

Q3 2025 Market Update

Our investment strategies continued to capitalise on buoyant financial markets in the third quarter as investors displayed increased resilience to geopolitical risks and trade tensions. We have successfully implemented changes to our strategies to improve downside risk protection whilst retaining positions to capture upside in financial markets.

Asset Class Returns (GBP) Q3 2025

EQUITIES	Performance
MSCI World (ACWI)	9.66%
FTSE 100	7.53%
S&P 500	10.06%
Eurostoxx 50	6.55%
Nikkei 225	11.30%
MSCI Emerging Markets	12.93%

BONDS	Performance
UK Gilts	-1.61%
UK Index Linked Gilts	-1.31%
UK Corporate Bonds	0.20%
Emerging Market Debt	2.65%

PROPERTY/COMMODITIES	Performance
Global Property	6.22%
Gold (\$)	16.73%
Oil (\$)	-0.84%

The continuation of the AI boom in equities means the US stock market and other tech-heavy markets should lead the charge over the rest of this year and next. By contrast, government bonds in general are unlikely to get much of a lift from what's left of major central bank easing cycles.

The mood in markets has continued to improve in recent months with risky assets making further ground. Equities were the strongest asset group in GBP terms in Q3, particularly tech-heavy markets. The return of

the MSCI Emerging markets index was 12.93% while other tech-heavy markets such as the Nikkei 225 and the S&P 500 weren't far behind at 11.30% and 10.06%, respectively.

In contrast, safe assets underperformed. UK Gilts posted losses in Q3 following the small gains registered in Q2. Gilts fell 1.61% as fiscal concerns added extra pressure on very long-dated bonds in some DMs, including the UK. Corporate bonds fared slightly better, gaining 0.20%. Sticky domestic inflation and the resulting expectations of tighter monetary policy also help explain the underperformance of UK bonds.

The main exception to this trend was gold which surged by 16.73% in Q3 partly driven by concerns about fiscal sustainability and Fed independence and the prospect of looser US monetary policy. This gain builds on top of its previous year-to-date gain leaving gold up 46% over the first three quarters of 2025.

Global property prices rose by 6.22% on the quarter following a decline in the first half of the year as markets anticipated looser monetary policy in the US.

Brent crude oil prices traded within a narrow range of \$65pb to \$70pb for much of Q3, following their large fall in Q2 as limited demand growth and increases in OPEC+ oil output kept the global market amply supplied.

Economic Outlook – US leads, others lag, in uneven global economy

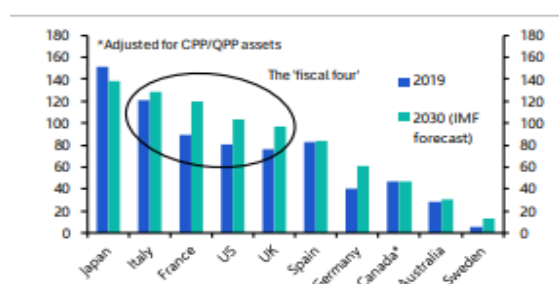
Global – World economic growth is expected to be a solid yet unspectacular 3% in 2026-27. However, growth is anticipated to become increasingly unbalanced with the US leading the way while Europe and China struggle. Tariffs have so far had a limited adverse impact on global activity. Export orders are soft but not collapsing. And, a continued lack of retaliation and some rerouting of US-China trade means world trade flows are likely to slow only a

touch. Otherwise, global growth seems to be holding up well. Admittedly, the weakness of labour markets in DMs is a concern. But it is rare for labour market downturns to presage recessions and other types of economic activity are holding up better supported by recent falls in policy rates and rising credit growth.

The US is expected to be the best performing major advanced economy as what appears to be an AI-related boost to productivity and investment offsets the supply-side effect of immigration curbs. As a result, GDP growth is expected to accelerate there. Inflation is anticipated to remain elevated at around 3% due to the combination of sticky services inflation and some tariff effects feeding through. Accordingly, the Fed is likely to reduce interest rates by less than markets are currently pricing in. By contrast, across the euro-zone, growth is expected to remain sluggish despite fiscal relaxation in Germany, and price pressures are weakening with wage growth easing and natural gas prices falling. With inflation likely to fall below target, the ECB has scope to cut interest rates further next year.

Fiscal strains will remain a source of concern, most notably in the US, UK and France given their poor debt dynamics. (See Chart 5.) The UK government is expected to respond with tax hikes which are likely to keep growth subdued. Austerity in France is set to be a very slow process, given its difficult political situation. The spread of OATs over Bunds is anticipated to widen further, but it is not expected to spiral into a fiscal crisis. Meanwhile in the US, tariff revenues will prevent the deficit from widening much further. While Italy's public finances remain fragile, its government is expected to make further progress in cutting the deficit.

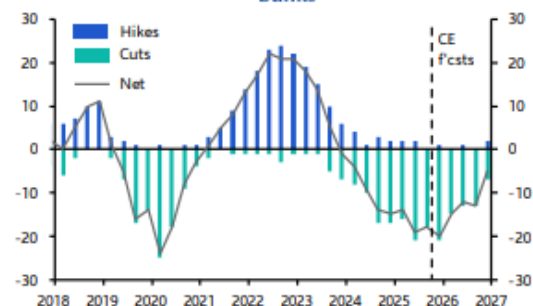
Chart 5: General Government Net Debt (% of GDP)



Finally, growth in emerging economies is expected to remain soft. With both fiscal support easing and exports set to provide less of a prop, China's GDP growth is expected to be just above 3% over the rest of this year. And, high interest rates will weigh on demand in Brazil. Meanwhile, growth in India and the Gulf economies is expected to be relatively strong.

The net result is that global GDP growth will remain soft by past standards. And while the global monetary policy loosening cycle is likely to soon be past its peak pace, there are still a significant number of interest rate cuts to come in 2026. (See Chart 8.)

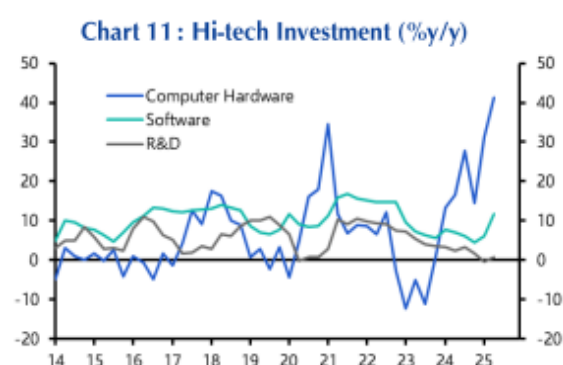
Chart 8: Number of Rate Cuts/Hikes by Major Central Banks



US – Tariffs are now expected to have only a minimal impact on GDP growth. In contrast, the surge in AI-related investment and the immigration crackdown are proving to be the bigger economic drivers. With the AI boom set to boost productivity, GDP growth is likely to accelerate from 2.1% this year to 2.5% in both 2026 and 2027, even as the curbs on immigration weigh on the labour force.

The slowdown in employment growth is due to some combination of tariffs, AI-related investment and immigration. (See Chart 10.) To the extent that it reflects uncertainty over tariffs, some improvement should be expected now that the Trump administration is closing deals with major trading partners. At this stage, however, it is likely the immigration crackdown is playing a bigger role. The AI investment boom also appears to be weighing on employment of younger workers. The impact of those latter two factors could continue to weigh on employment growth for some time.

On the plus side, the AI boom means that the investment outlook looks bright. In the first half of this year, despite rising long-term interest rates and tariff uncertainty, investment in computer hardware and software soared and we expect those faster growth rates to be sustained over the next few years. (See Chart 11.) As most hardware is now imported, this spending will not boost GDP directly, but it is likely that the related investments in domestically-produced software and research & development will.



It was originally expected that Trump's tariffs would subtract from US GDP, as the dollar strengthened and other countries retaliated. But the trade-weighted dollar has fallen and, as part of the panic to retain favourable access to US markets, other countries appear willing to lower tariffs on exported US goods. As a result, imports are now expected to fall by a bit more than exports.

Tariffs have also had little effect on final consumer prices so far. This is because the effective tariff rate remains below initial expectations based on pre-tariff import shares and importing firms are absorbing the tariffs by reducing their margins. Nonetheless, services inflation is set to remain elevated even as housing inflation drops back further. With the latter keeping PCE inflation well above target next year, the Fed is likely to cut its policy rate by only 75bp over the next 12 months.

Euro-zone – The front-running of tariffs gave the economy a boost in Q1 but growth slowed sharply in Q2 and surveys point to a similar

performance in Q3. That said, growth should pick up a bit heading into next year. Consistent with the view that US tariffs would have a small

Chart 10: Monthly Change in Employment (000s, 6m Ave)



impact on growth, export orders have actually risen this year. Looser fiscal policy in Germany should boost aggregate demand too. But the big picture is that economic growth is likely to remain subdued by international standards.

Surveys suggest the labour market is continuing to loosen. Together with past declines in inflation, this is feeding through to slower wage growth meaning services inflation should decline further next year. With energy prices declining, headline inflation is set to fall close to 1%. The ECB could “look through” a period of below-target inflation. But the risks are skewed towards rate cuts, particularly if the ECB is worried inflation expectations could once again become stuck at a low level. It is anticipated the ECB will cut rates twice more in 2026.

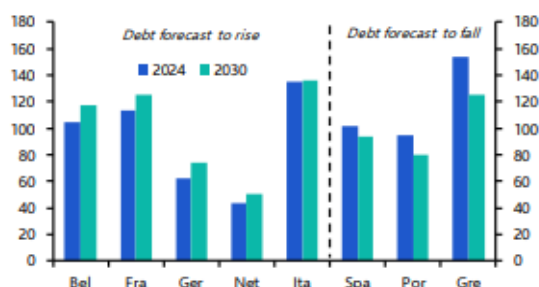
The shift in the association between bond yields and the exchange rate earlier this year has persisted. (See Chart 23.) But this does not imply interest rates no longer matter for the euro. The fact the ECB is likely to cut by more than expected and the Fed by less suggests the euro won't rise further against the US dollar.

Chart 23: US Dollars per Euro vs. Relative 2yr Government Bond Yields (%)



Arguably the biggest risk to the outlook is the high and rising level of public debt in France. By contrast, debt ratios in Spain, Portugal and Greece should continue to fall. (See Chart 24.)

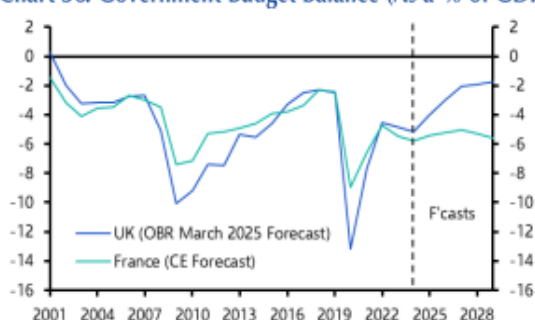
Chart 24 Gross Government Debt (% of GDP)



UK – The lingering drags from previous rises in interest rates, the hikes in business taxes in April and soft overseas activity explain why GDP growth is anticipated to slow from 1.5% this year to 1.2% next year. That said, the Budget on 26th November may dampen growth further. To avoid breaking her fiscal rules and to restore her fiscal headroom of £9.9bn, it is anticipated the Chancellor will need new policies that raise £28bn by 2029/30. With Labour MPs unwilling to stomach spending cuts and the markets unlikely to tolerate more borrowing, higher taxes (this time for households) may do the heavy lifting. A fiscal tightening of £28bn (0.8% of GDP) would trim GDP growth by 0.2%.

This would leave the budget deficit on track to fall from 5.1% of GDP in 2024/25 to 2.0% in 2028/29. That's a much bigger fall than is likely in France (see Chart 36), meaning the chances of a fiscal crisis involving a leap in yields is higher in France. Even so, all the ingredients for a fiscal crisis, bar a trigger, are in place. A UK crisis is not expected, but it's a risk.

Chart 36: Government Budget Balance (As a % of GDP)



Some of the possible tax hikes that have been mooted over the past month would boost CPI inflation for a year. But by hitting households' real incomes, higher taxes would also weigh on inflation further ahead. Indeed, they would add to the weakness in employment that was triggered by the rises in National Insurance Contributions for employers in last year's Budget. Since then, payroll employment has fallen by 0.5% and the somewhat unreliable LFS unemployment rate has risen from 4.3% to 4.7% in July. That loosening should feed through into a more marked easing in wage growth in the UK and a fall in CPI inflation to the 2.0% target by 2027.

Japan – The 0.3% q/q rise in Q2 GDP was driven by broadly positive fundamentals with business investment, consumption and exports all rising. However, exports to the US in July were the lowest they've been since January and motor vehicle output weakened noticeably, too. GDP growth is expected to slow from its current above-trend rate towards a more sustainable pace.

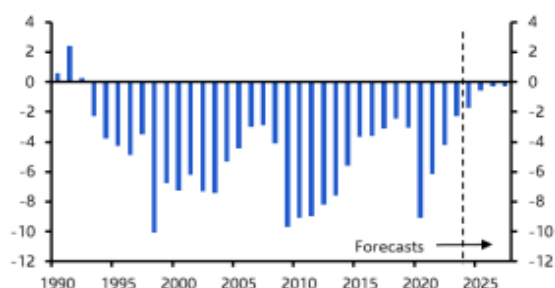
The BoJ remains concerned that a hit to corporate profits from higher US tariffs will weigh on business investment and wage growth. But while profit margins in manufacturing have weakened, they were around record highs across all industries in Q2 and firms' capital spending plans remained robust in the latest Tankan survey. The Bank has also been arguing that rapid price rises will keep consumer spending "more or less" flat for now. In contrast, consumer spending is set to remain a bright spot this year supported by healthy growth in real disposable income.

With consumer price inflation set to average nearly 3% this year, another robust pay hike in the upcoming Shunto wage negotiations appears likely. Headline inflation has come off the boil, but inflation excluding fresh food and energy has reached fresh highs in recent months. Amidst growing concerns that household inflation expectations are on the rise, the BoJ is expected to resume its tightening cycle in January. Due to falls in energy prices next year, headline inflation is

likely to fall below the Bank's 2% target. But with underlying inflation set to remain above that target, the Bank is anticipated to lift its policy rate to 1.5% by 2027.

The media narrative is that the recent surge in long-term government bond yields reflects concerns about the sustainability of Japan's public finances. With the budget deficit shrinking to a 30-year low in 2023 and probably having declined even further since then, that view appears misplaced. (See Chart 32.) The 10-year JGB yield is expected to rise further from 1.63% now to 2.00% by 2030 but that's largely due to tighter monetary policy.

Chart 32: General Government Budget Balance
(% of GDP)



China – China's economy is growing at a far slower pace than official figures suggest, but it hasn't slowed since the start of the year. (See Chart 57.) That's partly because exports have held up well despite US tariffs. But it's also because services sector growth, which had been weakening for some time, has picked up in recent months.

Chart 57: CE China Activity Proxy & Official GDP
(% y/y)



The leadership finally appears ready to do more to support households, with several new measures announced recently. This could in

time prove a significant turning point. However, with the labour market softening, the measures announced so far won't do more than keep consumption growth stable.

The country's overcapacity issue seems set to persist. Policymakers are unlikely to pursue an abrupt pullback in manufacturing investment while property is still declining and options for effective infrastructure spending are limited. Without a meaningful boost to consumption, China's capacity glut means supply will still outstrip demand for some time, keeping the economy in deflation.

Excess capacity will also continue to drive exports. While tariffs have resulted in a sharp fall in exports to the US, a trade-weighted depreciation of the renminbi has helped exporters gain market share elsewhere. That said, exports are unlikely to expand as rapidly as they have in recent years providing a still significant but smaller prop to growth.

In short, while the government is taking some positive steps to support households, the scale of the measures is too small to give a significant boost to consumption. As a result, China will still rely heavily on investment and external demand to drive growth which is anticipated to be just 3% over the rest of this year and next.

Asset Allocation Views

Bonds – Very long dated bond have come under pressure this year amid mounting fiscal concerns which has steepened the yield curve in several DMs. Looking ahead, US Treasuries are expected to offer only modest returns while most other government bonds are also set to underperform as easing cycles are generally reaching their ends.

Corporate bonds – Meanwhile, corporate credit spreads have generally continued to decline and are now, by some measures, very tight. They are unlikely to fall much further, and

disappointing economic growth in Europe and the UK could push spreads in those regions, at least, slightly higher over time. Nonetheless, large moves in spreads are not anticipated given the overall benign backdrop. That, coupled with the fact that government bond yields won't rise by much, means returns from corporate bonds over the next couple of years will be decent, albeit not spectacular.

Equities – The 'big-tech' sectors have been the primary drivers of the S&P 500's gain since mid-year. Indeed, the performance of country and regional equities indices has been heavily influenced by the shares of big-tech sectors in market capitalisations. Amid enthusiasm for AI, 'big-tech' is expected to continue driving up the S&P 500 over the rest of this year and next. Admittedly, some factors could derail the S&P 500 before end-2026, such as faltering demand for AI, a weaker economy, or renewed stress in the bond market. But an AI boom is taking hold in the US economy, which is generally faring better than recent labour market data suggest. And the bond market would be at greater risk if the Fed was tightening policy rather than easing it. Elsewhere, it is expected that tech-heavy stock markets, like Japan's, will continue to do well through end-2026 while commodity-heavy ones, like those of Australia and Canada, will underperform.

Emerging market equities – EM equities outperformed DM equities in Q3. China's tech-heavy stock market is expected to continue to fare well as the country's own AI+ initiative gathers momentum. Other tech-heavy stock markets in EMs, such as Taiwan and Korea, should also continue to do well. Meanwhile, India's stock market, which has underperformed since mid-year, is anticipated to continue lagging as earning expectations and valuations remain overly optimistic.

Commodities – The pattern in commodity markets since Q2 has been similar to much of the past year or so – precious metals prices surging while most other commodity prices head sideways. The price of Brent crude has traded within a narrow range of \$65pb to \$70pb for much of Q3. Ample supply due to

OPEC+ supply increases combined with sluggish demand growth mean Brent crude prices is expected to fall to \$50pb by end-2026.

Industrial metals – Industrial metals prices had been supported by tariff front-running, but that support is fading. A weak demand backdrop, alongside generally robust supply, is likely to weigh on copper and other base metals prices over the next few years.

Precious metals – Precious metals are on track for their best real annual return in decades partly due to concerns about fiscal sustainability and Fed independence, and the prospect of looser US monetary policy. While this rate of return is not expected to be sustained, prices are likely to continue to climb over the next couple of years supported by robust central bank demand.

Final Word

In summary, our disciplined and adaptable approach continues to serve clients well in a market environment that offers both opportunities and challenges. We remain focused on protecting against downside risks while seeking upside, with a preference for tech-driven equities and resilient sectors. We are cautious on government bonds given fiscal concerns, but see selective value in corporate credit. As always, we will monitor economic developments closely and adjust our strategies to seek to deliver efficient, robust outcomes for our investors.

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Managing Director

Sources: Capital Economics; Bloomberg; FE Analytics

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