

Investment Review

Q4/25

“The first rule of economics is that there is an infinite number of desires chasing a finite number of goods, services, and resources. The first rule of politics is to ignore the first rule of economics.”

– Thomas Sowell

Politicians and governments, it seems, have been doing exactly that, attempting to meet all the infinite number of desires. While a noble cause, it is neither feasible nor affordable, and therefore not sustainable. As so often in financial markets, when it stops is a matter of timing, and nothing can help investors with that, not even the very smartest AI tool, into which colossal sums are currently being invested. But that's another story...

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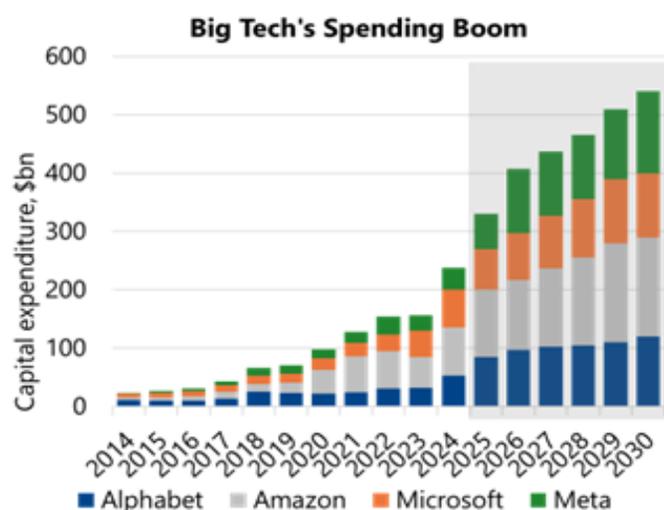
Introduction

“Dancing in a room in which the clocks have no hands.”

“The line between investment and speculation, which is never bright and clear, becomes blurred still further when most participants have recently enjoyed triumphs. Akin to Cinderella at the ball, they hate to miss a single minute of what is one helluva party. Therefore, the giddy participants all plan to leave just seconds before midnight. There’s a problem though: they are dancing in a room in which the clocks have no hands.” – Warren Buffett

Capex boom

This quote from his annual letter to Berkshire Hathaway shareholders back in 2000 has been rolled out again lately as comparison is drawn between the ‘dot.com’ bubble at the turn of the century and today’s AI mania. Common to both is a capex boom – back then into telecom and internet infrastructure, now into specialist chips, the data centres in which to house them and the power needed to operate them. The numbers are huge, \$3 trillion and growing. The chart below shows forecast spend from just the big four ‘hyperscalers’ – big and growing rapidly in the years prior to the launch of Chat GPT, exploding skywards on a different scale since.



Will returns ever justify the investment?

The rich valuations afforded to these and other big AI names have been rationalised by rising earnings, helped by capitalising expenditure and not charging it against profit. But there has been a notable recent increase in those questioning whether everyone, big tech and new financial interlopers in the space, will ever see the returns necessary to justify the investment. The 2000 capex boom had a transformational impact on society and the economy. But overcapacity of supply and rapid obsolescence meant returns never lived up to expectations. We are told "this time is different" (the most dangerous four words in investment), but counter with



"history does not repeat itself, but it does rhyme." There is an arms race in an exciting new technology again, society will benefit but there will be casualties along the way.

Many stock market indices reaching new highs

This is a US centric issue, driving the S&P index to new highs but adding to its hazardous concentration, c.30% in just the top five (large AI tech) stocks. Happily, narrowness here contrasts with the breadth of stock market rallies globally, many countries reaching new highs, including the UK, beating the S&P year to date but with the benefit of an historically low valuation that provides ample scope for further advances.

Long-term borrowing costs rise to a 30-year high

Not for the first time, positive sentiment in equities contrasts with a more cautious bond market. Rarely do moves in the latter capture the headlines in the same way that stock markets do. But for a moment in the quarter, front pages blazoned news that UK long-term government borrowing costs had risen to 30-year highs, above even the levels seen post the Truss budget fiasco. What the papers were depicting as a British problem, is endemic to markets across the developed world: too much supply of debt meeting too little demand, forcing prices down and yields up.

As always, a lot going on in global markets

No summer lull as we might have hoped for. A fuller exploration of long-term borrowing costs and other developments during the quarter in the pages that follow. Our aim, as always too, is to participate in the upside whilst proactively protecting the downside.

Market data

Group/Investment	Cumulative Performance %					Annual Performance %				
	3m	6m	1yr	3y	5y	2024	2023	2022	2021	2020
UK										
UK Large Cap Equity	7.5	11.0	17.5	51.5	91.6	9.7	7.9	4.7	18.4	-11.5
UK Mid Cap Equity	2.7	15.6	8.2	41.7	47.1	8.1	8.0	-17.4	16.9	-4.6
UK Small Cap Equity	6.9	11.6	16.2	50.0	84.1	9.5	7.9	0.3	18.3	-9.8
UK All Cap Equity	2.1	14.2	8.9	38.4	70.7	10.7	6.7	-13.6	23.0	7.1
Global										
Global Equity	9.7	15.4	17.4	56.8	85.4	19.8	15.7	-7.3	20.0	13.0
North America										
US Equity	10.1	15.0	17.2	61.7	105.8	27.3	19.2	-7.8	29.9	14.7
US Tech Equity	11.0	23.2	23.5	91.2	115.9	28.1	46.4	-23.9	28.7	44.3
Europe										
Developed Europe ex UK Equity	5.0	11.5	15.3	59.9	69.8	2.8	15.8	-7.5	17.6	8.9
Asia Pacific & EM										
Emerging Equity	12.6	16.5	15.7	37.5	43.5	14.8	2.9	-6.4	1.0	11.9
China Equity	23.2	19.0	30.9	41.0	-0.8	21.8	-16.6	-12.2	-20.2	27.3
Japan Equity	10.5	16.0	16.7	48.5	49.9	10.1	13.3	-4.8	2.5	11.1
Fixed Interest & Cash										
Global Government Bonds	0.6	2.0	1.8	10.2	-6.5	2.0	5.5	-13.8	-2.4	5.6
UK Gilts	-0.6	1.3	-1.3	3.8	-25.8	-3.3	3.7	-23.8	-5.2	8.3
UK Index Linked Gilts	-1.3	-0.5	-7.8	-14.7	-36.4	-8.3	0.9	-33.6	4.2	11.0
Bank of England Lending Rate	1.0	2.2	4.6	14.8	15.7	5.3	4.8	1.4	0.1	0.2
Other Assets										
Global Real Estate Equity	6.3	5.3	0.5	10.9	26.8	3.4	3.6	-14.0	24.2	-12.0
Global Energy Equity	7.7	-0.1	7.2	18.3	154.5	4.2	-1.4	47.7	34.7	-27.7

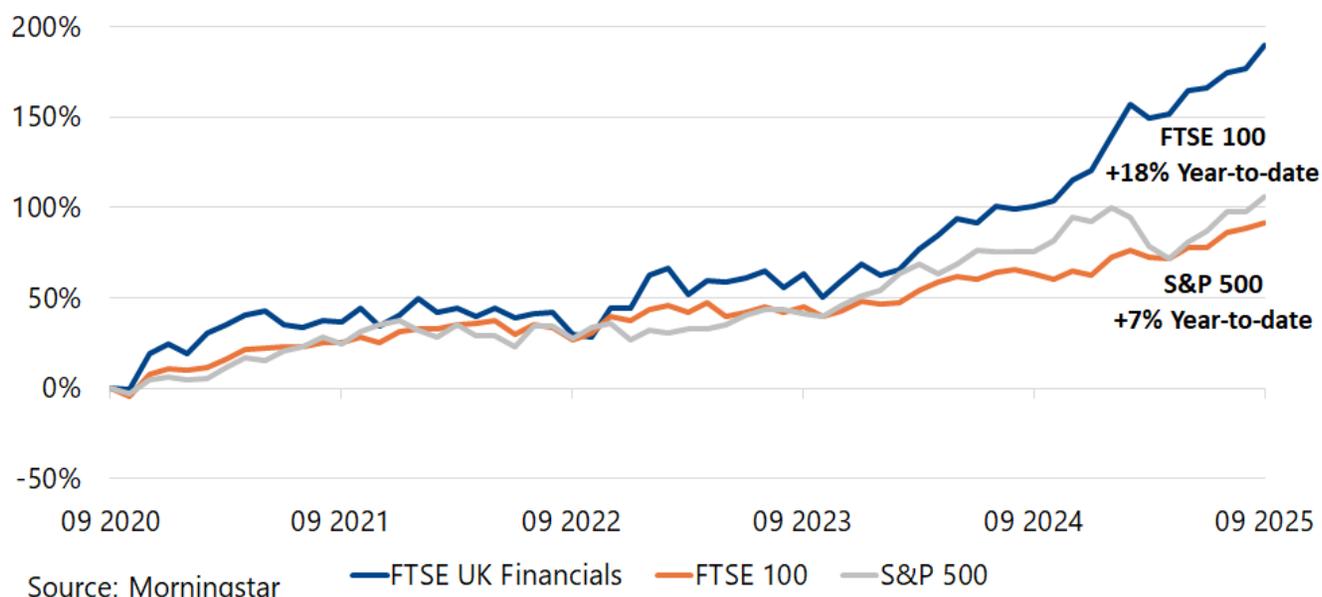
Note: Data as at 30 September 2025. Index returns are shown in GBP.

The indices used are the following: UK Large Cap Equity: FTSE 100, UK Mid Cap Equity: FTSE 250, UK Small Cap Equity: FTSE Small Cap, UK All Cap Equity: FTSE All Share, Global Equity: FTSE All World, US Equity: S&P 500, US Tech Equity: NASDAQ 100, Developed Europe ex UK: FTSE AW Dv Europe ex UK, Emerging Equity: FTSE Emerging, China Equity: FTSE China, Japan Equity: FTSE Japan, Global Government Bonds: FTSE WGBI (Hdg GBP), UK Gilts: FTSE Act UK Cnvt Gilts All Stocks, UK Index Linked Gilts: FTSE Act UK Index-Lnk Gilts AS, Bank of England Lending Rate: SONIA, Global Real Estate Equity: FTSE EPRA Nareit Global, Global Energy Equity: FTSE AW Ind/Energy. FTSE WGBI: The FTSE World Government Bond Index provides exposure to the global sovereign fixed income market, the index measures the performance of fixed-rate, local currency, investment-grade sovereign bonds. FTSE Act UK Cnvt Gilts All Stocks: The FTSE Actuaries UK Conventional Gilts All Stocks Index provides exposure to all British Government Bonds quoted on the London Stock Exchange. FTSE Act UK Index-Lnk Gilts AS: The FTSE Actuaries UK Index-Linked Gilts All Stocks Index provides exposure to all index-linked British Government Bonds quoted on the London Stock Exchange. FTSE EPRA Nareit Global. The index is designed to represent general trends in eligible real estate equities worldwide. The index covers Global, Developed and Emerging Markets. FTSE AW Ind/Energy includes all companies in the FTSE World Index that are categorised as Energy in the ICB sector breakdown.

Bank to the future for UK stocks

UK equities have delivered their fifth-strongest year-to-date performance in three decades in 2025, led by financials – with stronger, more disciplined, and better-capitalized banks at the forefront.

UK Financials vs FTSE 100 vs S&P 500 Returns



The quiet comeback story

Long dismissed as dull or lacking growth, the UK has delivered one of the year’s biggest surprises, even quietly outperforming Wall Street. Year-to-date, the main index is up +18% and thanks to the “safe-haven” greenback, investors tracking the FTSE 100 have outperformed the S&P 500 by more than 11% in sterling terms. In a year when the ‘Magnificent Seven’ have amplified volatility and tariff tensions heightened uncertainty, investors have taken some shelter in non-US assets. A partial tariff deal in May left UK stocks amongst the clearest beneficiaries, as investors prioritise stability above all else. Fiscal uncertainty remains, but as Luca Paolini of Pictet Asset Management notes, the UK is “a cheap old economy market with the right mix of defensives and cyclicals.” With 75% of revenues earned abroad, British firms have proved far more insulated than at first glance.

Mind the value gap

Value continues to stand out. Even after seeing the FTSE 100 pass the 9,000 mark for the first time since its launch in 1984, the index trades at about 13x forward earnings, versus 24x in the US. The UK’s bias towards value and defensive sectors has proved a key source of strength. The strongest returns have come from the two defence heavyweights, Rolls Royce Holdings (+88%) and BAE Systems (+63%) which, along with their

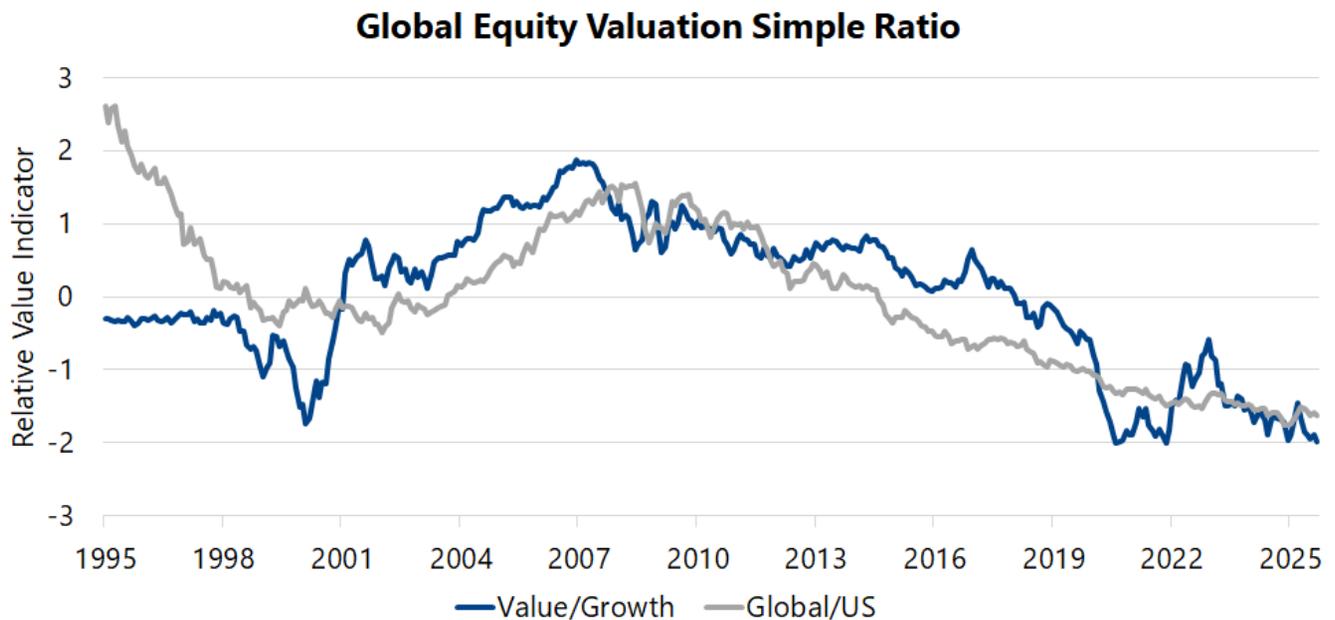
European peers, have rallied off the back of pledges by European governments to increase their defence spending. Low starting valuations, attractive yields, and higher-for-longer interest rates have continued to act as a tailwind for banks (shown in the chart above). The sector continues to be on investors' shopping lists thanks to generous dividends, well-capitalised balance sheets and the talk of reducing red tape introduced post-GFC.

Signs of life for London listings

Bloomberg data shows the first half of the year was the worst for London listings in 35 years – a 99% drop from the \$51bn high of 2006, and falling out of the 20 top markets for IPOs (Initial Public Offerings). Although the UK is not alone in this trend, the number of IPOs across Europe fell by 15% in the first half of 2025 compared with the same period in 2024, according to EY. Yet after a bruising spell, a wave of new arrivals is raising morale. The flotations of The Beauty Tech Group (producer of LED face masks) and Princes (the producer of Branston pickle), have been joined by the listing of specialist lender Shawbrook at a valuation of £2bn, giving hope that the market may have turned a corner.

Global value opportunities in a US focused world

Unlike the first half of 2025, profits – not politics – drove markets in Q3.



Source: Bloomberg

Market Monomania

Following initial US tariff announcements on 2 April, markets have bounced back to new record highs faster than ever before. The S&P 500 has climbed 34% since the lows of 8 April and the 'Magnificent 7' stocks alone have risen 61% over the same period. Again the story is one of extreme concentration in the US: the top 10 stocks now account for almost 40% of the S&P 500 index. Given the US now accounts for a record 68% of the world stock market, this is an issue that affects investors everywhere. The Shiller price-to-earnings ratio – a measure of how expensive the stock market is relative to long term earnings – now stands at 40x. This is well above the 35-year average of 27x and close to levels last seen during the dot-com bubble.

AI capex arms race

In the second half of 2025, we have witnessed exponential levels of capital expenditure amongst the AI hyperscalers. Nvidia announced a \$100bn investment in OpenAI, Oracle sold \$18bn of debt to finance its AI expansion, and OpenAI unveiled plans to build five data centres across America at an estimated cost of \$400bn – and without any explanation on how it will be funded. A circular deal dynamic is emerging, with AI companies transacting heavily between themselves, inflating valuations and propping up earnings growth. This initially gives the illusion of prosperity, but the circularity of funding does indeed

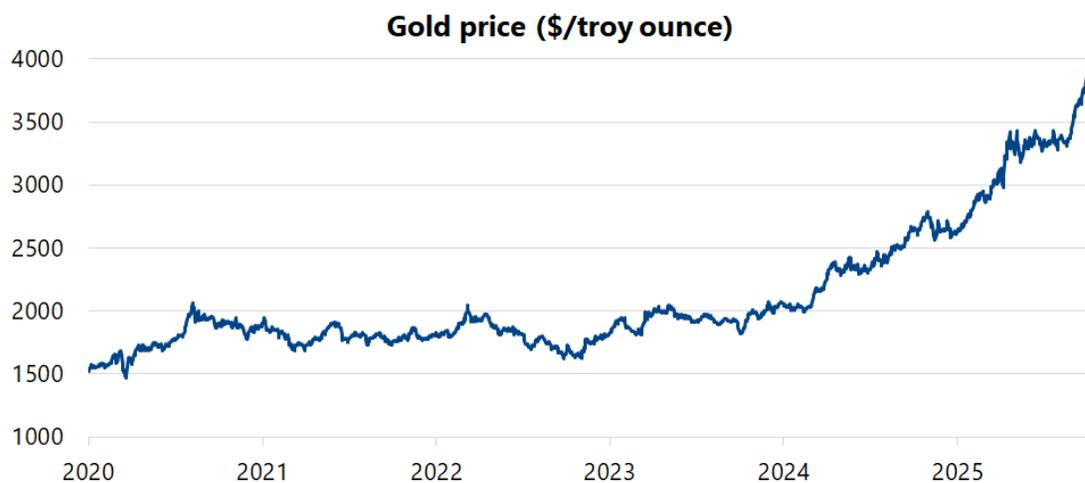
ring some 1999 alarm bells. To put this into perspective, technology investment was a larger contributor to US economic growth than consumer spending in the first half of the year. Should the end buyers of AI face an external cash flow shock, the merry-go-round might indeed fall off its hinges.

Navigating concentrated markets

While parts of the market appear stretched, opportunities remain in areas such as small-cap, value and international stocks, where valuations are more attractive (as shown in the chart above). Healthcare stands out. The MSCI World Healthcare Index has returned less than 6% a year over the past five years, lagging the broader market by 13%, and political uncertainty has pushed valuations to historic lows. Yet the sector offers solid earnings growth, favourable demographic trends and renewed merger and acquisition activity, all of which provide a supportive backdrop. The growing link between healthcare and AI is also spurring on fresh optimism. In June, Microsoft announced a diagnostic tool said to be four times more accurate than doctors in identifying complex conditions, highlighting the scale of potential change. Real progress will depend on investment from governments, regulators and technology firms to fund and apply AI across health systems. Nevertheless, the benefits of healthier populations and more efficient healthcare warrant focused attention.

The quarter of commodity contrasts

Gold surged to record highs as oil retreated and base metals held firm, underscoring widening divergences across global commodity markets. Investors leaned into safety over energy.



Source: Bloomberg

The gold rush rolls on

Gold prices have doubled in less than two years and risen more than 50% so far in 2025, as investors and central banks turn to the precious metal for safety. The rally, originally spurred by the Russia-Ukraine war, has continued with concerns over US government debt and the independence of the Federal Reserve, pushing gold above \$4,000. Central banks are buying bullion to reduce reliance on the dollar, while record inflows into gold ETFs show growing speculative retail interest. With prices jumping \$1,000 in six weeks, this surge echoes past peaks of 1980 and 2011 and which ended badly for those who bought at the top.

One eye on the lightweight

Aluminium has quietly emerged as one of the year's standout stories. After years of surplus, the market now faces the prospect of its first meaningful shortage in decades. China, which once flooded the world with cheap supply, has capped production at 45 million tonnes in response to US tariffs – just as demand is soaring across industries such as electric vehicles. The lightweight metal is now a popular substitute for copper, with the red metal at a price ratio of 4x to aluminium. Prices have jumped to around \$2,800 a tonne, lifted by tariffs, rising energy costs and dwindling inventories across the US and Europe. With stockpiles near record lows and fresh capacity slow to emerge, traders are starting to wonder where the next tonne will come from.

Oil slides further

Neither US rate cuts, conflict in the Middle East, nor Russian air incursions into Eastern Europe have revived the oil market, with Brent crude slipping to a five-month low near \$61 a barrel as supply again outpaces demand. The International Energy Agency pointed to a surplus in production, with global output exceeding consumption well into next year. Meanwhile, rising exports from key producers and record Chinese stockpiles have kept prices capped despite OPEC+ gently tightening the taps. Easing Middle East tensions and softer economic sentiment have further cooled the market, leaving oil less of a pressure point for inflation watchers.

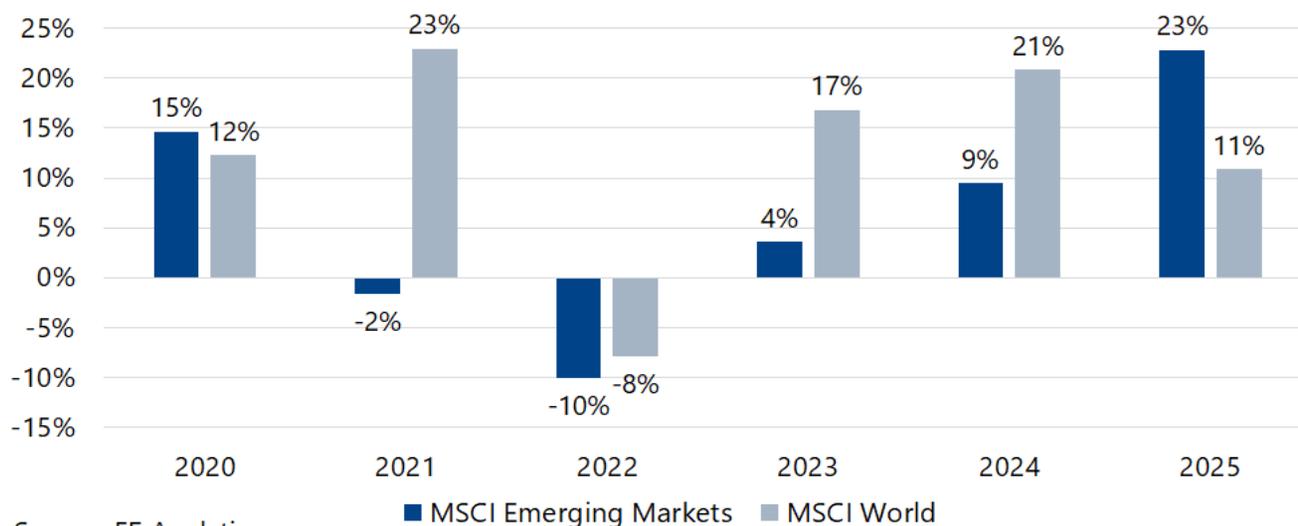
Crypto and dedollarisation

In Q3, digital assets staged a strong rebound, highlighting growing maturity and institutional adoption. Bitcoin gained 7%, while Ethereum surged 67% amid a dovish rate outlook and robust institutional flows, with Bitcoin hitting a new all-time high of \$124,500 in August. The passage of the GENIUS Act in July provided long-awaited regulatory clarity for dollar-backed stablecoins, a private-sector alternative. The market is small but growing rapidly and could help redistribute funds in the financial system, possibly even supporting US debt funding. A big step forward, though the asset class still behaves like a geared play on the NASDAQ, retaining its speculative nature.

The tide turns for emerging markets

Stronger growth, supportive currencies, and shifting investor sentiment are driving a rotation into emerging market equities.

Emerging Markets vs Global Equities



Source: FE Analytics

The emerging opportunity

Emerging markets (EM) have long represented a promising opportunity for investors. They offer attractive valuations and strong structural growth stories. In many ways, this is the opposite of what can be said for most developed market (DM) economies. Yet from 2020 through to the end of 2024, EM equities lagged their DM peers.

A change in leadership

This year has been different, with the MSCI EM Index outperforming the DM MSCI World Index. The reasons are twofold. First, four of the five largest EM markets (Brazil, China, Korea and Taiwan) have all delivered strong returns, all of which are up over 20% in GBP terms. Secondly, US equities have underperformed and with the US accounting for 70% of the World Index, global performance remains heavily influenced by the US, which continues to lag despite a strong recovery since April.

Not everyone is a winner

There is one notable exception to EM outperformance – India. The world’s most populated country has significantly lagged its largest peers this year, indicating a clear reversion to the long-term trend. Until just over a year ago, India was the darling of EM and home to the world’s most expensive stock market – even pricier than that of the US. During this period, Indian equity returns were impressive. As the second-largest

region within emerging markets, behind China – which remains mired in a deflationary property bust – the contrast was striking: China’s era was fading, while India’s was just beginning. Investor confidence was so strong that demand for EM ex-China funds surged, aiming to avoid China’s woes and capture the next big growth story.

The balance of risks

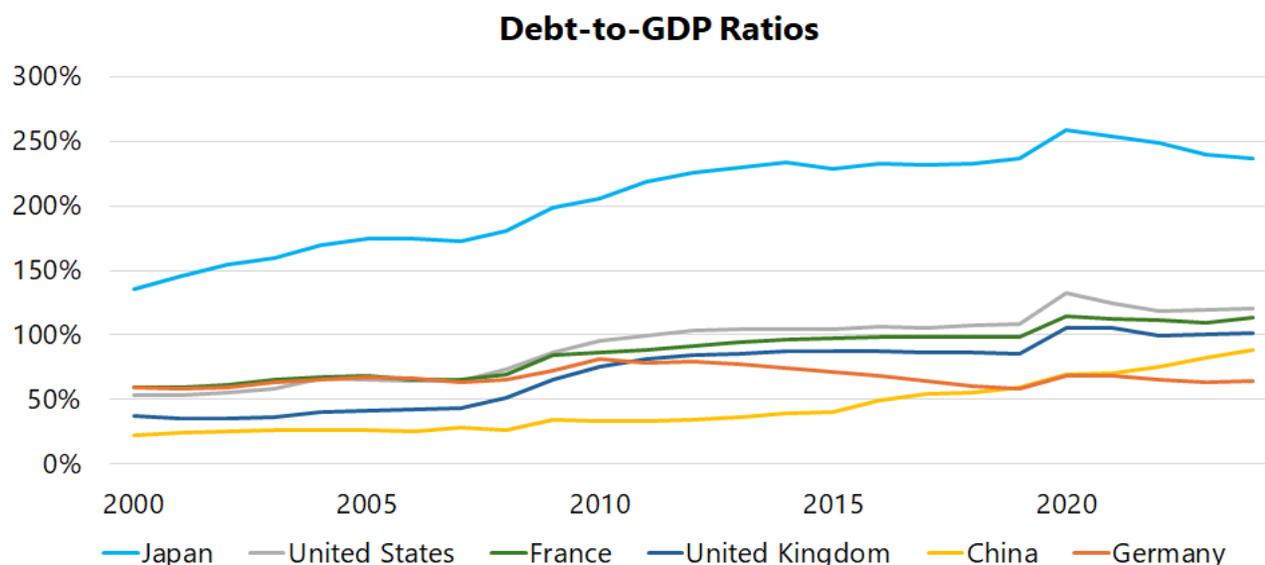
That trend continued until sentiment towards Chinese equities was so low and valuations were so depressed, that it didn’t take much to move the dial and get them pointing in the right direction. A year on from China’s initial stimulus announcement, the divergence in performance has been striking, China is up around 30%, while India is down 9%.

Thanks, uncle Sam

We have long highlighted the benefits to EM of a weaker dollar. While still historically strong, the dollar’s pullback this year has given EM economies some breathing room. Helping to lower the cost of dollar-denominated debt and making dollar-priced goods more affordable. While we are not currency experts, the question we are all asking ourselves is how much further can it fall?

Resilience in uncertain times

Markets have shrugged off tariff and political risks for now, but the durability of this optimism may soon be tested. Japan's leadership change and frontier market strength highlight how opportunity often hides amid instability.



Source: IMF

A new frontier

It's not just the large EM nations that have performed strongly – lesser-developed frontier markets have also outpaced their more established peers. This is particularly impressive given a fragile backdrop of global trade and political uncertainty. The trade-off here, of course, is that while these economies offer even greater long-term growth potential, they do so at the expense of higher exposure to both geopolitical and investment risks.

Tariffs? Forgot all about them

Interestingly, markets appear to have moved past tariff concerns. Despite the significant sell-off in April, global equities have mostly recovered and pushed to new highs. The resilience has been impressive, but is it complacent? The lagged effects of tariffs are expected to start showing through this quarter. Moreover, weaker data could prompt investors to reassess their risk exposures, which have reverted to their typical patterns following the early recovery in equities.

Japan boards the political merry-go-round

Prime Ministers around the world are massively out of favour and Japan is no exception to this trend. In a short term defined by high cost-push inflation and trade uncertainty, the deeply unpopular PM Ishiba resigned after serving less than a year in office. This adds yet another chapter to Japan's long history of short-lived leaders.

A first for Japan

This paved the way for Japan to elect its first female Prime Minister, Sanae Takaichi, who comes from the political school of Shinzo Abe. The administration that launched Japan's corporate reform agenda also set the stage for today's extremely weak yen and expansive stimulus program, leaving the country perched atop the debt-to-GDP rankings at a staggering 237%. Compare and contrast to the "excessive" levels in the US at 121% or the UK at 101%.

Regime change or reversion

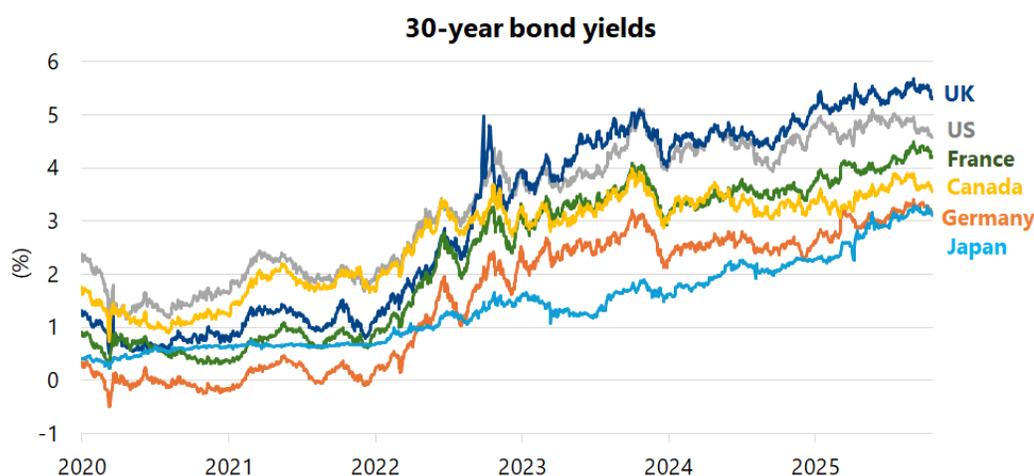
This comes at a point in time where Japan appeared poised to pivot toward a more disciplined fiscal and monetary stance. But will we now see more of the same old playbook – a weak yen, heavy debt issuance, and economic growth prioritised over fiscal responsibility? Time will tell.

Japanese equities remain a dark horse

Despite the political backdrop, Japanese equities have outpaced their developed market peers over the quarter, rising by over 12%. These are impressive short-term numbers, but the long-term picture looks equally encouraging. The ongoing improvement in corporate governance, a theme we've highlighted in previous quarterly reports, remains a key driver of improving Japan's market efficiency – a theme that could see further tailwinds with the newly appointed Prime Minister.

“UK 30-year gilt yield hits highest level this century”

So ran a headline in the FT at the start of September. To no great surprise, the shared headlines in both the Telegraph and the Mail (the same words but in a different order) were somewhat harsher, “Borrowing costs surge as Britain faces ‘moron premium’ under Reeves”.



Source: Bloomberg

Bond markets hit the headlines

Bond markets as a rule do not tend to grab the headlines, but when they do, it is generally not a good sign. Equally though, by the time the popular press report on some calamity in a financial asset, the worst is typically over. The figure in question reached 5.7% on 2 September, the highest level since 1998, but has eased a little since.

A developed nation problem

What the headlines fail to mention, and as you can see from the chart above, is that higher long-dated yields on government debt are a developed nation problem, not just a British disease. Whilst long-dated Treasury yields have fallen back a little of late, in response to weak employment data and concerns over the government shutdown, the yields on French OATs have gone up, a response to the resignation of France's fifth Prime Minister in two years, and now trade at a higher level than Italian BTPs for the first time since the euro launched in 1999.

Deficits, debt issuance and inflation

The story common to all revolves around deficits, debt issuance and inflation. The forever high US fiscal deficit (where spending exceeds revenue) is getting worse, an addiction to debt is sending total borrowing and the costs to service this to ever scarier and unsustainable levels, inflation is showing signs of creeping back up as tariffs work their way through the system, and to top it all, continual acid criticism from the White House bodes

badly for Federal Reserve independence. The market is currently discounting six quarter point rate cuts between now and the end of next year, woe betide if inflationary pressures cause this expectation to disappoint.

UK specific challenges

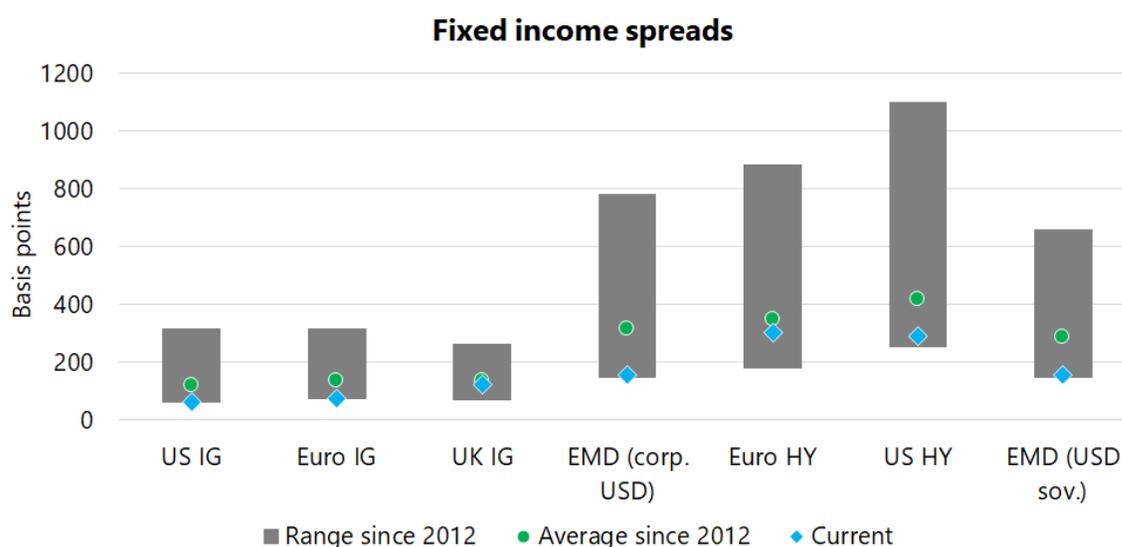
The UK faces specific challenges, not least stubbornly elevated inflation, that has kept the interest rate on hold, in contrast to recent cuts seen in Europe and the US. If, however, this inflation has been driven largely by government-imposed increases in NI contributions and the minimum wage, and to regulated increases in energy bills, most of this should fall out of the figures when annualized. In contrast to the US, the market is discounting no rate cuts until next Spring, the balance of risks given these low expectations, to the upside.

The upcoming Budget

A second UK specific factor adding a premium to borrowings costs is our exile to the naughty step since the Truss/Kwarteng 'mini' budget fiasco in 2022. Rachel Reeves's decision to increase borrowing in last year's Budget thwarted any early release for good behaviour. A lot now hinges on the upcoming Budget, about which there has been intense speculation and there is no value in us adding to that speculation here. We will all know the outcome within a month of this review.

“US credit spreads hit lowest level this century”

This FT headline from mid-August equal and opposite to the FT headline on the previous page that appeared a fortnight later. Equal in sensationalist use of ‘this century’, opposite in terms of highest and lowest.



Spreads at bottom of the range

The chart above is a little complicated. But the clear and simple message is this: that spreads (the yield premium over lower risk government debt), across all manner of credit securities and across all geographies, are at their lowest levels in a range covering the period since 2012.

Credit markets “weirdly confident”

The sub-heading to the FT article reads “Investors warn credit markets are ‘weirdly confident’ despite threats to global economy”. This confidence in credit echoes the positive sentiment on display in equity markets, and contrasts with the caution evident in government debt. One of them must be wrong.

Resilient corporate earnings

Both investment grade and high yield have performed well year to date. While concerns regarding the fiscal situation exist, investors in credit have been buoyed along by resilient corporate earnings, subsiding trade tensions and expectations of central bank rate cuts. Emerging market debt has additionally been supported by a weaker US dollar – still most of it

Little compensation for added risk

With credit spreads so tight, investors are receiving little compensation for the added risk of investing in non-government backed, riskier, debt securities. Corporate earnings have indeed been resilient but are following a cycle that now looks increasingly long in the tooth, with default rates still at historically low levels.

Credit loses diversification benefit

Traditionally, the attraction of holding bonds in a balanced portfolio is for them to be strong when equities are weak, to provide a steady and reliable income when risk-off sentiment in equity markets causes share prices to fall. If though demand for riskier credit, for high yield bonds in particular, has become closely correlated with risk-on appetite for equities, the diversification benefit is lost.

Asymmetric returns to rate moves

Government bonds are back paying you to be patient. They have the benefit of wide yield cushions, meaning yields can go higher still before the capital losses outweigh the return from the income received from the bond, in this sense offering asymmetric returns around rate moves, strongly positive if rates fall, a little negative if rates rise. They are a prudent hedge against any sudden shift in currently positive equity market sentiment.

Asset class views

Asset Class	Sub Asset Class						Change	Description
		--	-	=	+	++		
Preference by asset class	Equities	○	○	●	○	○	-	The cyclical outlook is balanced with expectations for slower, but still positive growth. Expensive valuations offset by rate cuts and pockets of opportunity within regions/sectors.
	UK	○	○	●	○	○	-	Fiscal position remains a hindrance to growth. Large discount to global peers and sterling weakness supports multinationals.
	U.S.	○	●	○	○	○	-	Large-cap expensive and US policy uncertainty is elevated. Higher risk of negative growth surprises. Mid & Small Caps attractive.
	Europe ex UK	○	○	●	○	○	-	Valuations have converged after a strong half of 2025. Investment in the region growing but Euro strength remains a headwind to large-cap earnings.
	Japan	○	○	○	●	○	-	Strong returns over the quarter outperforming DM peers. New PM's stimulative stance likely speeds up the corporate reform story at the expense of a weaker yen.
	Emerging Markets	○	○	○	○	●	-	US trade tensions remain a concern, but increasing intra-EM trade, attractive valuations, a weaker dollar, and high real rate economies with room to manoeuvre all support a positive outlook
	Fixed Income	○	○	●	○	○	-	Any fall in growth likely supportive for government bonds, less so for corporates. Attractive yields on offer but preference for higher quality.
	Global Aggregate ¹	○	●	○	○	○	-	Cautious on US fiscal risks, BoJ tightening, ECB near cycle end. IG spreads near historic tights. Negative equity correlation returned.
	UK Gilts	○	○	○	●	○	-	Low growth, inflation falling over medium-term and unemployment ticking up all point to rate cuts. Conscious of fiscal policy risks and debt levels rising further absent any spending cuts or tax rises.
	Global Index Linked	○	○	●	○	○	↓	Short-term inflation expectations are elevated but yet to feed into medium or long term. Less attractive given budget deficit concerns in US.
Global High Yield ²	○	●	○	○	○	-	Spreads at historically tight levels but all-in yields attractive. Balance of risks skewed to the downside despite demand for the asset class remaining strong.	
Other	Diversifiers	○	○	○	●	○	-	A low growth, higher inflation environment should be supportive if bond yields do not rise materially.
	Cash	●	○	○	○	○	-	Cash returns continue to fall as central banks continue their rate cutting regime.

1 Global Aggregate refers to investment grade bonds which could be government or corporate.

2 High Yield refers to corporate bonds with a higher default risk as decided by the ratings agencies.

Up/down arrows indicate a positive (↑) or negative (↓) change in view since the prior Investment Quarterly Review.

Equities

What we think

It has been a good year so far for equity markets globally, with two-thirds of countries in the global equity index (MSCI ACWI) finishing the third quarter at new 12-month highs, most of them setting new all-time highs. This breadth of performance is a healthy sign, stock markets internationally participating in the upside, rather than performance being focused on a single region or a select few individual markets.

Good markets despite Trump tariffs on goods into the world's biggest economy circa five times higher than they were before Liberation Day on April 2nd, despite government long-term costs of borrowing across developed markets at multi-year highs, and despite continued hostilities in Ukraine and Gaza. Successfully scaling a wall of worry.

Healthy breadth globally is in stark contrast to the unhealthy extreme concentration on Wall Street, a record 40% of the S&P 500 in just ten stocks, all of them seen as big beneficiaries of the AI boom. Unhealthy also is the exponential recent rise to record levels in margin debt, US retail investors borrowing money to invest in the stock market, with a geared benefit on the upside, but having to find the money to repay the debt if share prices fall – a potentially painful downward spiral.

All things considered, we are minded to keep our overall equity exposure unchanged, all portfolios at their long-term strategic asset allocation levels. Our most favoured region, emerging markets (EM), has been the best performer, helped by US dollar weakness, being further along the rate cycle, the structural long-term growth narrative, and a partial reversal of material underperformance over the previous c.15 years. We believe that in the right active manager's hands, there is still plenty of opportunity here.

Contrary to what you might think given the constant gloomy headlines, the UK has also been a strong performer, up 18% and beating the S&P 500 year-to-date (as we write). Despite this strong performance, we remain positive on our home market, trading at a c.35% discount to global peers and still the cheapest major stock market.

What we have done

Our biggest concern remains the US: extreme valuations and concentration, record retail investor leverage, and signs of speculative excess. Held aloft by an AI boom that has developed into a capex arm's race, participants in a high stakes game of poker, having to invest ever more to stay in the game.

We are though cognisant of economist J.M. Keynes wise warning, "markets can remain irrational longer than you can remain solvent," i.e. prices can diverge from fundamental value for a long time. Whilst we cannot predict when this boom might end, we can prepare, and so position a little more defensively, within an unchanged overall US equity position.

The way in which we have opted to do this is to add a new fund in the global healthcare sector. Healthcare has been the weakest sector within the materially underperforming defensives area of the market. It has faced big headwinds in the form of Trump's anger that US drugs tend to be priced higher than elsewhere and a Health Secretary happy to challenge other established norms, like the benefit of vaccination.

Longer term, Healthcare is a clear beneficiary of compelling structural factors; an aging global population and EM countries closing the vast healthcare spending gap with the West, e.g. India spending just 1% of US equivalent per capita spend. Shorter-term, the sector should be a big beneficiary of AI, e.g. shortening the decade-long process clinical trial process, improving the odds in drug discovery.

After extensive research spanning two quarters, we have chosen Janus Henderson Global Life Sciences. The fund has a strong track record, successfully employing a barbell approach, balancing a lower risk core with a higher risk satellite position in areas like Biotech where they have a proven record of success. Given the passive and ESG models follow the same tactical asset allocation as our core portfolios, we have added an equivalent position through a healthcare index.

Fixed interest and diversifiers

What we think

It has been an interesting quarter in fixed interest securities, long-term government bonds unusually stealing the limelight away from stock markets.

Government bond yields are the costs that must be paid to service a country's debt; the higher the level of debt and the higher the yields, the greater the cost to that country. They are unproductive costs, they do not pay for goods or services, and they squeeze the remaining available budget for areas like healthcare, education, or infrastructure.

Regrettably, this last quarter saw both debt and yields rise across developed nations. An addiction to borrowing that everyone knows is unsustainable, but governments seemingly unable or unwilling to kick the habit. It has developed into a smouldering volcano, little foreshocks hinting at it about to blow, but no telling as to when.

The risks of this in part reflected in the yields on offer, a decent figure now with scope for capital appreciation if those yields fall. From a position just a few years back, when c.40% of global government debt traded at negative interest rates – a 'return free risk' – investors are now again being paid to be patient. Safe, government backed income, that is back fulfilling a diversification role in balanced portfolios containing higher risk equity exposures.

By contrast, we see fewer attractions in corporate debt (credit), the premium being paid to own this insufficient compensation for the additional risk. As with government debt above though, this is not a blanket view. Not all credit is bad, just as not all government debt is good. They are both massive markets containing both opportunities and threats, we are not totally out of credit, but in both need to be selective along fundamentally researched lines.

Equity markets as we describe have been strong, the global breadth of performance healthy, but some unhealthy features in the dominant US. We believe it prudent therefore to maintain a strong offset and diversification function in the areas outside of equities, in fixed interest and (as the name suggests) in diversifiers.

What we have done

In truth, very little this quarter. We are pleased that our Strategic Bond fund managers have utilized their wide remits in the Bond asset class, to shift the balance of their portfolios prudently away from credit and towards government debt, and naturally being highly selective as to what country's debt they are investing in. Our overall exposure to credit is now significantly less than six months ago.

Elsewhere, we have exited a small position across the lower risk portfolios in a dedicated UK inflation Linked fund. We see little incremental benefit in holding this fund, we still have a global short-dated inflation linked fund, more diversified and less inherent interest rate risk.

We have not touched the diversifiers asset class position, and are happy that in our Cohen & Steers Diversified Real Assets fund, we have exposure to natural resources and precious metals that have traditionally provided a hedge against unsettled equity markets.

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