

Q4 2025 Market Update

Our investment strategies performed relatively well throughout the fourth quarter of the year, building on the solid performance achieved in the previous quarter. The revised changes to our asset allocation, whilst perhaps slightly premature, provided additional downside protection and have positioned the strategies appropriately for the financial markets we are expected to face in 2026.

Asset Class Returns (GBP, Q4 2025)

EQUITIES	Performance
MSCI World (ACWI)	3.46%
FTSE 100	6.86%
S&P 500	2.75%
Eurostoxx 50	5.19%
Nikkei 225	5.79%
MSCI Emerging Markets	4.88%

BONDS	Performance
UK Gilts	2.39%
UK Index Linked Gilts	3.49%
UK Corporate Bonds	0.20%
Emerging Market Debt	1.19%

PROPERTY/ COMMODITIES	Performance
Global Property	-0.77%
Gold (\$)	12.80%
Oil (\$)	-9.29%

The continuation of the AI boom in equities means stock markets most exposed to it, particularly the US and some of those in Asia, are set for strong gains. By contrast, with monetary easing cycles largely behind us, government bond returns are expected to be decent but not spectacular.

Equities continued to gain ground in GBP terms in Q4. The return of the MSCI World index was 3.46% after its 9.66% return in Q3. The returns were broad-based with the FTSE100

leading the way with a 6.86% return in Q4, supported by the rally in industrial metals prices in that period. Meanwhile, the S&P 500 lagged behind other equity markets with a return of 2.75%, although that comes on the back of a 10.06% gain in Q3.

Safe haven assets rebounded a bit, although they continued to underperform. UK Gilts posted gains of 2.39% in Q4 following the losses registered in Q3 as investors priced in more monetary policy easing by the Bank of England. UK corporate bonds fared worse, gaining only 0.20% in Q4.

The main exception to the underperformance of safe assets was, again, gold which surged by 12.80% in Q4 partly driven by a pick-up in ETF demand. This gain builds on top of its previous year-to-date gain leaving gold up 63% in 2025.

Global property prices fell by 0.77% in the fourth quarter after their 6.22% gain in Q3 as investors paired back their expectations for looser monetary policy in the US.

Brent crude oil prices fell by 9.29% in Q4 as limited demand growth and increases in OPEC+ oil output kept the global market amply supplied.

Economic Outlook – Muddling through

Global – 2026 will be a year of clear divergences in economic performance. The US economy will continue to benefit from the early stages of an AI boom. But growth in Europe is set to remain lacklustre and China’s economy will struggle to gain momentum amid deep structural imbalances. Taken together, this means that the global economy will continue to ‘muddle through’.

US tariffs have not had the big adverse effect on the global economy that many had feared at the start of 2025. In fact, global trade has been remarkably resilient, as supply chains have adapted quickly to US tariffs and tariffs globally

remain low. (See Chart 1.) Global trade is expected to weaken a touch this year, as tailwinds from the AI boom and policy easing fade, and base effects cause annual growth to slow. But tariffs won't cause trade to collapse.

2026 will be a year in which the economic benefits of AI strengthen. This will be especially true in the US, where a further rise in AI investment and stronger productivity growth should offset the drag on GDP growth from immigration curbs. In contrast, despite a step-up in fiscal stimulus in Germany, growth in Europe will generally remain subdued as AI adoption continues to lag that in the US. This means that US economy will be back to outperforming other DMs.

Chart 1: Global Effective Tariff Rate (%)



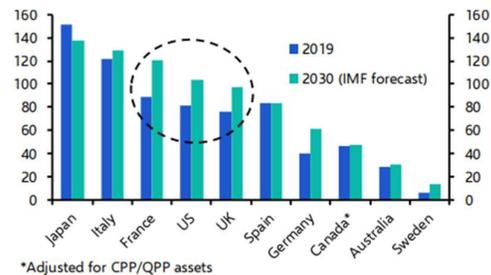
Meanwhile, growth in emerging economies is expected to remain soft. Although the official figures will continue to show GDP growth of around 5% in China, underlying growth is expected to remain much lower at around 3%, as fiscal policy and exports provide less of a prop to activity. Growth in other Emerging economies, namely Brazil and Russia, is expected to disappoint, while other emerging economies in Asia and the Middle East are anticipated to surprise to the upside relative to consensus expectations.

Meanwhile, there are various headwinds for the global economy. The US-China trade truce agreed in late October has done little to resolve underlying tensions between the two superpowers, meaning US-China fracturing will continue to shape the direction of trade, capital and technology flows in the coming year. And while a fiscal crisis in any major economy is not anticipated this year, fiscal strains will probably

continue to cause bouts of market volatility. France, the US and the UK remain most vulnerable. (See Chart 4.)

Altogether, global GDP growth is expected to remain around 3% year-on-year in the coming quarters, which is a touch below its pre-pandemic trend pace.

Chart 4: General Government Net Debt (% of GDP)



*Adjusted for CPP/QPP assets

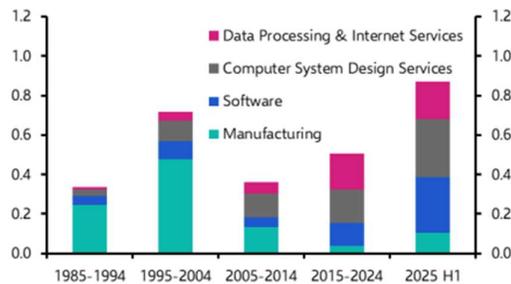
US – It is increasingly likely that the surge in AI-related investment in 2025 marks the start of a multi-year capex boom. Even allowing for ongoing labour market softness that will weigh on consumption growth, GDP growth is expected to be 2.5% in both 2026 and 2027.

The strong 4.3% annualised gain in Q3 GDP, is likely to have been followed by weaker growth in Q4, as the government shutdown probably weighed on activity. Growth should rebound in the first quarter of 2026, however, as that distortion is unwound and last year's budget reconciliation boosts tax refunds from late February onwards. The near-stagnation in employment will persist for some time, as immigration curbs restrain labour supply and AI-related productivity gains cap demand for new hires. Without a more marked rise in unemployment, however, wage and income growth should hold up relatively well.

Business investment growth averaged 8.4% annualised in the first half of last year thanks to the AI boom. (See Chart 11.) Admittedly, most of the hardware was imported, so it does not add directly to GDP. Nonetheless, software investment and R&D are also anticipated to grow strongly. Business investment growth is expected to be 6.5% in 2026 and 7.4% in 2027.

The GDP-by-industry data also show a big acceleration in the contributions to growth coming from the ICT services sectors in the first half of 2025. (See Chart 12.) Admittedly, it is only for six months but, strikingly, the average contribution was bigger than during the dotcom decade between 1995 and 2004.

Chart 12: ICT Industries Contributions to GVA Annualised Growth (% Pts)



The AI boom should also drive solid growth in labour productivity, which will help to offset the negative impact on the economy's supply side from the administration's immigration curbs that are weighing on labour supply.

With core inflation remaining above the 2% target for some considerable time, the Fed is likely to cut its policy rate by only 25bp in 2026.

Euro-zone – Growth is likely to remain subdued overall, with the largest countries struggling while smaller countries outperform. With inflation likely to drop well below target, the ECB is expected to cut interest rates twice in 2026.

Past ECB cuts have done little to boost activity, partly because private sector borrowing costs have not fallen far. (See Chart 17.) Caution

among consumers, shown by the high saving rate, has also reduced the impact of rate cuts.

Meanwhile, there may have been a small pick-up in AI-related investment in 2025, but any measurable impact on productivity in the near term is not anticipated.

Chart 11 : Hi-tech Real Investment (%y/y)

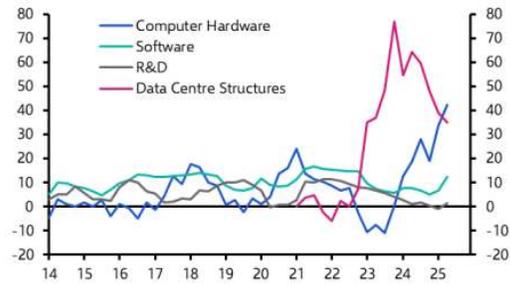
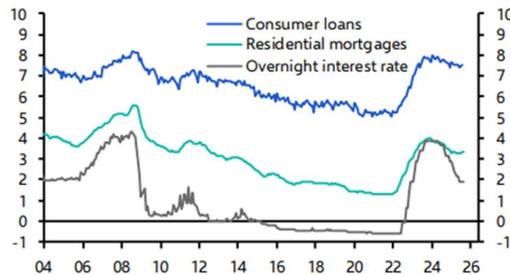
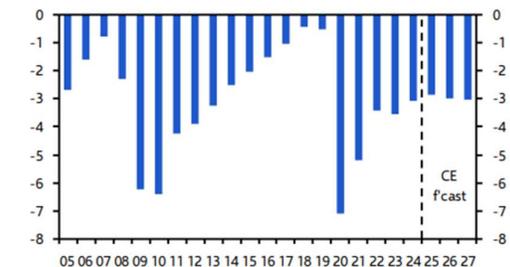


Chart 17: Euro Overnight Interest Rate & Interest Rates on Euro-zone Bank Loans (%)



Looser fiscal policy in Germany should lead to higher public investment, but the boost is likely to be more limited than most expect. With other countries tightening fiscal policy, there will be only a small fiscal expansion in the euro-zone as a whole. (See Chart 19.)

Chart 19: Euro-zone Government Budget Balance (% of GDP)



At the national level, Spain and other smaller countries are doing a lot of the heavy lifting,

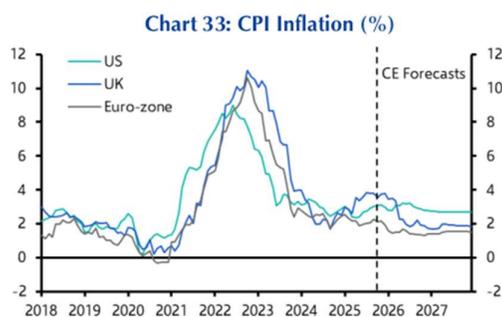
and their better growth prospects are reflected in better public debt dynamics. By contrast, growth is anticipated to be below average and public debt to rise in Germany, France and Italy.

The labour market is loosening gradually. Together with past declines in headline inflation, this will contribute to a significant slowdown in wage growth, which in turn will bring services inflation down much further. With food and energy inflation falling too, inflation is anticipated to decline to 1.5% early this year and remain around that level. If wage growth and services inflation decline as expected, the balance of risks would tilt towards ECB adopting looser monetary policy.

All told, euro-zone GDP growth is set to remain around 0.3% q/q this year.

UK – 2026 is expected to be the year that inflation falls to the 2% target and that, as a result, the Bank of England cuts interest rates to 3.00%. Politics could limit the fall in yields.

After being above the 2% target for five years, a fall in CPI inflation from 3.6% in October 2025 to 2.0% by the end of 2026 would leave inflation in the UK below the rate in the US and similar to that in the euro-zone. (See Chart 33.)



Some of this fall will be due to the unwinding of the boost from regulated prices that reinvigorated UK inflation in April 2025. And some of it will be due to a drag from the weakening in the labour market exacerbated by the big rises in business taxes in April 2025.

The unemployment rate has risen from 4.1% in August 2024 to 5.0% in September 2025 and it

is expected to peak at 5.2% in early 2026. This will contribute to a slowdown in wage growth, a big driver of services CPI inflation.

After rising by around 1.4% in 2024, real GDP growth is expected to be 1.0% in 2026 and 1.2% in 2027. Both would be below the economy's potential rate of 1.5%. With the economy growing below potential and CPI inflation falling faster than the Bank is forecasting, the Bank of England is expected to cut interest rates from 4.00% now to 3.00% in 2026. As that's lower than the trough of 3.50% priced into financial markets, 10-year gilt yields are likely to fall from around 4.49% now to 4.25% in 2026. Yields may fall by less should the announced fiscal tightening not materialise. In fact, yields could jump, at least temporarily, if Keir Starmer and Rachel Reeves are replaced by MPs more inclined to raise borrowing.

Japan – The economy is expected to continue to grow at a healthy pace, meaning the labour market will remain very tight. While headline inflation is set to fall below the BoJ's 2% target next year, underlying inflation should hold up well. Accordingly, the Bank is anticipated to lift rates to 1.75% by 2027.

The 0.6% quarter-on-quarter contraction in Q3 GDP was partly due to a large 8.2% plunge in residential investment, which reflected changes to the building code taking effect in April. A strong rebound is expected in Q4.

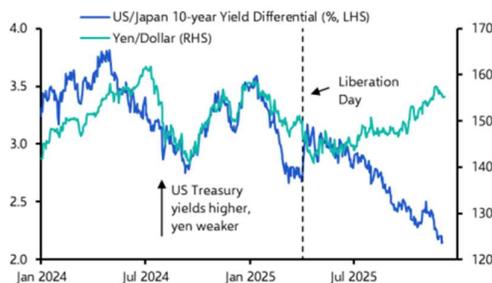
Export volumes have weakened recently as the frontrunning at the start of 2025 has reversed and manufacturers remain unusually downbeat about the outlook for their profits. However, there are few signs that trade tensions are affecting the wider economy. Lower inflation, tax cuts and transfer payments included in the latest supplementary budget are likely to result in a rebound in income growth and consumer spending. Wages have kept growing by 2-3%. And, the early indications are that next year's spring wage negotiations will result in another round of strong pay hikes.

Headline inflation remains well above the BoJ's 2% target, but that strength is driven to a large extent by strong food inflation. The BoJ has been arguing that soaring food prices are a temporary supply shock, but rising labour costs have played an important role.

Although the slashing of the gasoline tax surcharge and the resumption of utilities subsidies will push headline inflation well below the BoJ's 2% target in the first quarter, inflation excluding fresh food and energy, will only weaken gradually and it is expected to settle a touch above the BoJ's 2% target.

BoJ Governor Ueda signalled in a recent speech the Bank will resume its tightening cycle. The Bank is expected to lift its policy to 1.75% by 2027. Accordingly, the 10-year JGB yield is likely to climb to 2.5% over the next couple of years. The yen hasn't benefitted from rate differentials moving in its favour in 2025. (see Chart 32.) But as the BoJ normalises policy further and interest rate differentials continue to move in its favour, it is expected to strengthen to 140 against the dollar end-2027.

Chart 32: Yen/Dollar & Interest Rate Differentials

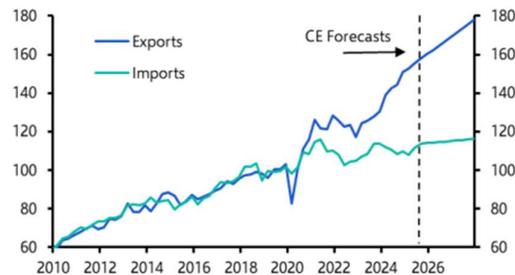


China – Fiscal support and a ramp-up in AI investment will prevent a sharp slowdown, but underlying growth is expected to be closer to 3% in 2026 in contrast to official GDP growth of roughly 5%.

US tariffs haven't been a big drag and the industrial sector has continued to outperform. While direct exports to the US have fallen almost 30% year-on-year overall exports have still grown by 5.4% in 2025 thanks to a rise in rerouting and exports elsewhere. Exports are

expected to continue growing over the coming years, partly because exporters will cut prices further as domestic supply continues to outstrip demand. (See Chart 59.)

Chart 59: China Goods Trade
(real, 2019 = 100, seasonally adjusted)



The leadership has signalled that self-sufficiency and technological leadership will be central priorities of the 15th Five Year Plan (2026-2030), pointing to still substantial state support for manufacturing investment. A strong pick-up in AI-related capex in 2026 should also help prop up investment.

The government is taking some steps to address the other element of China's macro imbalances: the weakness of consumption. But with the pace of rebalancing likely to be slow, the economy is anticipated to remain in deflation in both 2026 and 2027. Fiscal policy will provide a significant (albeit smaller) support to growth this year. Some monetary easing is also anticipated in 2026. But with deflation keeping real lending rates restrictive, this won't do much to boost credit demand.

The property sector downturn is set to drag on. Property construction is likely to fall by a further 30% and house prices to keep declining through 2026 and into 2027. That said, as the property sector's share of China's economy continues to shrink, the resulting contraction will become a smaller drag on overall growth.

Asset Allocation Views

Bonds – Although concerns about debt issuance and fiscal positions have been prominent at times, the recent sell-off seems

to have been driven by reassessments of monetary policy. In the US and Japan, this reassessment is expected to continue and yields will keep rising. By contrast, modest falls in government bond yields are expected in most of Europe by end-2026.

Corporate bonds – Corporate credit spreads remain very tight and they are not expected to fall much further. Indeed, sluggish economic growth in Europe and the UK could mean spreads in those places drift higher over time. The effect on corporate bond yields will be partly offset, however, by the decline in government bond yields in that region. By contrast, US spreads are anticipated to remain tight, but rising Treasury yields will weigh on returns. Overall, only moderate returns are expected for corporate bonds.

Equities – The performance of the US ‘big-tech’ sectors, information technology, communication services, and consumer discretionary, has been mixed in the final quarter of 2025, amid concerns about the sustainability of the AI boom. Nonetheless, these sectors are expected to collectively lead the charge again in 2026, driving the S&P 500 up to 8,000 as AI enthusiasm continues apace. Beyond that, valuations look increasingly stretched, raising the risk of a correction in 2027, with ‘big-tech’ shares likely to bear the brunt of the selling. The correction, however, might not drag on for as long as it did in the 2000s as a US recession is not anticipated.

Equities in the US have generally not outperformed those in many other major DMs in 2025, especially in US dollar terms. Nonetheless, they are expected to outperform many of them again in 2026, before underperforming in 2027. That view is heavily influenced by the shares of big-tech sectors in market capitalisations.

Emerging market equities – EM equities comfortably outperformed their DM counterparts in 2025. This partly reflects a rebound from a slump that followed the US election at the end of 2024. Equities in Asia are

expected to fare well in 2026 given their big exposure to technology. Meanwhile, the rally in LatAm and EMEA equities is unlikely to continue given risk premia is unlikely to fall much further and industrial metals prices are expected to fall.

Commodities – Precious metals have continued to surge this quarter, with industrial metals joining in the rally. Brent crude has generally trended lower since it spiked to around \$80pb in June. The removal of Venezuelan president Nicolás Maduro is unlikely to have a meaningful near-term effect on oil prices. Venezuela produces around one million barrels of oil per day, or just 1% of global supply, so any short-term disruption to its output can easily be offset by greater production elsewhere. A combination of modest demand growth and rising supply is expected to weigh on oil prices over the next couple of years, with Brent crude falling to around \$50pb by the end of 2026 and oscillating around this level throughout 2027.

Industrial metals – Recent gains in industrial metals prices have been driven by tight supply conditions and the prospect of AI-related demand. But prices are anticipated to come off their recent highs in 2026 as the ongoing property downturn curbs Chinese demand.

Precious metals – Gold and silver have again seen some of the largest price rises in Q4 2025, extending their year-to-date outperformances vis-à-vis other commodities partly supported by a pick-up in ETF demand. As monetary policy is not loosened in the US as much as markets currently discount, precious metals prices are likely to fall by end-2026.

Final Word

Looking ahead, markets are likely to remain changeable as economies grow at different speeds and interest rates begin to settle. While headlines can feel unsettling at times, periods like this often reward patience and a clear long-term plan rather than short-term reactions.

Our focus remains on helping clients stay aligned with their goals through sensible diversification and careful risk management. By keeping portfolios well balanced and focused on the long term, we aim to ensure clients remain confident and on track, whatever the market environment.

Scot Laing (Chartered FCSI)

Managing Director

Sources: Capital Economics; FE Analytics

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