



meridian
ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

This has been another extraordinary quarter, starting strongly in February, being blindsided by the Iranian war in March but recovering in April even though the impasse between the USA and Iran continued. The result was a positive quarter for equities which belied their underlying volatility. For bonds, the results were not so good as they reflected fears of increased inflation which led to revised expectations on the movement in short term interest rates.

The tables below detail relevant movements in markets :

International Equities 30.01.26 - 30.04.26

Total Return Performances (%)				
Country	Local Currency	£	US\$	€
Australia	+0.2	+3.9	+2.9	+4.3
Finland	+16.0	+15.5	+14.4	+16.0
France	-0.3	-0.7	-1.7	-0.3
Germany	-0.7	-1.1	-2.1	-0.7
Hong Kong	-1.0	-0.3	-1.3	+0.1
Italy	+5.6	+5.1	+4.1	+5.6
Japan	+5.9	+5.3	+4.2	+5.7
Netherlands	+0.3	-0.1	-1.1	+0.3
Spain	+0.4	N/C	-1.0	+0.4
Switzerland	+1.8	+1.3	+0.3	+1.7
UK	+2.8	+2.8	+1.8	+3.2
USA	+4.1	+5.1	+4.1	+5.5
All World Europe ex UK	+0.9	+0.3	-0.7	+0.7
All World Asia Pacific ex Japan	+6.3	+6.5	+5.5	+7.0
All World Asia Pacific	+6.2	+6.1	+5.1	+6.6
All World Latin America	+2.0	+5.5	+4.5	+5.9
All World Emerging Markets	+2.4	+2.5	+1.5	+2.9
All World	+4.1	+4.7	+3.6	+5.1

Source : FTSE All World Indices

FTSE Actuaries UK Conventional Gilts All Stocks Index (total return) : -0.5%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

	30.01.26	30.04.26
Sterling	4.52	5.01
US Dollar	4.24	4.39
Yen	2.24	2.49
Germany (Euro)	2.84	3.03

Sterling's performance during the quarter ending 30.04.26 (%)

	Quarter Ending 30.04.26
US Dollar	-0.8
Canadian Dollar	-0.8
Yen	+0.4
Euro	+0.3
Swiss Franc	+0.4
Australian Dollar	-3.8

Other currency movements during the quarter ending 30.04.26 (%)

	Quarter Ending 30.04.26
US Dollar / Canadian Dollar	N/C
US Dollar / Yen	+1.2
US Dollar / Euro	+1.1
Swiss Franc / Euro	-0.2
Euro / Yen	+0.1

Significant Commodities (US dollar terms) 30.01.26 - 30.04.26 (%)

	Quarter Ending 30.04.26
Oil	+61.2
Gold	-7.4

MARKETS

- Equities performed strongly during the quarter. Asia Pacific outperformed in local currency terms whilst Australia and Europe ex UK underperformed although both indices recorded slightly positive returns.
- Fixed interest markets recorded negative returns as perceptions of future interest rate changes adjusted to the new higher inflation environment.
- Overall, foreign exchange movements were not significant, other than to note strength in the Australian dollar, largely because of three ¼% interest rate rises since January.
- The sharp rise in the oil price followed on from events in the Middle East.
- Gold fell back from previous highs.

ECONOMICS

Investors have every reason to be confused by the performance of markets during these unusual times. Whilst bonds have not performed well, equities have and, at the time of writing, stand at around all time highs. Given the current geopolitical background, it was not meant to be like this.

What might one reasonably expect to happen? Perhaps just staying with the economic aspects of the Iranian situation, it is the effect on energy prices which is the starting point because this is where the immediate impact is felt through a rise in inflation. A second order effect, and a serious one were it to occur, would be that a shortage of energy caused economic activity to weaken as manufacturing output had to be curtailed. If bad enough, this could lead to recession in some countries.

Against this background, it is easy to see why fixed interest securities have been weak since the Iran crisis started. Prior to the beginning of March, most investors and economists expected interest rates, as set by the central banks, to continue their downward trajectory as inflation eased. Expectations have abruptly reversed and higher interest rates now seem more likely. Why might central banks raise interest rates when these recent events are likely to mean lower economic growth than previously expected? An important reason is that they would not want higher inflation to affect longer term expectations which might then feed into, for example, pay negotiations, thus becoming a self fulfilling influence on prices. Higher interest rates would also bear down on economic growth but have the effect of making price rises more difficult to push through, thereby helping to bring down the rate of inflation. If real interest rates become negative as they did in the Covid period, that phenomenon itself has the ability to raise inflation as it encourages more borrowing, including for house purchases, which can feed through to the general economy.

This is the theoretical effect on the private sector but what about the government sector? The news is not good here, either. Whilst the consequences of the current conflict in Iran for interest rates, as described in the previous paragraph, referred to the short end of the market where central banks dictate policy rates, the effects will be felt right along the maturities of government bonds and, by extension, to the private sector bond market. As clients will know, we have long harboured a negative view on

fixed interest markets, mainly because many governments have continued to increase their debt levels on the back of continuing budget deficits. Increasing issuance of government bonds to finance these deficits can be expected to raise countries' borrowing costs and threaten their credit ratings as evidenced by many sovereign downgrades by the rating agencies. Undoubtedly, this could become a test of creditworthiness in some cases. So, for many reasons, current developments are very serious for many governments as they raise their borrowing costs and all that results from that. Borrowing restraints imposed by the markets can therefore force governments to take unpopular measures to deal with this new unexpected and, for them, unwelcome development. These would be either to raise taxes or cut public spending, or a mixture of the two. Whichever course of action is taken, the measures can be expected to reduce economic growth leading to a negative doom loop. In the more extreme scenario when not only does a government have to face the costs of rising interest rates with all that entails, as just described, but also economic activity being curtailed by higher energy costs or energy shortages, the difficulties become ever more severe for government finances. Any politician who feels he or she can face down the bond markets will be in for a shock. In fact constraints put on profligate governments by the bond markets can represent investors' best friends if they make governments face economic reality.

Given this scenario, weakness across nearly all government bond markets as a result of the Iranian situation would seem logical and accord with normal economic analysis but what is interesting and worth delving into further is why there has been a wide dispersion of performance amongst the various countries' government bonds. They tell a meaningful story. If we look at the ten year government bonds, those which have performed relatively well so far this year include countries with high levels of energy self sufficiency. They include the USA, Canada, China, Sweden and Brazil (in this latter case yields have fallen in absolute terms). On the other hand, amongst those which have performed worst, the UK, Italy, Portugal, Greece, Japan and South Korea, a common theme is weak energy self sufficiencies. This is logical because the current conflict poses particular risks to these countries, financially and logistically. If we look further into the movements in these ten year government bonds, it is also noticeable that those countries with weak finances in terms of their overall indebtedness showed some overlap with these energy affected countries. The biggest rise in ten year government bond yields in absolute terms was in the ten year UK gilt, showing a rise at the time of writing, of 46.1 basis points so far this year. Japan, an even more heavily indebted country, saw its ten year JGB yield rise so far this year by 40.6 basis points, although this also is related to the new Japanese Prime Minister's economic policies. Two other heavily indebted countries, Greece and Italy, have also seen above average rises in their government bond yields, particularly the former. By contrast, almost certainly because of its energy self sufficiency position and the longer term advantage of having the world's major reserve currency, the rise in the ten year US Treasury bond yield has been a relatively modest at 16.6 basis points, this in spite of its poor fiscal and debt position.

Clients will recall the acronym "PIIGs" at the time of the 2011 eurozone debt crisis, standing for Portugal, Ireland, Italy, Greece and Spain. Now a new acronym has been proposed called "BIFs" standing for Britain, Italy and France because of their current fiscal vulnerability. If we go back to the ten year government bond yields we see that, within this group, the UK has to pay far more for its ten year money than Italy and France (4.93% versus 3.73% and 3.62% respectively). In our recent reviews of the bond markets we have particularly concentrated on the issues in the UK and France, less so on Italy which seemed to have stabilised its position albeit with a far higher level of outstanding debt than the UK or France. Now, however, as a result of its unfavourable energy position and some loss of momentum for the Prime Minister after a referendum defeat it is beginning to come back into the market's crosshairs. The concern about France reflects the fact that its politics are so fragmented that it cannot take important decisions as to how to address its debt problem. There is no majority to tackle public spending or to take meaningful steps to address its chronic budget deficit problem. It is not a position which is sustainable, hence its inclusion in the BIFs.

It is the situation of the UK that we wish to address, picking up comments we have made in a number of our recent reviews. The UK's position in the current energy crisis is not a good one and this is clearly unhelpful but the elevated interest rate on UK debt is what is called the "moron risk premium". Why is this so? One reason is that the UK is more inflation prone than many of its competitors. There are a number of reasons for this including various cost push factors, some of them as a result of government policy decisions in areas such as pay and government taxes. There were also labour shortages post Covid which pushed up wages whilst regulated prices have risen. It's subjective but it is also possible that the UK is paying a political risk premium given current instability. As in France, the government is finding it very difficult to obtain the parliamentary backing for attempts to rein in public expenditure, even though it has a large majority, and it is noticeable that the gilt market is susceptible to what might have been thought unsettling news, particularly on the political front. As this is being written, we note that the ten year gilt's gross redemption yield has broken through 5% on two recent occasions although it is slightly below that level now. The Chancellor is very aware of the importance of her fiscal rules in keeping the gilt market on side and one of the worries for investors is that if she were to be replaced, say, by a new UK Prime Minister and Chancellor of the Exchequer who have less regard to them, the market would take fright. An additional problem for the UK, which we have often mentioned before, is that about a quarter of the gilt market comprises index linked gilts so the rise in inflation makes funding the budget and overall outstanding deficit even more expensive.

So, coming back to the question at the beginning of this review, we can see why bond markets have not been performing well. The general reason is that inflationary expectations have risen and bond yields need to adjust to these and also for deteriorating debt metrics. In its latest World Economic Outlook, the IMF has a reference global inflation forecast for 2026 of 4.4%, based on a short, sharp shock. In a severe case, it has the inflation rising to 5.8% which would then be over 6% in 2027. So, investors are right to change their minds on interest rate movements in the light of current events and the rise in bond yields which we have seen would be par for the course. Furthermore, where there have been relatively favourable moves in government bond yields, these can be explained in part by a favourable energy situation. Where the performance has been relatively bad, these can be explained by all or some of poor energy self sufficiency, weak debt metrics and political concerns in addition to deteriorating inflation prospects.

So, if the move in the bond markets, given the current economic circumstances, plays to the text books, why does the world equity market (at a high as this is written) not obey the rules or, at least, accepted theory? Growth is slowing down, inflation is rising and bond markets are weak, all of which should be negative for equity prices. In its latest World Economic Outlook, the IMF now sees growth for the world economy at 3.1% in 2026, a downgrade of 0.2% on its January forecasts. For Advanced Economies generally, it has left its January forecast of 1.8% unchanged but, within that, the most notable features are that it has only changed its forecast for the USA slightly, down by 0.1% to 2.3% and, for the UK, where it has downgraded its forecast significantly by 0.5% to 0.8%. In the context of what we have said about the two economies earlier, these changes in forecast look logical. The eurozone countries have seen modest reductions in their projected growth rates. Equities' good long term performance has been driven by economic growth which means rising profits and dividends translate into higher share prices. With the rising levels of government debt in many countries, a continuation of economic growth is a prerequisite for addressing the debt problem. Given the prevailing uncertainties reflected in the IMF's latest economic growth downgrades, this is going to be difficult to achieve for many countries. What is interesting however, is that the shift in investor sentiment away from the USA and towards Europe earlier this year has, at least for the moment, been reversed with investor enthusiasm for the USA picking up. We have in a number of our reviews in 2025 and so far in 2026, explained how important it is to play the ball and not the man. It doesn't need saying that President Trump elicits very strong feelings amongst many people and it is likely that the previous switch in sentiment away from the US stock market, now seemingly reversed, partly reflected this. Whether that is true or not, as an investment manager we have to consider what is actually happening and put aside any views which we may have on matters not relating to investment.

We do, however, along with economic factors, take into account political matters, not to express any views on governments around the world but to look at the consequences of their particular policies for investors. So, whilst views on governments can be highly subjective but not relevant to us as an investment manager, the implications for an economy and, by extension, investors of their particular policies are less subjective if rooted in economics although still subject to argument, and these we do take into account.

For us, the USA has long been our favoured area for investment and the performance of that market has justified our confidence. In the short term, US companies are producing good earnings figures. The expected growth rate of Q1 2026 earnings is likely to have been somewhere between 13% and 15%. With an unchanged market level, this brings down the ratings of US shares, something that concerns investors given their elevated ratings compared with most other markets. This would be the sixth consecutive quarter of double digit earnings growth, helped, of course, by the technology sector's AI related demand. More fundamental issues which, at present, make the USA a market in which investors feel comfortable to invest are its good productivity record compared with many of its competitors which has led to a relatively good economic growth rate. There are a number of reasons for this, one being that it is a more nimble economy than its G7 competitors. Substantial technology investment, not impeded by the level of regulation seen, for example, in the EU, has seen it leap ahead in AI development. This is almost certain to mean that the USA's productivity performance is likely to continue to be superior to those of its competitors. In the areas of tax policy and regulation, its policies are more pro business and, by extension, more pro investor. As a general point, the USA has a range of companies in which to invest which other countries find hard to match. As mentioned earlier, in the context of the Iranian conflict, the USA's strong energy security also stands out as an attraction. So, whether in regulation or tax, the policy consequences are positive, certainly compared to many of its competitors. We have often mentioned the importance of messaging and, at least for investors, these are generally positive from the USA. Of course, it's not all one way and the policy which has the worst economic consequences for everyone, not just the US, is tariffs. Whilst a minority of economists support tariffs as an economic policy, most will believe they have malign economic consequences. Amongst other downsides, they distort international trade, lead to inefficiencies, make consumers poorer, slow down economic growth and lead to higher inflation. The irony is that the USA may be less affected than other countries because it is a relatively closed economy. Total trade represents about 27% of GDP so compared with relatively open economies like that of the UK where exports are important, the USA has some protection from the tariffs which President Trump has imposed although they are affecting the USA's inflation rate which could be a problem for the President come the mid term elections next November. Now, with additional pressure from energy price increases, notwithstanding the USA's strong energy position, it could change the Federal Reserve's interest rate outlook. On balance, however, the investment consequences of US policy decisions in areas like tax and regulation, whether one agrees with them or not, are positive. It is also relevant to point out, however, that the political background for investors in the USA is about as favourable as it is likely to be with the Republicans holding the executive and legislature. Independent observers believe the Republicans will lose their majority in the House of Representatives in November with the outcome for the Senate uncertain. As elsewhere, politics has become highly polarised in the USA, so some caution is in order.

The situation in the UK and Europe is quite different. These countries are more exposed to the energy problems arising from the Iranian situation, lacking the indigenous resources of the USA and, whilst the USA has poor deficit metrics, it has the advantage of having the world's largest reserve currency. Some figures from the Bank for International Settlements show the importance of the US dollar in the world economic system. It comprises 57% of currency reserves, 89% of foreign exchange trades, 61% of foreign currency debt issuance, 54% of export invoicing and 51% of interbank foreign exchange transactions. The importance of the US dollar to the world economy does not mean that it has a free pass as far as its deficits are concerned (the Economist Intelligence Unit estimates its budget deficit at 6.6% of GDP this year whilst USA's outstanding government debt as a percentage of GDP

is around 124%) but it seems to have more leeway than some other countries and we noted earlier on in this review that its bonds have performed relatively well against those of the BIFs (just to remind readers that this is the new acronym for Britain, Italy and France) having taken over from most of the PIIGS (Portugal, Italy, Ireland Greece and Spain) as the main cause of concern.

In the UK, whilst the equity market has held up well, mainly because of the strength of the big international earners, the oil and mining companies, the fixed interest market is fragile, being more stressed than many other government bond markets by recent events. The downgrade in the IMF's economic growth forecasts for the UK, 0.5% to 0.8% this year, is greater than for the two other members of this new "BIF" group with France downgraded by 0.1% to 0.9% and Italy by 0.2% to 0.5%. Now, given that an acceleration in economic growth is the best way of stabilising and then improving a country's debt position, this downgrade is alarming. In the UK, economists can be fairly confident that they can correctly identify the consequences of certain policies. So, the increase in the employers' National Insurance contributions, sharp increases in the minimum wage and changes in business rates which raise costs for many businesses will raise inflation, affect employment levels and have negative effects on economic growth. Messaging is also important. The Energy Secretary is reported as saying (before removing the comment and replacing it with a milder one) that in relation to BP's recent profit announcement that "profiting from a crisis is morally and economically wrong". It is not for us to comment on his statement but what one can say for sure is that the message about investing in the UK is a negative one. By design or not, most economic measures (mainly tax and associated imposts) are and will continue to have negative consequences for economic growth which is vital if the poor fiscal situation is to be addressed. As we have seen, the UK bond market is highly susceptible to concerns about the UK's finances. If the IMF is correct in making such a significant downgrade to the UK's economic forecasts, then the Chancellor's fiscal headroom could quickly disappear. Adherence to fiscal discipline is what investors in UK gilts are fixated on so any slippage, perhaps if there is a new Chancellor, which is not addressed is likely to be badly received in the gilt market, something which the UK cannot afford.

France's yield position in the ten year government bond market relative to Italy and Greece has recently improved and its bonds now yield less than those of Italy and Greece (other than the 30 year bond in this latter case). The gap between French and German government ten year bond yields has also narrowed. At its peak, the yield premium was over 80 basis points, now it is down to 63 basis points, still sizeable but not as bad as it was. Nevertheless, the problem in France mirrors in one respect the UK in that the government is finding it very difficult to deal with the budget deficit estimated by the Economist Intelligence Unit to be 5.3% of GDP this year. Whereas in the UK the government has a large majority, in France the parties are fragmented, making agreement on the measures needed to address the same fiscal position very difficult to achieve and the stop gap measures taken to stabilise the position, as in the UK, have hit the corporate sector (large companies in the case of France) and those considered wealthy.

In Italy, the government has just reduced its growth forecast to 0.6% for this year and next (slightly higher than the IMF's forecasts) with the deficit raised to 2.9% of GDP this year and 2.8% next year with a warning that further revisions are likely given the uncertainty. Whilst that budget deficit level is well below that of the UK and France, the problem is the level of outstanding government debt as a percentage of GDP. The government now estimates the level will rise to 138.6% this year from 137.1% in 2025 and remain virtually unchanged next year. The Minister of Economy & Finance says that the government may approve a windfall tax on energy companies to fund relief measures aimed at helping families and firms paying high energy bills. Whilst it is understandable that the government wants to do something about this difficult situation, the fact remains that arbitrarily taxing companies, as has happened in the UK and France amongst others, lowers the direct and indirect attraction of investment in that country and raises the cost of capital.

Bringing this all together, we think that it is rational, at least for the moment against this ever changing background, that the US market has regained its relative performance against the UK and Europe. It has better economic prospects and has so far eschewed measures, unlike the UK and parts of Europe, that reduce the investment attraction of the USA although we note that the political climate may change as a result of the mid term elections.

However, whilst we can rationalise the diverging performances of fixed interest and equity markets at the moment, there would normally be limits about how far the divergence can go. During the period of ultra loose and unorthodox monetary policy brought about by the Covid effect on economies, equities typically yielded considerably more than bonds, a reversal of the usual situation, so the case for equities was strong on income grounds providing the world economy did not totally collapse. Now, we have reverted to the usual position (Switzerland excluded) where bond yields exceed those on equities, the normal situation, but not by enough to cause serious concern given the trend for dividends to rise over time. However, if the potential risks in the bond markets materialise as a result of rising inflation brought on by the consequences of the Iranian conflict, or concerns about debt levels in a number of countries lead to credit rating downgrades and significant further rises in yields, this will pose problems for equity markets so investors need to keep on top of these potential problems.

In the discussion of the relative performances of bonds and equities, it is important to note that equities have derived important support from share buybacks. Companies with spare capital like to use them to enhance shareholder value, along with dividends, given that they can raise earnings per share and add a scarcity value to their shares by taking blocks of them off the market. If we look at the USA in 2024, there was a record US\$942.5 billion in S&P 500 buybacks and the level exceeded US\$1 trillion in 2025. This is not just a US phenomenon but share buybacks have given equities a helping hand when comparing their performances with those of fixed interest securities and remain an important support for equity markets.

However, notwithstanding the serious geopolitical and economic issues affecting the world at present, it would be right to end on a brighter note given that investors should take a long term perspective. We have noted the effect of the huge investment in AI on the US economy in enabling it to show superior growth to that achieved in most developed countries. We also note, as companies report their latest earnings, increased mention of AI and the cost savings it achieves. Whilst there are many unknowns about the effect of AI, intuitively it seems likely that it will help to raise productivity levels and, through that, economic growth and, optimistically, if governments do not spend the bonus, help to reduce the debt levels, the size of which, in terms of servicing costs, weighs down on countries' fiscal problems and therefore their economic growth potential. We think some investors are looking beyond current geopolitical and economic problems to a more optimistic future enabled by AI and this is one reason why equities have performed well. We can't foresee what is going to happen in the short term but for those taking a long term perspective for their investment strategy, as they should, AI seems like a compelling argument for investment in international equities, particularly in the USA. We can see no such attraction for bonds at present.

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