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Investment Comment

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Markets started 2025 strong, though trade uncertainty, rate concerns, and DeepSeek's unveiling caused jitters late in January. February saw rising US growth fears as doubts over policy weighed on sentiment, dragging down developed market equities. Bond markets focused more on weak US data than inflation risks, while market leadership broadened beyond prior cycle winners. The end of March witnessed dips in major US, European, and Asian indices, as markets reflected the widespread uncertainty over President Trump's upcoming slew of 'Liberation Day' tariffs on 2 April.

In the UK, gilt yields surged at the start of the year, with the 10Y yield reaching its highest level since 2008 and the 30Y yield hitting levels last seen in the 1990s, driven by persistent inflation and a deteriorating growth outlook. January CPI cooled more than expected at 2.5% y/y (2.6% expected), with Services CPI falling to 4.4% (4.9% expected), though Core Services CPI remained elevated. Unemployment ticked up to 4.4%, in line with expectations. In February, the Bank of England (BoE) cut interest rates by 25 basis points (bps) to 4.5%, with a surprising vote split as hawkish member Catherine Mann pushed for a larger 50bp cut.

The economy grew 0.1% in Q4, defying expectations of contraction, as services and construction offset production declines. CPI rose to 3% y/y in February, above the 2.9% expected, driven by VAT changes on school fees and rising food costs. This then fell to 2.8% y/y in March, 0.1% below expectations, while Services CPI remained elevated at 5%. As expected, the BoE held rates steady in March, with the Committee expressing concerns over higher inflation expectations. The Composite PMI edged down from 50.6 in January to 50.5 in March, reflecting ongoing manufacturing weakness. Chancellor Rachel Reeves' Spring Statement provided little reassurance, with the Office for Budget Responsibility (OBR) cutting 2025 growth forecasts to 1% and warning of rising unemployment and inflation. The increase in National Insurance from April is expected to contribute to sustained inflation.

The European Central Bank (ECB) cut rates by 25bps to 2.75% in January amid stagnating growth, with German GDP contracting -0.2% (annualised) and Eurozone growth flat. European equities rallied on expectations of more cuts, extending into February as investors priced in a potential Ukraine ceasefire. German Chancellor-in-waiting Friedrich Merz announced a nearly €1 trillion fiscal package for defence and infrastructure, boosting defence stocks but limiting sovereign yield declines due to concerns over borrowing.

Inflation rose to 2.5% y/y in January before dropping back to 2.30% in February, and unemployment dipped to 6.2% (6.3% exp.). Manufacturing PMI rose from 45.1 in January to 48.7 in March but remained in contraction, while Services PMI slipped from 51.6 to 50.4. The ECB cut rates by another 25bps to 2.5% in March, with two more cuts expected. However, rising government spending due to US policy adds uncertainty to the inflation outlook. Q4 GDP was revised up to 0.2% from 0.1%.

US markets surged after Trump's inauguration, marking the best first week for a president since Reagan in 1985. January ended strong, despite trade and rate uncertainty, though European equities outperformed their US peers. Personal Consumption Expenditure (PCE) held at 2.6% y/y, while Nonfarm Payrolls (NFPs) surged to 307k (160k exp.), pushing unemployment to 4.1% and reinforcing the Fed's cautious stance. February saw US equities decline, led by weakness among large-cap stocks, amid soft data and falling bond yields. NFPs disappointed at 125k (170k exp.), but unemployment unexpectedly fell to 4.0%. PCE inflation stayed at 2.5% y/y. March brought a sharp drop in confidence and growing stagflation fears, and the S&P 500 and Nasdaq Composite both tumbled as uncertainty peaked ahead of Trump's tariff announcements. Manufacturing PMI rose from 49.3 in January to 50.3 in March but is expected to dip below 50 in April. NFPs printed at 151k (160k exp.), while unemployment rose to 4.1%.

The Fed held rates at 4.25–4.50% but expects 50bps of cuts this year, with Powell signalling no rush to ease policy amid uncertainty on trade, immigration, and fiscal policy.

Japan's monetary policy entered a new phase as the Bank of Japan (BoJ) hiked rates by 0.25% in January to 0.5%, the highest since 2008, reflecting persistent inflation above 2%. Core CPI peaked at 3.2% in January before easing to 3.0% in February. Unemployment fell to 2.4% in January but rebounded to 2.5% in February. The BoJ held rates in March, citing trade risks, though the pricing-in of ongoing normalisation of monetary policy saw 10Y JGB yields hit 1.57%, the highest since 2008. Markets expect the next hike in September.

China's disinflation persisted, with CPI rising to 0.5% in January before falling to -0.7% in February. PPI remained weak at -2.3% in January and -2.2% in February. Q4 GDP grew 5.4% y/y (5.0% exp.), while equities rallied into February, helping emerging markets outperform as the US dollar weakened. However, deflation, rising unemployment (5.1% vs. 5.0% prior), and uncertain US trade policy now weigh on sentiment.

Sterling-denominated returns of major indices	**10Yr (p.a.)**	**5Yr (p.a.)**	**1Yr**	**Q1 2025**
	%	%	%	%
Fixed Interest				
Overseas Bonds (unhedged)	1.9	-2.5	1.0	-0.3
Index-Linked Gilts	-1.1	-7.5	-8.1	-1.5
Corporate Bonds	1.5	-0.2	2.5	0.7
Equities				
UK	6.0	12.0	10.5	5.1
World (ex-UK)	11.3	15.3	4.5	-5.1
Emerging Markets	5.2	7.1	5.8	-0.1
Property	-0.1	0.5	-4.2	1.5
Commodities	4.2	13.6	9.9	5.6
Infrastructure	4.3	1.1	13.5	2.5
ARC Sterling Balanced Asset	3.2	5.1	2.9	-0.5
ARC Sterling Steady Growth	4.4	6.7	2.5	-1.2
ARC Sterling Equity Risk	5.2	8.2	2.5	-1.7
MSCI PIMFA Income	5.1	7.1	4.0	-0.5
MSCI PIMFA Balanced	5.9	8.4	4.6	-0.9
Cash	1.5	2.5	5.0	1.1

Source: MSCI UK IMI, World Ex-UK, Emerging Markets; ICE BofA Global Broad Market+, Bloomberg UK Government Inflation-Linked Bond, ICE BofA Sterling Non-Gilts; UK IMI Liquid Real Estate; Bloomberg Commodity Index (GBP Hedged); IT Infrastructure; Asset Risk Consultants (preliminary data); MSCI PIMFA; Cash Equivalent (Bank of England Base Rate). Total Return, Sterling adjusted.

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