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ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

This has been a solid quarter for international equity investors, less so for bond investors, interspersed with signs of nervousness against the uncertain geopolitical background. As this is written, one manifestation of this is wildly gyrating gold and silver prices. In this review, we discuss the events which may shape markets this year.

The tables below detail relevant movements in markets :

International Equities 31.10.25 - 30.01.26

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	-0.1	+2.4	+6.9	+3.7
Finland	+5.3	+3.9	+8.5	+5.3
France	+0.2	-1.1	+3.3	+0.2
Germany	+3.4	+2.0	+6.6	+3.4
Hong Kong	+12.2	+6.9	+11.7	+8.4
Italy	+7.0	+5.6	+10.3	+7.0
Japan	+6.9	+2.2	+6.8	+3.6
Netherlands	+13.8	+12.3	+17.3	+13.8
Spain	+13.2	+11.7	+16.6	+13.2
Switzerland	+7.4	+7.2	+12.0	+8.7
UK	+5.7	+5.7	+10.4	+7.1
USA	+1.2	-3.1	+1.2	-1.8
All World Europe ex UK	+6.9	+6.0	+10.7	+7.4
All World Asia Pacific ex Japan	+8.1	+3.3	+7.9	+4.7
All World Asia Pacific	+7.7	+3.0	+7.5	+4.3
All World Latin America	+17.8	+18.2	+23.4	+19.7
All World Emerging Markets	+6.2	+1.2	+5.7	+2.5
All World	+3.5	-0.2	+4.2	+1.1

Source : FTSE All World Indices

FTSE Actuaries UK Conventional Gilts All Stocks Index (total return) : +0.3%

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

	31.10.25	30.01.26
Sterling	4.41	4.52
US Dollar	4.08	4.24
Yen	1.66	2.24
Germany (Euro)	2.63	2.84

Sterling's performance during the quarter ending 30.01.26 (%)

	Quarter Ending 30.01.26
US Dollar	+5.0
Canadian Dollar	+2.4
Yen	+4.7
Euro	+1.5
Swiss Franc	+0.1
Australian Dollar	-2.4

Other currency movements during the quarter ending 30.01.26 (%)

	Quarter Ending 30.01.26
US Dollar / Canadian Dollar	-2.8
US Dollar / Yen	+0.5
US Dollar / Euro	-2.6
Swiss Franc / Euro	+1.2
Euro / Yen	+3.2

Significant Commodities (US dollar terms) 31.10.25 - 30.01.26 (%)

	Quarter Ending 30.01.26
Oil	+8.9
Gold	+25.0

MARKETS

- International equity markets edged higher but for sterling based investors these gains were lost because of currency movements.

- In local currency terms, there were strong performances from Latin America, Asia Pacific ex Japan, Europe ex UK, Japan, Emerging Markets and the UK. The USA underperformed and Australia was slightly negative.

- Apart from Australia and Latin America, sterling returns were lower because of the strength of sterling. The recovery in the Australian dollar pushed sterling returns in that market into positive territory.

- Bond yields, as measured by those on ten year government bonds, moved higher, with a dramatic rise in JGB yields in response to policy initiatives from the new Japanese Prime Minister.

- In the foreign exchange market, as touched upon above, sterling rose against all the currencies in our table except for the Australian dollar, buoyed by strong commodity prices.

- Gold had a very strong quarter as investors piled in on the back of the unsettled geopolitical situation. As this is written, just after the month end, gold and silver prices have plunged although it is too early to say if the price at the end of January represented a peak in this cycle.

- Oil rose at the end of the quarter on the possibility of a US attack on Iran.

ECONOMICS

It is difficult to know where to start as investors survey the geopolitical and economic scene with ever increasing puzzlement and try to rationalise the strength of stock markets. After all, tariffs are supposed to represent bad economics yet the US economy appears to be performing well and many countries affected by them have been able to counter at least some of the adverse economic effects. It is still, of course, early days but the outcome has not been as it was supposed to have been, at least so far. Although it has caused US inflation, currently 2.7%, to be above the Federal Reserve's target 2% range and is raising cost pressures for many US companies, the overall US corporate earnings outlook is highly satisfactory with expectations at this early stage of 2026 for an increase of around 15% which, if correct, should help to underpin the US equity market. As far as geopolitical events are concerned, the US President is certainly tearing up the rule book in the sense of sometimes doing what he says he will do, something which is not always the case with politicians. The removal of the Venezuelan President to the USA to face charges and threats to Greenland would have been unimaginable until recently yet markets now just generally shrug their shoulders. Similarly with the situation in Iran where the US has threatened to intervene following the crackdown on dissidents and is assembling a powerful naval strike force. We have written before that investors seem to be increasingly inured to all this disturbing news, treating it as the new normal. But if an investor had been disturbed enough by all the economic and geopolitical news of recent years and used it as a reason not to invest, significant opportunity costs would have been incurred. The answer lies in an investor's level of risk tolerance and from recent evidence it seems that investors are becoming less risk averse. Given all that is going on in the world, this might seem like hubris. Whilst equities remain our preferred asset class and we have a high degree of exposure to that asset class, we are not blind to the risks so we have to balance our positive view with an appreciation of what might follow and consider the trade offs.

On the geopolitical front, if the USA carries out its threats to Iran, this would be in a different league to its actions in Venezuela, the fall out from which has largely been contained. Although Iran has been militarily weakened, intervention there is a much higher risk. The worst possible event would be if China invaded Taiwan, an ever present threat although not an immediate one in most observers' eyes. Either of these events would be serious, it goes without saying, but are probably not likely enough for investors to be taking full scale precautionary actions which they might regret afterwards if nothing happens. Of these two possibilities, a military conflict in Iran is the more likely one in the immediate future given what we know about the disposition of the USA's naval force.

But what of the world economy and issues surrounding it? Well, firstly, let us look at the latest IMF World Economic Outlook published in January. It is now predicting slightly better outcomes with growth estimated at 3.3% for 2026, the same as projected for last year and 3.2% in 2027. Not much change is expected in Advanced Economies where it estimates growth this year slightly higher at 1.8% against 1.7% last year and an expected 1.7% in 2027. We mentioned at the beginning that the US has so far defied expectations following the imposition of tariffs. In the third quarter of 2025 annualised GDP growth was 4.4% and there are expectations that it will be higher still in the fourth quarter at 5.4%. In the IMF's projections for 2026, it sees growth of 2.4%, falling to 2.0% in 2027. The eurozone is expected to remain an area of low growth (Spain excepted), with projected growth slightly lower in 2026 at 1.3% (1.4% in 2025) and 1.4% in 2027. Italy is expected to be a particularly weak area with growth at 0.7% this year and next. The UK's growth rate is expected to be 1.3% this year and 1.5% next year, closely in line with that of the euro area. Japan, a country we will discuss later, is forecast to grow at 0.7% this year and 0.6% next year. Emerging Markets and Developing economies, as usual, are expected to grow more quickly than Advanced Economies with the IMF projecting 4.2% growth for this year against 4.2% for last year and an expectation of 4.1% for 2027. Within that, China's growth rate is expected to decline to 4.2% this year from 4.4% projected for last year and 4.1% projected for 2027. For India, growing faster than China, the projection is 6.4% for this year (7.3% in 2025) and 6.4% again for 2027.

However, given the US tariff impositions and retaliations, where they exist, economic forecasts for 2026 and 2027 must be qualified more than ever. We are also awaiting the Supreme Court's ruling on the legality of the President's tariffs but, so far, they have not had as much effect as expected but it is still early days. Without doubt, they will have longer term effects. Supply patterns will change as companies work out the most effective way to mitigate the additional costs which tariffs impose. Indirectly, they can affect interest rates. Although the US President is trying to push the Federal Reserve to reduce interest rates, the fact that inflation is higher than targeted should make it more difficult for the Fed to cut interest rates and these higher than anticipated rates could be expected to have a negative effect on economic growth. One of the important factors driving economic growth in the USA in 2025 and which will continue to apply in 2026 is AI capital expenditure which on one estimate is expected to have contributed 20% to 25% to real GDP growth in 2025 after allowing for the cost of imported hardware. Worldwide, according to Gartner, AI spending in 2026 is forecast to reach US$2.52 trillion. So, AI expenditure will continue to have an impact on economic growth in 2026 but this should be differentiated from the effect which AI will have on productivity growth and, hence, economic growth in the future. There are mixed opinions on this but some companies have already pointed to meaningful productivity increases in their own businesses.

Of course, forecasts made this early in the year are always subject to a margin of error which would normally be expected to decrease as the year goes by because of the additional economic information which becomes available. For this year's forecast, the margin of error could be even greater because of the uncertainty over geopolitical events. We have touched upon Iran and China/Taiwan earlier. If we had to guess, one would say that the China/Taiwan situation will be the same as now a year hence albeit with a lot of sabre rattling between the two sides in between but that Iran could become an even more serious short term issue. With President Trump ratcheting up the pressure on Iran, there has to be a high level of concern. As we said earlier, any military intervention by the USA would be of a different order to events in Venezuela. Domestically, President Trump acts in an unpredictable way which complicates investment decisions. The fact that the US stock market is standing around record levels, albeit that non US investors will have had some offset from US dollar weakness, suggests that, on balance, some of his actions meet with approval and these would be in the area of tax and deregulation. Other actions can be seen as unhelpful and idiosyncratic. Most, but not all, economists regard tariffs as bad because they distort the economic system, lead to sub optimal outcomes for many consumers, adversely affect supply chains and slow down economic growth. The fact that President Trump's tariffs have not yet, and perhaps may not, have the effect originally expected does not detract from their negative characteristics. It may be that he underestimated the possible consequences of retaliation, especially by China, which is not frightened to hit back. If we take the crucial rare earths' market, China is estimated to have approximately 70% of global rare earth mining production and between 90% - 95% of the world's processing and refining capacity. Given the importance of rare earths in the field of technology and green technologies, China's dominant position poses a major threat to the USA if China chooses to weaponize it. Domestically, the President's pressure on the Federal Reserve Chairman in particular and the Federal Reserve in general is very dangerous. To reduce interest rates significantly when inflation at 2.7% is above the target level of 2% and the economy is growing strongly is unwise monetary policy because it would be inflationary, risk destabilising the bond market and exacerbating the US dollar's weakness. President Trump has said that he wants to see a weaker US dollar but his rhetoric could lead to extreme weakness and one has to be careful what one wishes for. The weak US dollar is helping the profits of many US multinationals and the USA is a relatively closed economy so the inflationary effects are more muted than in an open economy like that of the UK but talking down the US dollar is a dangerous game. Then, out of the blue, came the President's call for US banks to limit the interest rate on credit card borrowings to 10% for one year and calls for defence companies to stop paying dividends and executing buy backs although, as shareholders would expect, RTX, the company particularly named by the President, pushed back and said that it remained committed to its dividend. After a while, targeted comments like these lose their influence in markets but, against a more pro business and pro market Administration, they are confusing.

Notwithstanding the rather uncertain direction of economic policy in the USA, the relatively good current performance of the US economy, a generally more pro business and pro investor Administration, plus a wider range of companies than are available in other markets in which one can invest, including the key technology sector, makes the US market our favoured area. Nevertheless, some investors are reported to moving some of their investments away from the USA because of the hard to understand actions just described. Of course, a geographically diversified portfolio is essential to manage risk but with the US equity market accounting for around 60% of the FTSE All World Index, major increases in other markets' exposure to well above their weighting in that index has to represent a strong conviction about those areas.

So, what do we think of these other markets? One general concern which we have articulated in many of our recent reviews is the level of government debt and size of budget deficits which we think poses a threat to bond markets. The US is a serial offender with an estimated budget deficit for 2025 of 5.9% of GDP and outstanding government debt to GDP at 124% and the projections get worse. We have mentioned in several reviews the "exorbitant privilege" which the USA enjoys by virtue of the US dollar being the world's largest reserve currency and this allows it to run deficits which other countries may not get away with. However, it doesn't alter the fact that the USA may face a buyers strike at some stage if its finances continue on this dangerous debt spiral. We talk about Japan below but Japan is the largest foreign holder of US government debt. It holds approximately US$1.13 trillion to US$1.15 trillion worth. The danger is that with Japanese bond yields rising sharply, Japanese investors may find domestic debt relatively more attractive than US dollar debt. Meaningful Japanese sales could destabilise the US and other bond markets.

So, perhaps, surprisingly, we might start with Japan. Although its high debt level has always been well flagged, around 237% of GDP, most of this is held domestically with a large amount in the hands of the Bank of Japan. With very low interest rates, it has not been a major talking point for investors but with a change of Prime Minister to Sanae Takaichi, her tax and spending measures have upended the Japanese bond market with the effect not being isolated to it. The big issue which affected sentiment towards the bond market and caused big movements in the Yen was her statement that Japan's 8% consumption tax on food and non alcoholic beverages should be suspended for two years. This comes after give aways in last November's budget after she came to power. Japanese bond yields along the curve have risen sharply and the government's 40 year bond yield broke through 4%. The Bank of Japan is also reducing its bond purchases which raises yields as it increases the supply to the market. This has not yet affected the Japanese equity market where loose fiscal policy in the context of high public spending may give a boost to share prices. That is in addition to the market's welcome for corporate governance reforms which benefit investors. The economy has problems, demographics are a big issue, but relative to some areas, these are not as bad so any investors reducing their US exposure could certainly consider Japan as an area in which to increase weightings.

Moving on to Europe, also an area attracting investors rebalancing their portfolios away from the USA, our main concern in the bond market remains France. Recently, in relative terms, French government bonds have performed well against German bonds. Although Germany remains the eurozone's best credit, the loosening of the debt brake and the vast amount of money to be spent on defence and infrastructure has caused German government bond yields to rise sharply and the gap between the French and Germans ten year government bond yields has narrowed from 80 basis points at one stage to under 60 basis points now. Because France is the second largest eurozone economy, what happens there matters greatly elsewhere. 2024's inconclusive parliamentary election result has made governing almost impossible, certainly as far as fiscal policy is concerned, and the difficulty in agreeing a budget has led to policy paralysis. We have, in previous reviews, referred to the importance of messaging to markets. Investors naturally want to see positive messaging from governments and one of the countries where they are not getting this from is France. With a budget deficit of 5.7% of GDP and outstanding public debt at 113% of GDP, the country's bonds are always vulnerable to a buyer's strike. With the French parliament dominated by populists who have no appetite to tackle public spending and with the electorate in a similar frame of mind, it is difficult to see meaningful action being taken to address the problem. One of the fallbacks for finance ministers in this position is to make impositions on companies and the wealthy, this policy representing the line of least resistance. The messaging, however, is awful because it makes a country less attractive for investors whether it is for direct investment or through the stock market. As we have often said, any problems in the French bond market will have a spillover effect on the rest of the eurozone bond market and this remains an area of fragility. As this is written, the French budget has been passed but it does not begin to meet the longer term needs relating to the French government's finances

Investors who are considering raising their weighting in Europe also have to bear in mind that its long term growth prospects are modest. It is over regulated and highly risk averse and the continent's problems were outlined by Mario Draghi's report on European competitiveness published in September 2024 which highlighted many of these. Compared with the USA, its productivity record is poor which reflects in its low growth rate compared to the USA as highlighted in the IMF projections detailed earlier in this review. He also highlighted the EU's inability to take sufficient advantage of digital technologies from the internet to the current day. One of the USA's complaints about the EU is its confrontation with US technology companies, manifesting themselves in large fines. It is noticeable how few large technology companies there are in Europe. The precautionary principle relating to innovation has held back European companies in a way which would not happen in the USA. Europe is home to many world class companies and we have important exposure but there are reasons why the USA has had a better economic performance than the EU and it is difficult to see that changing in the near future.

The UK is home to a number of large multinationals where what happens in the UK is of relatively minor importance although the perception of the UK may indirectly affect some investors' view of the particular shares. However, whilst the UK is not in the level of difficulty in which France finds itself, there are significant similarities with both countries being fiscally challenged and finding public spending very difficult to get under control. Although the UK government has a large parliamentary majority, it does not have the support of its MPs to address the level of public spending so the burden of the fiscal actions which need to be taken has, as in France, fallen on business and individual taxpayers. Business also faces significant costs from forthcoming employment legislation so these combined with government imposed cost increases, are affecting the UK's attractiveness as an investment area both directly and indirectly. However, any deterioration in the UK's fiscal position is likely to see the private sector facing more imposts. It is important to note that the market is very sensitive to political developments. An example recently was when the Mayor of Manchester indicated his wish to stand in the Gorton and Denton by election, although his possible candidature was rejected by the NEC, Labour's governing body. The news caused a temporary gilt edged market spike because he had previously talked about Britain being in hock to the bond market. As investors know, you can't do that because the bond market is all powerful and even the most aggressive politician will ultimately recognise this. For example, it is believed that a major reason President Trump pulled back significantly on his 2nd April 2025 tariff announcements was because of an adverse reaction in the US bond market. Many political commentators believe that there may be a leadership contest for the UK Labour party. If this should happen and a new regime comes in which investors believe will lead to looser fiscal policy the UK bond market could face a difficult time. In these reviews, we keep out of politics, but we do observe market indicators, in these cases in the bond markets and these could be relevant for the UK this year if the pundits are correct. What we can observe in the UK, is the opposite to what is happening in the USA, in that, whether the UK Chancellor means it or not, the measures taken to address the UK fiscal problems are being seen to be hostile to business, wealthy individuals (the end of non dom status) and wealth creation. The messaging is not good. So, from an investment point of view, we do not see the UK market as suddenly more attractive relative to the USA. Domestically orientated UK companies are likely to find financial and regulatory challenges very testing in 2026.

It is also important to have some exposure to Asia outside Japan, as we have mentioned above, as an area of growth significantly better than in developed economies. Country experiences have been mixed and the tariff issue will cause some distortion and changes in trade patterns but undoubtedly the centre of economic gravity is moving east with China becoming increasingly influential politically and economically. If the US dollar is to remain weak, which is not a given, one would expect Asia and emerging economies to benefit because the temptation for investors to buy US dollars in the expectation of a currency gain would be lessened. Importantly, the burden of borrowings in US dollars is lessened.

What we have tried to show in this review is that one can see why investors may be reducing their US content against the background of sometimes erratic and confusing Presidential policy decisions, but also to point out that the USA has some advantages over areas where investments may be diverted. On the positive side for the USA is its faster growing economy, lower taxes and the deregulation agenda. This is set against the well known issues which are troubling investors, some of which we have described above. We mentioned Japan as an area of interesting possibilities, but also risks, under the new Prime Minister and investors with low Japanese weightings could have good reason for increasing their exposure. The UK and Europe do not present a compelling case for a diversion of funds although there are always good quality companies in which one should invest. Finally, there is a case for increased Asian exposure. However, for us, moves away from the USA need to be considered carefully given that, notwithstanding the unpredictability of events, it retains compelling attractions. The general theme of this review has been the fiscal challenges faced by many countries and the risks for bond markets where we remain negative for the reasons outlined in this review. Whilst we continue to favour equities as an asset class, we must expect volatility, given the background and some negative quarters.