Quarterly review

for the three months to 30 June 2025

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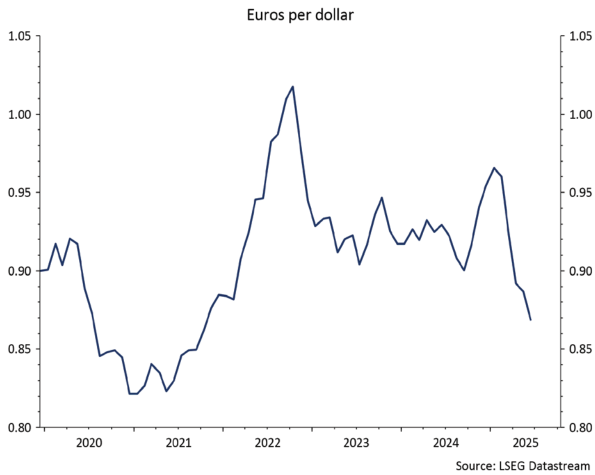
Global equities rose 5.20% in sterling over the second quarter of 2025, led higher by US technology stocks, which recovered 16.06% having been weak in the first quarter. Donald Trump put punitive tariff proposals on hold for 90 days pending bilateral talks, raising expectations of a more measured approach to trade policy. President Trump's fiscally-expansive "big beautiful bill" was enacted on July 4, with the vice president's vote tipping the balance in the Senate. Despite escalating Middle East conflict, oil and gold prices fell 10.48% and 0.89% in sterling respectively.

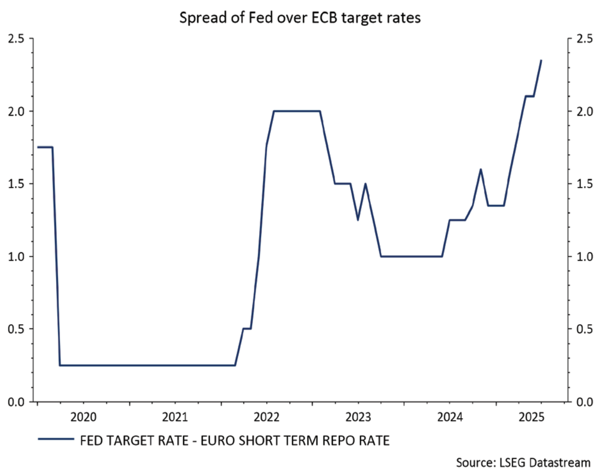
In May, investors were heartened by a Sino-US trade truce. This confirmed a climbdown from the latest trade war escalation as top-rate US tariffs on Chinese exports were reduced from 145% to 30% while recently-hiked tariffs on other imports fell from 125% to 10%. Tariff revenues may help fund Trump's "big beautiful bill", which extended the tax cuts in his 2017 Tax and Spending Act for the next decade and increased defence and border security spending at the expense of spending on health, green energy and some benefits.

In the first quarter of 2025, US gross domestic product (GDP) fell 0.5% according to the third estimate. In June, the Federal Reserve cut GDP growth forecasts for 2025 and 2026 from 1.7% and 1.8% to 1.4% and 1.6% respectively. Trump's mercurial policy-making, particularly on tariffs, may have hurt business and consumer confidence and deferred some spending decisions. The Fed left its policy interest rate unchanged at 4.25-4.5% because of above-target inflation and resilient jobs data. In May, the core personal consumption expenditures index, the Fed's preferred inflation measure, was 2.7% and may rise should tariff increases be passed on to consumers via higher prices. In June, unemployment was close to historic lows at 4.1%. Trump lobbied the Fed to cut rates but robust economic data appeared incompatible with easier monetary policy.

The "big beautiful bill" was opposed by some fiscal conservatives, including Elon Musk at the Department of Government Efficiency because it raised the US debt ceiling, the amount the public sector may borrow, by $5 trillion. US public sector borrowing rose to a $36.7 trillion record high in July. In 2024, it stood at 124.3% of US GDP. In May, Moody's joined the other leading credit-rating agencies, downgrading US sovereign debt to a notch below the highest rating although US government bonds remain one of the world's safest investments.

The dollar fell 7.96% against the euro over the quarter as fears about US borrowing outweighed the attractions of interest rates likely to remain higher for longer as bond investors demand higher rewards for financing government spending. This fall occurred despite US policy interest rates being higher, as shown in the charts below.





Eurozone inflation was at the European Central Bank's 2% target rate in June, giving the ECB flexibility to cut its main policy rate by a quarter percentage point to 2%. Retaliatory tariffs may raise prices but could be offset by cheaper Chinese goods being redirected from the US to the eurozone, as implied by the chart overleaf.

Quarterly review (continued)

for the three months to 30 June 2025

Equities in Europe excluding the UK, up 6.17% in sterling, outperformed thanks to lower interest rates and German infrastructure and defence spending.

Source: LSEG Datastream

Dollar-weakness is typically associated with higher demand for emerging market assets. Equities in Asia excluding Japan and emerging markets also outperformed, up 6.12% and 5.68% in sterling respectively despite relative weakness by Chinese and Indian stocks, which fell 3.85% and rose 3.35% respectively. There are grounds to remain cautious about Chinese stocks because of Sino-US trade tensions and slowing economic growth. Indian equities, however, appear attractive because India's economy is growing rapidly and companies are benefitting from the government's pro-business policies. China, Taiwan, India, South Korea and Brazil account for as much as 75% of some emerging market indices. Some smaller stockmarkets such as those of Mexico, Indonesia and the Philippines have, however, attractions because they have lower levels of debt relative to GDP and higher growth prospects than the US and Europe.

UK stocks modestly underperformed, up 4.12%, but smaller companies gained 14.26%. First-quarter UK GDP rose 0.7% but growth has faltered since and the Bank of England cut its policy rate by a quarter point to 4.25% despite price rises remaining above target, with consumer price inflation rising from a 1.7% low last September to 3.6% in June. In July, the Office for Budget Responsibility highlighted the economy's vulnerability, with the budget deficit running at 5.7% at the end of 2024 and the ratio of government debt to GDP continuing to rise. Public sector finances are under pressure from an ageing population while US isolationism has shown the need for greater defence spending. The high UK savings ratio is testimony to workers' caution ahead of the autumn Budget, which is expected to increase taxes.

At the quarter end, there were grounds to be positive on overall prospects for equities although US stocks appeared priced for perfection and looked, therefore, relatively unattractive. Larger companies in Europe and some emerging markets were trading on lower valuations, offering investors potentially higher returns than lower-risk assets such as shorter-dated sovereign bonds. Amongst lower-risk assets, shorter-dated inflation-linked bonds may provide some protection should tariffs prove inflationary. Gold provides diversification and may prove a safe-haven should investors retreat from equities and other riskier assets.

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