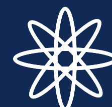

meridian

ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

It has been a mixed quarter for international equity investors and those who fared best were non US dollar based investors with significant US exposure as US shares rose modestly in US dollar terms but more significantly in terms of other currencies given the US dollar's strength. Bond investors suffered negative returns as inflation fears started to surface and the increase in the supply of bonds unnerved investors.

The tables below detail relevant movements in markets :

International Equities 30.09.24 - 31.12.24

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	-1.1	-5.4	-11.7	-4.8
Finland	-6.3	-6.9	-13.1	-6.3
France	-3.0	-3.6	-10.0	-3.0
Germany	+1.8	+1.2	-5.5	+1.8
Hong Kong	-9.3	-2.8	-9.3	-2.2
Italy	+1.4	+0.8	-5.9	+1.4
Japan	+5.4	+2.8	-4.1	+3.4
Netherlands	-5.9	-6.5	-12.7	-5.9
Spain	-2.1	-2.7	-9.1	-2.1
Switzerland	-4.6	-4.9	-11.2	-4.3
UK	+0.6	+0.6	-6.1	+1.2
USA	+2.8	+10.0	+2.8	+10.7
All World Europe ex UK	-3.3	-3.8	-10.2	-3.2
All World Asia Pacific ex Japan	-4.2	-1.8	-8.3	-1.2
All World Asia Pacific	-1.1	-0.3	-6.9	+0.3
All World Latin America	-5.9	-9.2	-15.2	-8.6
All World Emerging Markets	-3.8	+0.2	-6.5	+0.8
All World	+1.3	+5.9	-1.1	+6.6

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : -3.1%

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

Currency	30.09.24	31.12.24
Sterling	4.00	4.56
US Dollar	3.78	4.57
Yen	0.85	1.07
Germany (Euro)	2.12	2.36

Sterling's performance during the quarter ending 31.12.24 (%)

Currency	Quarter Ending 31.12.24
US Dollar	-6.5
Canadian Dollar	-0.6
Yen	+2.5
Euro	+0.6
Swiss Franc	+0.4
Australian Dollar	+4.5

Other currency movements during the quarter ending 31.12.24 (%)

Currency	Quarter Ending 31.12.24
US Dollar / Canadian Dollar	+6.5
US Dollar / Yen	+10.0
US Dollar / Euro	+7.7
Swiss Franc / Euro	+0.2
Euro / Yen	+2.1

Significant Commodities (US dollar terms) 30.09.24 - 31.12.24 (%)

Currency	Quarter Ending 31.12.24
Oil	+3.3
Gold	-2.0

PERFORMANCE DURING 2024

International Equities 29.12.23 - 31.12.24

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+11.4	+2.9	+1.1	+7.9
Finland	+0.5	-4.2	-5.8	+0.5
France	+1.9	-2.8	-4.5	+1.9
Germany	+18.7	+13.3	+11.3	+18.7
Hong Kong	-0.6	+1.7	-0.1	+6.6
Italy	+21.9	+16.3	+14.3	+21.9
Japan	+20.6	+10.1	+8.2	+15.4
Netherlands	+7.1	+2.2	+0.4	+7.1
Spain	+18.3	+12.8	+10.9	+18.3
Switzerland	+6.5	+0.7	-1.1	+5.6
UK	+11.0	+11.0	+9.0	+16.3
USA	+25.1	+27.3	+25.1	+33.5
All World Europe ex UK	+8.6	+3.1	+1.3	+8.0
All World Asia Pacific ex Japan	+15.2	+12.2	+10.2	+17.5
All World Asia Pacific	+17.0	+11.5	+9.5	+16.8
All World Latin America	-7.8	-24.6	-25.9	-20.9
All World Emerging Markets	+17.4	+14.8	+12.8	+20.3
All World	+20.6	+19.8	+17.7	+25.6

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : -3.3%

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

Currency	29.12.23	31.12.24
Sterling	3.52	4.56
US Dollar	3.88	4.57
Yen	0.60	1.07
Germany (Euro)	2.02	2.36

Sterling's performance during the year ending 31.12.24 (%)

Currency	Year Ending 31.12.24
US Dollar	-1.5
Canadian Dollar	+6.4
Yen	+9.5
Euro	+5.1
Swiss Franc	+6.1
Australian Dollar	+8.3

Other currency movements during the year ending 31.12.24 (%)

Currency	Year Ending 31.12.24
US Dollar / Canadian Dollar	+8.6
US Dollar / Yen	+11.6
US Dollar / Euro	+6.7
Swiss Franc / Euro	-1.1
Euro / Yen	+4.7

Significant Commodities (US dollar terms) 29.12.23 - 31.12.24 (%)

Currency	Year Ending 31.12.24
Oil	-2.9
Gold	+26.5

MARKETS

The performance of international equity markets in Q4 2024 was driven by the USA. Provided investors had significant exposure to US equities, there was a good chance of a positive return. In local currency terms, the FTSE All World Index showed a total return of +1.3%, in sterling terms +5.9%, in US dollar terms -1.1% and, in euro terms, +6.6%. Looking at local currency returns first, there were positive returns from the FTSE Japan Index, +5.4%, the FTSE USA Index, +2.8%, and the FTSE UK Index, +0.6%. On the negative side, the FTSE All World Latin America Index returned -5.9%, the FTSE All World Emerging Markets Index -3.8% and the FTSE All World Europe ex UK Index -3.3%. In sterling terms, the results changed significantly. The FTSE USA Index returned +10.0% but on the negative side were the FTSE All World Latin America Index, -9.2%, the FTSE Australia Index, -5.4%, and the FTSE All World Europe ex UK Index, -3.3%.

It was a negative quarter in the international bond markets. Taking ten year benchmark government bond gross redemption yields, there was a rise of 56 basis points to 4.56% in the UK government bond, 79 basis points to 4.57% in the US Treasury bond, 22 basis points to 1.07% in the Japanese Government Bond and 24 basis points in the German Bund to 2.36%. Looking at the UK government bond market a different way the total return on the Bloomberg UK Gilt 1-10 years was -1.1% and on the Bloomberg UK gilt 15 years + index it was -7.1%.

The feature of the foreign exchange market was the strength of the US dollar following the US election results. Against the US dollar, sterling fell by 6.5% and against the Canadian dollar by 0.6%. On the other hand, sterling rose by 4.5% against the Australian dollar, by 2.5% against the yen, by 0.6% against the euro and by 0.4% against the Swiss Franc.

In the commodity markets, oil, as measured by Brent crude, rose by 3.3%, but gold, following its strong run, fell by 2.0%.

Turning to look at the full year picture for 2024, the strength of equities will have surprised many investors but, to achieve anything like the return of the FTSE All World Index, it will have been necessary to have significant exposure to the US equity market and, within that, to have heavy exposure to the Magnificent 7 tech stocks, in particular Nvidia, Apple, Meta, Microsoft and Amazon. In local currency terms, the FTSE All World Index showed a total return of +20.6%, in sterling terms +19.8%, in US dollar terms +17.7% and, in local currency terms, +25.6%. Looking at local currency returns first, the FTSE USA Index was the stand out performer with a return of +25.1%. The FTSE Japan Index matched the return of the FTSE All World Index at +20.6%. The stand out performer on the negative side was the FTSE All World Latin America Index which returned -7.8%. In strong positive territory, but nevertheless significantly underperforming the FTSE All World Index, were the FTSE All World Europe ex UK Index, +8.6%, the FTSE UK Index, +11.0% and the FTSE Australia Index, +11.4%. In sterling terms, the FTSE USA Index increased its advantage, returning +27.3%. None of the other markets in our table increased their returns as measured in sterling terms but some worsened noticeably, particularly the FTSE All World Latin America Index where the return deteriorated to -24.6%, reflecting significant currency weakness in the area. The return on the FTSE Australia Index fell to +2.9%, on the FTSE Japan Index to +10.1% and on the FTSE All World Europe ex UK Index to +3.1%.

In contrast to international equities, fixed interest securities suffered a poor year. Again, taking ten year benchmark government bond yields, the gross redemption yield on the UK government bond rose by 104 basis points to 4.56%, on the US Treasury bond by 69 basis points to 4.57%, on the Japanese Government Bond by 47 basis points to 1.07% and, on the German Bund, by 34 basis points to 2.36%. Putting the total return on UK gilts another way, the total return in the Bloomberg UK gilt 1-10 years was +0.25% and the Bloomberg UK gilt 15 years + it was -10.5%.

In the foreign exchange markets, it was a strong year for the US dollar in particular, but also for sterling, although the latter did fall by 1.5% against the US dollar. However, against the Yen, sterling rose by 9.5%, against the Australian Dollar by 8.3%, against the Canadian Dollar by 6.4%, against the Swiss Franc by 6.1% and, against the euro, by 5.1%.

In the commodity markets, oil, as measured by Brent crude, fell by 2.9%, but gold, in its traditional role as a store of value in uncertain times, rose by 26.5% although ending the year off its high.

ECONOMICS

In our year end review, we like to look back twelve months to see how our forecasts fared, those which were correct, those which were wrong and those which were somewhere in between and then to analyse these outcomes. We said that it looked as if 2024 would be a year of modest movements. In the case of bonds, we said that we continued to consider that they offered doubtful value until we could be sure that inflation has been tamed. We were correct in the sense that we continued to avoid investment in bonds which was the right call because they experienced another poor year. It was also correct to comment on inflation because, although the figures came down, towards the end of the year doubts started to creep in about inflation’s trajectory in 2025. This we will cover later. In the context of bonds, we mentioned in the year end review and in those of earlier months that the level of governments’ borrowings were likely to be an issue because of the sheer size of supplies of new paper and central banks’ Quantitative Tightening. If anything, we were not sufficiently negative about the prospects for bonds but, because we had no plans to invest in them in 2024, this was not an issue regarding the constitution of clients’ portfolios and the drag on returns which they imposed. In terms of the movement in gross redemption yields in selected international government bonds, the table below shows the extent of the weakness in markets and, therefore, negative returns for bond holders.

Gross Redemption Yields %
At 08.01.25

	2 years	**5 years**	**10 years**	**30 years**
UK	4.50 (4.21)	4.51 (3.75)	4.79 (3.78)	5.35 (4.39)
USA	4.26 (4.38)	4.44 (4.01)	4.67 (4.05)	4.91 (4.20)
Germany	2.19 (2.56)	2.30 (2.10)	2.55 (2.15)	2.76 (2.37)
Japan	0.63 (0.03)	0.80 (0.19)	1.16 (0.60)	2.31 (1.61)

Figures in brackets reflect gross redemption yields at 06.01.24

The short end (2 years) of the markets show some concerns about prospects for the UK even though interest rates have been cut whilst the rise in Japanese yields reflects the rise in Japanese central bank interest rates after a long period of negative yields. But the interesting point to note is the shape of the yield curve which is now sloping upwards in each of the four government bond markets shown above. This is a more traditional slope for a yield curve and suggests some concern about inflation. The change in yields demonstrated by this table shows the pain which many holders of fixed interest securities suffered in 2024.

Our comment on cash at the end on 2023 was that for it to be a good investment as an asset class, as opposed to a small percentage of a portfolio being held opportunistically, we would have to believe that prospects elsewhere were extremely bad and that rarely was this the case. We didn't believe this to be the case and we said that the outlook was not bad for equities. This proved to be a significant understatement given that it has been another quite positive year for international equities. However, importantly, although we did not expect equities to perform as well as they have done, we maintained our equity exposure so our underestimation of the expected performance of equities did not harm our clients' portfolios. This was in the context of our final statement in that review which was that "a modest but satisfactory return from international equities seems the most realistic assumption at present".

Markets are driven mainly by economics and politics with the latter particularly important in 2024 but, firstly, we will look at the economic aspect and we will update a table we used last year.

Review December 2024

(at the time of writing 08.01.2025)

	Year On Year Inflation	Year on Year Core Inflation	10 year Government Bond Yields	Policy Rate
USA	2.7% (3.1%)	3.3% (4.0%)	4.67% (4.05%)	4.5% (5.50%)
UK	2.6% (3.9%)	3.5% (5.1%)	4.78% (3.78%)	4.75% (5.25%)
Eurozone	2.4% (3.4%)	2.7% (3.4%)		
France	1.8% (4.1%)	1.5% (3.6%)	3.37% (2.64%)	3.15% (4.5%)
Germany	2.8% (3.8%)	3.1% (3.5%)	2.55% (2.15%)	3.15% (4.5%)
Italy	1.4% (0.5%)	1.8% (3.1%)	3.68% (3.84%)	3.15% (4.5%)

Figures in brackets as at 06.01.24.

What this table shows us is that year on year inflation and core inflation rates have fallen since last year and that, except in Germany, there are positive real interest rates both in relation to the headline inflation rate and the core inflation rate. This wasn't always the case twelve months ago. However, if we look at the latest inflation figures, the year on year rate is creeping up. That is also the case for most, but not all, measures of the core inflation rate. As 2024 came to a close, concerns about the trend of inflation grew and this was reflected in bond yields. The relationship between bond yields and inflation is not nearly as uncomfortable as it was when inflation was very high after Covid but the cushion is not necessarily comfortable because, as we will discuss, the outlook for inflation in 2025 is difficult to call.

The outlook for economic growth is clearly important for markets. Last year, we used the OECD economic forecasts for 2024 as a basis for our discussion and it is interesting to note how 2024 looks like turning out, again using OECD projections. Understandably, the outstanding performer against expectations was the USA. This time last year, the OECD was projecting growth of 1.5% for the USA whereas it now believes that it will have turned out to be 2.8% and it is not difficult to see this as one reason why the US market has shown a strong performance in 2024. For the euro area as a whole, projected growth was 0.9% and the expected outcome for 2025 is expected to be close to that, at 0.8%. However, within the euro area, there has been one big outlier, Germany, for which 2024 has been a very disappointing year. The OECD only expected very modest growth a year ago at 0.6% but no growth is now expected. The UK has performed slightly better than expected with an expected outturn of 0.9% against the expectation of 0.7% although the year looks like ending on a weak note. Japan has been disappointing with -0.3% growth expected for 2024 whereas a year ago the OECD had expected growth of 1.0%. India looks like surpassing the OECD's estimate of 2024 growth of 6.1% and now it expects the outturn at 6.8%. It was relatively cautious about the prospects for China in 2024 expecting growth of 4.7% whereas it is now forecasting an outcome of 4.9% which is still considered relatively disappointing. Because of the unexpected strength of the US economy its forecast for G20 growth in 2024 a year ago of 2.8% is now forecast to be 3.3%. So, the contrast between the USA, on the one hand, and Europe, including the UK, and Japan, on the other, could not be more stark.

Looking ahead to 2025, the OECD sees G20 growth at the same level as expected in 2024, 3.3%, and the disparities, although not quite as wide between the USA and Europe, including the UK, and Japan remain. It forecasts US growth in 2025 at 2.4%, the euro area at 1.3%, the UK at 1.7% and Japan at 1.5%. The forecast for India is 6.9% and China 4.7%. Whether the disparity in performance of the various economies translates into the same difference in performance of the various equity markets in 2025 remains to be seen and here we come to politics.

It was said that 2024 was the year of 40 elections. We have often made the point that politics can be more important than economics in determining the direction of markets and we think this was the case in 2024 but will be even more so in 2025. We emphasise that Meridian does not give a political view on policies which are emanating from various governments, that is not our job, but we do look at policies through the eyes of investors. The conclusions are likely to be less subjective than those of an investment manager giving their own view on the merits or demerits of governments' policies. Another point we make is to play the ball and not the person by which we mean that it is important not to become sidetracked by personalities but rather evaluate what they do or might do rather than what they say.

So, there is no other place to start than the USA, the outstanding major equity market of 2024 and, given the trajectory of the US equity market since 5th November, it is reasonable to conclude that politics has been at play. The result of the Presidential and Congressional elections was a Republican trifecta i.e. they won the Presidency and both chambers of Congress. There is therefore a reasonable chance that the President-elect may be able to see his proposed legislation enacted. So, looking through the eyes of an investor in US equities what might this mean on the positive side? Taxes are likely to go down rather than up. This contrasts with Democrat plans to raise corporate and some personal taxes. We have in 2024 regularly been monitoring the increasingly intrusive role of regulation in various economies, including the USA. The President-elect has made tackling regulatory overreach a main aim of his and his executive powers give him the ability to replace seemingly increasingly activist regulators with those more in tune with his deregulatory instincts. Whether one agrees with the trend for ever more regulations or not, they are an increasing cost burden on companies with negative consequences for growth and investors will see positive consequences from the President-elect's deregulatory push. It may be nuanced. The tech companies have increasingly been in the crosshairs of the Federal Trade Commission and Department of Justice which

have been aggressive in the pursuit of Big Tech. There is some suggestion that they will still come under scrutiny, if less aggressively than from the present regime of regulators. What investors will be pleased about is the almost certain rowing back of investigations into M&A deals. The current crop of regulators have been aggressive in their approach to some M&A deals which are now likely to see an increase in activity, something which can be expected to benefit markets. The banking sector is likely to see many more deals in the tiers below the mega banks. The energy industry is certainly likely to benefit from the new regime as it rolls back the policies of the Biden Presidency. So, investors in US equities will see as very positive for the market the President elect's plans for taxes and deregulation. What might they not like? One will be the threat to inflation and, therefore, interest rates that could arise from his tariff threats and deportation plans for illegal aliens. In the case of tariffs, which he may well by using as a negotiating tactic because that is the way he works, the economic effects would be malign. They would raise prices on imported goods and, insofar as domestic companies would face less competition, US firms could have more pricing power. Tariffs put grit in the works of international trade and therefore reduce the level of international trade which through negative secondary effects reduce growth in the world economy. For investors, this is likely to mean that corporate profits and dividends would be below what they would otherwise be. If the President's deportation plans are implemented in a significant way, there will be labour shortages in many industries leading to a bidding up of wages with all the inflationary consequences which would result. If inflation rises, then the Federal Reserve is likely to keep interest rates higher than they would otherwise have been, a negative for equity markets. So, from an investment point of view, investors will hope that animal spirits will receive a boost from the President elect's plans for taxes and deregulation, thereby encouraging economic growth, and that he will rein back on the negative aspects of his economic plans. The one issue we have not mentioned here is the size of the budget deficit and outstanding level of public debt. This is a very significant issue which we will be discussing later in this review in the context of our views on the fixed interest market.

Whilst investors can and have taken some encouragement from the US election results, it is not likely that they will feel the same about Europe and the UK. Dealing with the eurozone firstly, the French elections stand out as highly consequential amongst those which occurred in 2024 and, likewise, the forthcoming German election also. These must also be seen in the context of the eurozone. Looking, firstly, at France where a major setback in the European elections for President Macron's party and the strength of the RN's results caused him to make a decision which he might now regret, even if he would not say this publicly, to call parliamentary elections with disastrous results at least as far as President Macron is concerned with the centre almost wiped out and strong performances from the National Rally (RN) and the hard left coalition, the New Popular Front. The inability to form a stable government, as shown by the short reign as Prime Minister of Mr Barnier, a centre right politician, means that, with a budget deficit seemingly spiralling out of control and no meaningful measures to reduce the budget deficit and address France's fundamental budget issues, the outlook seems bleak and potentially destabilising for the eurozone and its currency. France has not balanced its budget since the 1970s and the problem is seemingly intractable. Whenever meaningful measures are attempted to address the nation's finances, social unrest ensues and governments usually back down. A case in point was the decision to raise the pension age. The RN and New Popular Front wanted to reverse the decision although the RN's policy has become more nuanced. Investors will see this as a flight from reality. France's budget deficit is likely to be over 6% of GDP for 2024, twice the EU's permitted level. Its outstanding level of public debt as a percentage of GDP is over 110% of GDP and the ratio of government spending to GDP is not far short of 60%. It is instructive that Mr Barnier had looked to the private sector for substantial extra taxes to help to reduce the budget deficit. All of this has been taken badly by investors, hence the relatively poor performance of the French stock market in 2024. It is difficult for investors to see anything positive about the investment outlook for France. The other issue is that the state of France's public finances cannot be isolated from the rest of the eurozone. As the eurozone's second largest economy, severe problems with its finances threaten to spill over to the eurozone as a whole. At the moment, as far as eurozone debt markets are concerned, the problems in France have been contained. French government bonds have performed poorly, reflecting the debt problem, but it hasn't affected the eurozone bond market as a whole where,

although bond prices have fallen, they are not at present showing signs of stress indicated by the situation in France. The spread in the ten year government bond market between French and German bonds is over 80 basis points and, at times such as now, French bonds have been showing a higher yield than Greek bonds. Whilst the ECB has an instrument at its disposal, the Transmission Protection Instrument, to counter the risk of financial fragmentation following the normalisation of monetary policy, it would be hard to find a justification for its use. It is worth quoting when the TPI can be used. The TPI will enable the Eurosystem to purchase assets "in jurisdictions experiencing a deterioration in financing conditions not warranted by country specific fundamentals". Secondly, the ECB should assess whether "jurisdictions in which the Eurosystem may conduct purchases under the TPI pursue sound and sustainable fiscal and macroeconomic policies". Given the situation as it now is in France, it would be difficult to justify using the TPI if the above two criteria are respected. We are not there yet but if it continues to prove impossible to make meaningful progress towards its budget deficit targets, the early warning signs being seen in the French government bond market could become stronger. The euro is, of course, a political project, so pressure on the ECB to use the TPI could be difficult to resist. However, other eurozone countries like Germany could well resist its use. All this is, of course, for the future but change in France seems almost impossible so the private sector is the one politicians look to for more money. It is little wonder that investors steered clear of the Franch market in 2024, notwithstanding France's world class companies, and it is difficult to see this changing in 2025.

But it is not just France which has its political problems. In 2024, the three way German governing coalition collapsed and there are to be elections in February. Again, there has been some hollowing out of the centre with the rise of hard left and hard right parties. Germany's problems are different from those of France and, importantly, its financial situation is much stronger with a budget deficit likely to be well under 2% of GDP this year. Its debt is around 62% of GDP and it is the eurozone's strongest credit. It has a much criticised debt brake which limits its budget deficit and this has been given as a reason for, amongst other things, Germany's infrastructure problems. Its energy policies have also been cited as a reason for some of its current problems. It was over dependent on Russia for its energy and the latter's invasion of Ukraine brought this point home. Industry has to bear very high electricity prices. In the past, the profile of the economy with its large manufacturing base and strong trade connections with China were considered major bull points. Now they are not and the plight of the car industry facing mandated electric car production targets, strong competition from Chinese made EVs and high energy costs has had a significant effect on the German economy. As a result of industry's problems, the German economy is not expected to grow in 2024 and only by a small amount in 2025. In view of this, it may be surprising that the German stock market has performed so well in 2024. In fact, it is due to a very strong performance by a small number of "blue chips". So, whilst investors in German securities will not directly worry about the financial problems which France is facing, they will be concerned about the outcome of February's elections. The CDU/CSU is almost certain to obtain the largest share of the vote and they are more business friendly than the other parties, other than the FDP, which seems unlikely to reach the 5% threshold to obtain seats in the Bundestag so the CDU/CSU may have to coalesce with a less business friendly party.

Investors will also have general as opposed to specific concerns about Europe as an investment area in 2025. It is no coincidence that Europe regularly underperforms the USA in terms of economic growth and productivity and the disparity in outcomes for 2024 is reflective of this. The broad reasons are fairly clear. Productivity growth is way behind that to the USA. A high degree of regulation compared with the more lightly regulated USA is an issue for those doing business in Europe. There is a much less entrepreneurial attitude in Europe and this is shared by the EU itself, some governments and regulators for whom the precautionary principle is paramount unlike the position in the USA. So, it is easier to make technological progress in the USA and it is no coincidence that Europe has very few high tech companies compared with the USA. Regulators in the EU have been particularly aggressive towards the big US tech companies and whether or not they are right to do so, the message investors receive is clear. A very interesting article in The Times on 19th December underlines why investors might feel the EU is sending out the wrong signals in the technology sectors. It referred to

the Digital Markets Act, the Digital Services Act and the EU AI Act. The broad point was that these Acts were incredibly bureaucratic which made it difficult for US companies to comply with them and the article cited a letter from CEOs of Europe businesses, including SAP, a real German success story, saying that the heavy handed new regulations mean that Europe "now risks falling behind in the AI era". The article also referred to the Digital Markets Act being used to clobber American tech companies with fines adding up to billions of euros but that not a single European firm has been hit with penalties of meaningful scale. On a different issue, which we touched upon when discussing France, when budgetary issues become a problem, the private sector is regarded as a cash cow by some countries like Spain and Italy with various windfall taxes on the banking and energy sectors. So, looking at Europe through the eyes of an investor, the contrast between the possibilities which might open up in the USA following the recent elections and those that will not for Europe are becoming more stark and not in a good way. These comments are general ones. There are plenty of world class companies in Europe but how investors may view their prospects informs our allocation to European equities.

Turning to the UK, we have always been keen to avoid home bias which can distort one's investment judgement on the basis that UK companies will be better known to many investors than foreign ones. In principle, we have felt that is the wrong view to take with currency mismatching sometimes put forward as a reason why an investor should go for home bias. Except for very specific reasons, we have never accepted that argument believing that the opportunities to invest in a wide range of companies internationally, which may not have equivalents in the UK market, is one which should not be missed. The UK is a medium sized economy and the UK stock market represents about 3% of the world stock market compared to the USA which represents about 64%. Whilst we do not hug index weightings, unless one was highly negative about the US market, we would always have a substantial weighting there.

Since the UK's General Election in June, investors, whether one agrees of disagrees on the measures the new government has taken, will feel that there is little reason to raise their weighting in UK equities and perhaps to reduce them. On the economic front, the Budget hit employers with an additional 1.2% National Insurance contribution. With the Chancellor having emphasised the legacy she had to deal with in negative terms, the combination of actions and words has served to have a noticeable negative effect on business sentiment. The higher employers' contributions will result in a combination of higher prices, the effect of which may cause the Bank of England to adjust its interest rate policy, lower than expected pay increases and therefore purchasing power, lower company profits and dividends than could otherwise have been the case, poorer employment prospects and lower capital investment than would otherwise have been the case. The effect of the Budget and downbeat economic comments post the election from the Prime Minister and the Chancellor, have resulted in a marked change in business confidence in the UK. Additionally, UK companies will have to face changes in employment laws which will result in higher costs, less flexibility and greater risks. Although this is a contentious issue more widely, investors will look at the further increase in windfall taxes on North Sea energy companies and the lack of support for development of new oil and gas fields as negative messages for international investors who might invest in the UK. On the tax front, the exodus of some non doms as a result of targeted tax changes will not be felt to send a good signal for those wishing to invest in the UK whilst the IHT moves in farming and private businesses also send out a negative signal. As we have said in previous reviews, messaging sends out an important signal to investors and investors will not feel the messaging is good from the UK. On the plus side, the loosening of planning regulations to enable more housebuilding is a positive signal for growth. Overall, investors will not feel that they have been given any reason to increase their weightings in UK equities. The significant underperformance of the UK equity market speaks to views on its attractions. As this is written, the pound is under significant pressure in the foreign exchange market and bond yields have risen sharply. This is not a surprise in view of recent developments in the UK.

In the OECD's economic forecasts quoted at the beginning of this review for the G20 nations, the top three forecasts for growth in 2025 are India, 6.9%, Indonesia, 5.2%, and China, 4.7% and, although some way off, the forecasts are not much different for 2026, at 6.8%, 5.1% and 4.4% respectively. India is establishing a lead over China in terms of growth and a generally positive perception of the opportunities for foreign investment. But there was an election surprise there in that Mr Modi did not gain an absolute majority and, instead, has to rely on two other smaller parties for a majority so some element of uncertainty has been introduced. However, investors will probably feel that it is a more predictable investment prospect than China. The US/China stand off on tariffs and possibly, although hopefully not, Taiwan is a major uncertainty and has to inform one's investment view of the area. The Renminbi was at a 20 month low versus USD and on 8th January China sold bonds in Hong Kong international market to support the currency.

Another market affected by elections is Japan where the recent election, suddenly called by the new Prime Minister, did not go well and the LDP has to rely on other parties for its support. The Japanese stock market performed well in 2024 although for non yen investors returns were significantly pared by the weakness of the currency. Corporate governance reforms have been given a boost to the market together with evidence of more M&A activity. Whether reforms will continue is important for investors with the stock market at around an all time high, although not for foreign investors when currency considerations are taken into account.

As we mentioned earlier, we continue to find it difficult to make a case for fixed interest securities. Inflationary risks arise from the possible imposition of tariffs by President-elect Trump and also cost push inflation in countries where wages are rising quite rapidly such as the UK where the trend will be reinforced further by significant increases in minimum wages. In the USA, it may occur if the President elect carries out his policy of deporting illegal aliens for the reason mentioned when we were discussing the USA's prospects. But our main concern is the continuing level of budget deficits in many countries and the consequential very large borrowing requirements. If we look at the Economist Intelligence Unit's forecast of budget balances for 2024 amongst various countries, we note an eye watering figure of -7.1% for the USA. The US dollar has the advantage of being the world's largest reserve currency and so might have more leeway than other countries but, intuitively, one feels there has to be a limit to the appetite of investors for the supply of new debt which will be offered to the market. There do not appear to be any measures being proposed to tackle these deficits. In the euro area, we have mentioned France where the most immediate threat is likely to materialise. The EIU forecasts a budget balance of -6.2% for 2024 and the question is at what level of interest rates will investors be prepared to finance France? Other big numbers are the UK, -4.0%, Japan -4.7% and Italy -4.3%. Italy has a very high level of outstanding public debt to GDP at about 138% of GDP. Given low economic growth in many countries, it will be difficult to close budget deficits and to stop the ratio of public debt to GDP from rising. We think that one of the risks for markets in 2025 is that rising levels of debt will cause problems in the bond markets with a knock on effect in the equity markets. The build up of debt servicing costs will continue to impact on budget deficits which will lead to fiscal retrenchment and lower growth as either taxes have to rise or public spending be cut. The bond market does pose a non trivial threat to equity markets which even those managers like ourselves who favour equities have to recognise.

So, how does this all come together for 2025? Mainly because of the very large budget deficits being run by many countries we think that bond prices will be under pressure. There is also the possibility that inflation will start to rise. Something could crack at some stage and there is a particular risk for eurozone bond markets if France cannot put forward a credible plan to bring down its deficit to the EU mandated 3% of GDP. Bond investors should watch France very closely. Cash as an investment, as opposed to holding a modest percentage amount in a portfolio for opportunistic purchases, does not look attractive. To do that, other assets would have to look even more unattractive and, whilst we can put bonds into that class, we would not put equities there. The case for equities is that whilst bonds have little going for them in 2025 in our view, very modest economic growth will give support

to company profits and dividends. However, some markets are more attractive than others. Europe and the UK do not have much going for them as we have tried to show with businesses being saddled with extra tax and regulation and an anti wealth and anti business feeling prevalent in some European countries including the UK. That, at least, is how investors will see it. As a result, there will not be much growth. For the USA, there are certainly risks as we have outlined but there are also some very positive measures for investors to look forward to in the areas of taxation and deregulation. So, although the US, stock market has performed well in 2024 and is highly rated, it has more going for it than other areas we have discussed. Even in those areas which do not attract us, there are individual companies that stand out so we will always have some exposure to the area.

In the background are all the geopolitical problems of the world. Stock markets seem to be inured to these events and are perhaps too complacent. However, it is difficult to imagine a time when we don't face seemingly intractable geopolitical issues. There is always a reason to be on the sidelines waiting for the fog of uncertainty to disappear but, for long term investors, being out of the market can prove costly. So, to sum up, we continue to favour equities over bonds and, in the former, the USA remains our favoured market. With all the geopolitical problems around, on top of the economic ones which we have mentioned, we must expect equity markets to be impacted at some stage in the year so, although we continue to favour international equities, it may be an uneven journey. Geographical diversification remains of paramount importance for sterling based investors.

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