplomatic positions upended in Q1, with an emboldened second-term US President Trump in the driving seat. While a US administration seeking to deliver an end to Russia's invasion of Ukraine without Europe or Ukraine at the negotiating table might seem unthinkable, markets are taking a more constructive assessment. With the US seemingly determined to bring Russia 'in from the cold', as we wrote in our Q4 2024 Quarterly Edit, a "reintegration of Russian energy exports back into the global supply chain … could collectively boost supply, pushing down on energy prices, and helping to dampen any renewed global inflation pressures."

Germany's spending splurge is a big deal, but it risks a sting in the tail for European neighbours

The threat of the US abandoning its European defence guarantees led to a major increase in European defence spending commitments in Q1. German politicians did the unthinkable in March to bypass the country's fiscal 'debt brake' conservatism and approve a massive defence and infrastructure programme. However, with government bond yields rising, the 'Achilles heel' of the eurozone's one-size-fits-all monetary policy risks driving borrowing costs higher for those countries much less able to fund such spending hikes. While the opportunity for higher German economic growth is welcome, the region still has unresolved challenges, including increased Chinese trade competition and US-led tariff volatility.

US tech giants lose some of their lustre amid mixed results and a 'DeepSeek' AI tremor

Given their dominance in US and global equity indices, results from the US 'Magnificent Seven' technology group of companies (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA and Tesla), were always going to be important. Artificial Intelligence (AI) posterchild Nvidia saw good-but-not-great numbers, disappointing investors used to big positive surprises. Volatility in megacap tech shares was also driven in Q1 by a Chinese start-up company 'DeepSeek' which claimed to have built a low-cost AI engine, raising doubts around industry estimates for capital expenditure sums going forward. All in all, the quarter's events were a timely reminder of the importance of managing stock concentration risk in portfolios.

US exceptionalism challenged, as the 'Trump trade' gives way to a value investment style

Coming into 2025, forecasts predicted another year of US exceptionalism, due to US President Trump's policies of lower taxes alongside deregulation plans, positioning the US economy to continue to beat much of the world. Instead, those expectations appeared to moderate in Q1 as concerns around tariffs drove fears of sticky inflation alongside lower economic growth. This may have arguably motivated global asset allocators to rethink their ex-US global allocations, with one beneficiary the relatively cheaper-valued UK stock market which outperformed the US in Q1.

China's uncertain investment outlook despite renewed interest in the country's stock market

China's economy continued to struggle in Q1, despite Beijing setting out an 'around 5%' annual economic growth target for the third year in a row. There appears to be a disconnect between this target and ongoing issues like weak Chinese consumer, falling house prices, high youth unemployment, and deflation risks. Over the past six months or so, policy makers have cut interest rates and promised more government spending, in turn providing a boost for China's stock market over that time. However, reservations remain over whether this creates enough of an improvement in the longer-term outlook necessary to take a more constructive investment stance.

2025 OUTLOOK

As we look ahead, we recognise there are key factors that will shape the global economic landscape, influencing investment strategies and market performance.

Reviewing the economic outlook

This year, decisions taken by the US Trump administration are already having far-reaching consequences for the rest of the world. Fears that Trumps' tariffs might slow economic growth and increase inflation, put pressure on equity prices in Q1. Despite these fears however, we continue to believe that on balance a US recession is unlikely, that global economic growth will remain steady, and inflation will continue to ease. In the case of the world's biggest economy, jobs and wage growth remain constructive, and an expectation of tax cuts alongside a likelihood of lower interest rates later this year should support market sentiment more broadly.

A question of market breadth

Regarding US megacap technology, recent share price weakness 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 now command an uncomfortable degree of concentration within broader equity indices. Yet 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' US tech group of stocks relative to our industry benchmarks.

Investment strategies

To navigate the complexities of the current economic landscape, we employ a diversified approach across various asset classes.

Equities: We maintain a positive stance on equities, but spread across regions and countries, helping to deliver diversification including across investment styles.

Bonds: We prefer those bonds with a higher quality and shorter maturity, helping to both balance the duration and credit risks we take elsewhere, but at the same time still offering relatively attractive yields. This approach helps to limit sensitivity to unexpected volatility around interest rates, economic growth, and inflation.

Alternatives: Our investments in alternatives, such as structured return products, can offer expected returns and yields that do not always move in the same direction as stocks and bonds. This strategy can help to mitigate overall risk while balancing portfolios.

Navigating uncertainties

Overall, our diversified approach aims to position portfolios to be as best able as we can to navigate the global and economic uncertainties that lie ahead. By spreading investments across various asset classes and regions, we can better manage risks and seize opportunities as they arise.

UK

UNITED KINGDOM

The UK equity market index earns about three-quarters of its aggregate revenues from outside the UK, making it sensitive to global trends. UK equities are a key part of our investment strategy. They include shares of companies in 'value' sectors like resources and financials, which might be undervalued, such as on a price-to-earnings ratio or dividend yield basis. These sectors can help balance our growth investment style allocations in other regions and asset classes globally.

US

UNITED STATES

US corporate results in Q1 reflected a still-resilient consumer and healthy job market. 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 valued. Given the balance of risks, the outlook was lowered from positive to neutral in March.

EU

DEVELOPED EUROPE (EXCLUDING THE UK)

Continental European stocks performed well in Q1, driven by hopes for increased government spending, and led by a significant increase in defence commitments from Germany, the region's largest economy. However, while Germany has the debt-to-GDP (Gross Domestic Product) ratio headroom to allow for significant fiscal spending, the same cannot be so-easily said of the other major European countries. Meanwhile, there are still significant headwinds for the region more broadly, including US tariff risks as well as increased export trade competition from China.

AP

ASIA PACIFIC (EXCLUDING JAPAN)

The region's dominant economy, China, continues to face significant economic challenges. Issues such as a heavily indebted property sector, high youth unemployment, and weak consumer confidence will all likely take time to resolve. While China's policy makers have promised support for the economy, helping to lift risk assets in recent months, the country is still at risk of being stuck in a deflationary spiral, while US-China tariffs create unwelcome headwinds for export growth and business sentiment.

JP

JAPAN EQUITIES

In recent years, the Tokyo Stock Exchange has been working to help companies manage their finances better. Alongside the recent return of inflation after years of stagnation, this has improved the outlook for Japan's financial markets and shareholder returns. However, Japan still faces significant challenges particularly high public debt levels and an ageing population. These issues make it harder for the Bank of Japan to pull away from its long-standing low-interest rate monetary policy settings.

EM

EMERGING MARKETS

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.

Outlooks defined: *We express positive, neutral, and negative outlooks across a range of asset classes. These are defined as our judgement as to the expected return compared to the relevant broader asset class benchmark over our central forecast period of twelve months.*

POSITIVE **NEUTRAL** **NEGATIVE**

Important information

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