



**meridian**  
ASSET MANAGEMENT (C.I.) LIMITED

## INVESTMENT MEMORANDUM

This has been a strong quarter for international equities but not so for the fixed interest market. The US equity market has led the way with an excellent performance, magnified for foreign investors by the strength of the US dollar. Bonds have been held back by supply and inflation concerns. In the foreign exchange markets, the US dollar was boosted by the US election results.

The tables below detail relevant movements in markets :

### International Equities 31.10.24 - 31.01.25

Total Return Performances ( % )				
Country	Local Currency	£	US\$	€
Australia	+5.0	+3.4	N/C	+4.4
Finland	+3.1	+2.1	-1.3	+3.1
France	+8.4	+7.4	+3.8	+8.4
Germany	+12.9	+11.9	+8.1	+12.9
Hong Kong	-5.5	-2.4	-5.7	-1.5
Italy	+8.6	+7.6	+4.0	+8.6
Japan	+3.4	+5.2	+1.7	+6.2
Netherlands	+8.6	+7.6	+4.0	+8.6
Spain	+6.6	+5.6	+2.1	+6.6
Switzerland	+6.7	+5.2	+1.6	+6.1
UK	+7.8	+7.8	+4.2	+8.8
USA	+6.8	+10.5	+6.8	+11.5
All World Europe ex UK	+7.0	+6.0	+2.5	+7.0
All World Asia Pacific ex Japan	-0.1	+0.9	-2.5	+1.9
All World Asia Pacific	+1.0	+2.4	-1.1	+3.3
All World Latin America	N/C	+1.9	-1.6	+2.8
All World Emerging Markets	-0.1	+1.7	-1.7	+2.7
All World	+5.8	+8.3	+4.7	+9.3

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : +0.2%

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

Currency	31.10.24	31.01.25
Sterling	4.44	4.54
US Dollar	4.28	4.54
Yen	0.93	1.23
Germany (Euro)	2.39	2.46

## Sterling's performance during the quarter ending 31.01.25 (%)

Currency	Quarter Ending 31.01.25
US Dollar	-3.9
Canadian Dollar	+0.2
Yen	-1.9
Euro	+0.9
Swiss Franc	+1.4
Australian Dollar	+2.3

## Other currency movements during the quarter ending 31.01.25 (%)

Currency	Quarter Ending 31.01.25
US Dollar / Canadian Dollar	+4.4
US Dollar / Yen	+2.0
US Dollar / Euro	+4.8
Swiss Franc / Euro	-0.4
Euro / Yen	-2.7

## Significant Commodities (US dollar terms) 31.10.24 - 31.01.25 (%)

Currency	Quarter Ending 31.01.25
Oil	+4.6
Gold	+0.3

## MARKETS

It has been a strong quarter for international equity markets. In local currency terms, the FTSE All World Index returned +5.8%, in sterling terms +8.3%, in US dollar terms +4.7% and, in euro terms, +9.3%. Looking at local currency returns firstly, the best performers were the FTSE UK Index, +7.8%, the FTSE All World Europe ex UK Index, +7.0% and the FTSE USA Index, +6.8%. On the negative side, the worst performer was the FTSE Hong Kong Index, -5.5%, whilst the FTSE All World Asia Pacific ex Japan Index and the FTSE All World Emerging Markets Index both returned -0.1%, whilst the FTSE All World Latin American Index was unchanged. Looking at sterling adjusted returns, the outstanding performer was the FTSE USA Index, +10.5%, whilst the only index to show a negative return on our table was again the FTSE Hong Kong Index which returned -2.4%.

Turning to the government bond markets and using ten year government bonds as the benchmark, all showed rises in gross redemption yields and negative returns over the quarter, although there was some recovery towards the end of the period. The gross redemption yield on the UK government bond rose by 10 basis points to 4.54%, on the US Treasury bond by 26 basis points to 4.54%, on the Japanese Government bond by 30 basis points to 1.23% and on the German Bund by 7 basis points to 2.46%.

In the foreign exchange market, the outstanding performer was the US dollar against which sterling fell by 3.9%. The yen was also stronger with sterling weakening by 1.9%. Elsewhere, sterling rose by 2.3% against the Australian dollar, by 1.4% against the Swiss Franc, by 0.9% against the euro and by 0.2% against the Canadian dollar.

In the commodity markets, gold was little changed, rising by just 0.3%, and oil, as measured by Brent crude, rose by 4.6%.

## ECONOMICS

These are interesting times. The advent of a Republican trifecta in the USA (Presidency and control of the Senate and House of Representatives) with radical policies which represent a break from the past will provide a fascinating economic experiment. So far, markets have reacted enthusiastically to the presence of a new occupant in the White House but, of course, it's far too early to make a judgement. Just as this review is being completed has come the announcement of 25% tariffs on Canadian and Mexican imports, temporarily withdrawn, and 10% on those from China. The immediate market action has been negative but one day's movement doesn't mean it's the start of a trend.

What we can do is to look at the main principles of President Trump's economic plans and with Republican control of the Senate and House of Representatives, albeit by slim margins, there is a good chance that he will be able to advance his programme. Because the President polarises opinion, it is easy to become sidetracked by personalities and take one's eye off what is relevant to investors. So, it is important to look at what the new management of the USA does or might do rather than what the President says.

The three main pillars of the President's economic policies are tax cuts, deregulation and targeted tariffs where he considers them appropriate. The economic background which he now inherits in office is quite good as far as the USA is concerned and relatively, compared to other developed countries, very good, but the financial position of the US government, as with many others, is not good. The IMF's World Economic Update of January 2025 projects the USA growth rate in 2025 at 2.7% and in 2026 at 2.1%. For Advanced Economies, the respective figures are 1.9% and 1.8% so the USA is expected to show an above average performance. By contrast, the eurozone is expected to grow by only 1.0% in 2025 and 1.4% in 2026 and Japan by 1.1% and 0.8% respectively. The UK is somewhere in the middle with a forecast of 1.6% growth in 2025 and 1.5% in 2026 although, already, there are some doubts about this year's prospects which we will come onto later. The unemployment rate at 4.1% compares favourably with that of the eurozone where it is 6.3%. An international problem, exacerbated by Covid and the need to support economies, is the size of budget deficits and, in the case of the USA, it is extraordinarily high at over 7% of GDP. We will come back to this.

As in previous economic reviews, we want to emphasise that we do not pass judgement on countries' economic policies by giving a Meridian view of whether we believe that they are right or wrong. What we do is to look at policies through the eyes of an objective investor who has the ability to invest his or her money in any country either through direct investments or indirectly through the stock market and will therefore judge each potential investment opportunity on its merits.

The USA, like many countries, is significantly polarised and whereas in the past there was an overlap between Democrats and Republicans in the centre of US politics that is no longer the case with policy differences quite clear. So what will investors like about the new management in the USA? One of the issues which we have written about regularly in 2024 is regulation and its effect on economies and, therefore, markets. It has now come sharply into focus under Donald Trump. Perhaps, as a businessman, he understands in a way which politicians in other parts of the world do not, the insidious effects of over regulation on economic activity and companies' behaviour. Obviously, investors appreciate that some degree of regulation is important but will consider that overzealous regulation means that economies and companies are held back from realising their potential. Under President Biden, regulations grew spectacularly and freeing the economy from unnecessary regulations has to represent a very positive cost saving for companies. Regulations fall into different categories. There may be what might be called micro regulation where governments or other authorities oversee through these the daily running of companies often involving having to expand expensive HR departments. These increase the costs of running a business and can hold back productivity. Then there are what might be called macro regulation which, if overzealous, can also hamper the growth of businesses or new ideas. A classic example is the technology industry where regulators might apply light touch or heavy touch regulation. The difference between the US and EU situation highlights this very well. AI is an excellent example. In the USA, firms have much more freedom to develop ideas with regulations coming in later if there are perceived to be any ill effects from specific technological developments. In Europe, where, unsurprisingly, there are few tech giants, the precautionary principle means that no harm has to be proved before technological (or other) developments can be progressed. From what can be seen from the President's early moves, the deregulation agenda is being pushed hard and appointees more sympathetic to his ideas put in positions in agencies such as the Federal Trade Commission and Department of Justice. Lifting the burden of excessive detailed regulations or those which can stymie growth, is likely to raise the animal spirits of businesses and investors in the USA. M&A activity, which had been held back by the previous teams of regulators, seemingly in some cases on ideological grounds, is likely to see a resurgence.

The President's low tax mantra, in contrast to what the Democrats had planned, will also be well received by investors. More money left in the pockets of companies or individuals can be expected to encourage growth resulting in higher profits and dividends. But investors, whilst welcoming the President's tax and deregulation plans, will also be seeing things that they don't like as much, notably the threats of tariffs on imports and the level of US government borrowing.

Firstly, why might investors dislike tariffs? Looked at from basic economic theory they are inefficient. On the basis of comparative advantage, other things being equal, countries will produce and export those goods where they are most efficient and import other goods from countries where they have a comparative advantage. This would be the optimal position as far as consumers were concerned with free trade and perfect markets so that economic activity and consumer welfare is maximised. This is the ideal state of affairs but this position is never reached in practice but the aim of governments should be to get as near to it as possible. The reason why tariffs can be justified in certain circumstances is if trade is distorted by subsidies. So the theory of comparative advantage can be negated if a country, which does not have a comparative advantage in certain goods, tries to give itself one by subsidising the manufacturing of the relevant goods and selling them below cost. In modern trade parlance, this is known as dumping. Whilst it might give a benefit to the country providing the subsidies, it damages its trading partners who might have the comparative advantage in the absence of subsidies. In these circumstances, there can be a justification, in theory, for imposing tariffs on the countries which are dumping the goods and we see a lot of this now in relation to Chinese exports. Dumping goods at subsidised prices, say in the USA, can lead to deindustrialisation and job losses. So, steel would be a good example of a product where China has excess capacity and weak domestic demand but faces tariffs on its exports. The second order effect is that manufacturers in countries which import subsidised products like steel get a benefit from this as far as their import costs are concerned so there can be unwelcome second order effects in terms of tariffs raising their input costs. Consumers lose because they would be having to pay higher prices for goods.

We cannot be sure how far President Trump might go in imposing tariffs (he has just started as this final draft is prepared) but this would be a protectionist measure which would slow down world trade and introduce inefficiencies and distortions to international trade and certainly cut the world's economic growth rate. This would result in negative effects for companies and their shareholders by way of profits made and dividends distributed. There could be another more malign effect which is probably worrying investors more at the moment and that is the potential negative effect on inflation. The imposition of a tariff on imported goods would raise prices. But there could be another negative second order effect which is that domestic producers in a protected market will raise their prices in the absence of stronger import competition and this could also contribute to a rise in inflation. Then, if that happens, say in the USA, the Federal Reserve may take a more hawkish view on interest rates which will impact investors' views of the trajectory of interest rates.

We will have to see how President Trump uses his tariff threats. They are not just about subsidised imports, they are being threatened against countries for political reasons such as illegal immigration and drugs coming into the USA, taxation of US companies abroad etc. The investment conclusion is that tariffs, as threatened, are highly undesirable.

In the election campaign, neither side mentioned what they planned to do about the US budget deficit, standing at over 7.0% of GDP. The USA has an advantage to the extent that the US dollar is the world's leading reserve currency and many holders of US dollars do not have any choice but to hold it. The danger is that, if the US economy does not show significant growth, the levels of debt will worsen because the tax revenue will not meet targets. If tariffs are imposed that could be the catalyst for a slowdown or stalling of the US economy with its negative effect on federal tax revenue overall although the tariff revenue could provide some offset. As the supply of debt coming on to the market increases, it is reasonable to assume that investors will want a higher interest rate with its implications for debt servicing costs. So, as we look at the USA from an investor's point of view, we can see some very positive attractions and some quite negative ones.

If we now turn to the eurozone, we think investors would be hard put to find many positives. Politically, it is in a dangerous place with political turmoil in the two biggest eurozone members, Germany and France. In Germany, the collapse of the three party coalition will lead to an election in February with the CDU expected to gain the most votes but it is likely to have to find a coalition partner. Germany's problem is not financial in that it has a strong fiscal position but is limited by the debt brake in terms of what it can spend. The debt brake, except in emergencies, limits the federal government's structural deficit to 0.35% of GDP. It will remain the eurozone's strongest credit but it has serious problems with the high price of energy and a car industry which is in real trouble partly as a result of competition from Chinese EVs and high energy prices which are affecting manufacturers generally as well as possible future US tariffs. Whilst its problems are serious, they are not in the same league as those of France. Following the indecisive parliamentary election results, the political landscape is fragmented with the centre having collapsed. In any circumstances, a political vacuum like this would be serious, against the background of a budget deficit of over 6% of GDP, well above what is allowed under EU rules, it is critical. History shows that it is very difficult to get the French people to accept cuts in government spending which many observers believe is vital to stabilising the country's finances and there is no majority in parliament for such a policy, essential as it would seem. Because it is difficult to cut public spending in France without social unrest developing, the corporate sector and wealthy individuals end up being targeted but this is not a scenario which appeals to investors and it is no accident that the French stock market performed poorly last year relative to many others. The danger for the eurozone is that any problems which France might have in financing its debt at a reasonable interest rate will spill over into the rest of the eurozone. As France does not have its own currency, it does not have the flexibility in monetary policy that the USA or UK does.

As we saw from the latest IMF World Economic Outlook forecasts earlier on, the eurozone is an area of low growth and growth is what it needs to tackle its debt problems. In fact, the best growth is coming from Spain at around 3% in 2024. Compared with the USA, the eurozone has a growth and productivity problem and it is not difficult to see why. It lacks the dynamism of the USA and investors will note the high degree of regulation in the eurozone which contributes to the stifling of growth. We talked earlier about how Europe adopts the precautionary policy in assessing new developments, especially in technology and, within that, AI is a good example. If one wonders why there are so few high technology companies in Europe it is because they are up against heavy regulation which doesn't exist to the same extent in the USA. Furthermore, the competition regulator in the EU gives the impression of being obsessed with investigating and fining US tech companies, something that President Trump has not been slow to shout about. It is, however, possible to see some change in the mood music within the EU with increased pressure from companies, politicians and some EU governments for a relaxation of regulation, current and future, of which there is plenty in the pipeline. The EU is a high tax area and usually the template for governments, when finances are tight, is to tap the corporate sector. At its very simplest not many would quibble with the view that the EU's poor economic performance compared with that of the USA can boil down to it being a highly taxed and highly regulated area. Looking at the EU through the eyes of an investor, it is not appealing although, of course, there are world class companies in the region and one should not ignore good companies in the area when compiling a portfolio.

From Europe ex the UK to the UK where investors may feel the prospects are similarly depressing. The sentiment has changed dramatically since July's General Election. On the positive side, many investors saw a government with a large majority bringing stability to the UK and might have bought the idea that the government was pro business as it advertised in the run up to the election. In the event, investors have had a rude awakening with the Budget in October giving investors and businesses a real shock. The steep rise in employers' National Insurance contributions, sharp increases in the minimum wage as well as more employment legislation reflected a perfect storm for businesses generally and, specifically, for private businesses and for farmers, with the hit on

Inheritance Tax being unexpected and a real threat to their long term viability. We said earlier, how important messaging was and investors will interpret these actions as extremely negative being anti business and anti wealth and there are more bad messages. On the personal side, the additional taxes on non-domiciled individuals have sent a strongly negative message about the UK's attitude to wealth and, inevitably, there has been a significant exodus of non doms and it will be difficult, if not impossible, to reverse the trend. All of these consequences were entirely predictable and investors will find it hard to understand why the government felt these measures were consistent with the pro business line it was putting forward before the General Election. In fact, it was boxed in by pre election commitments so the Chancellor had very limited choices.

Are there any positive messages coming from the government? The UK's financial position is difficult. It is borrowing far too much and the only way to start making progress towards making inroads into the debt mountain is to encourage economic growth which should raise tax revenue and reduce some costs such as unemployment benefit as well as the more difficult task of cutting public spending. It is easy to damage confidence, as we have seen, but far more difficult to restore it and then expect concrete results. But, interestingly, in recent days, we have seen what appears to be a change in government attitude to the economy. It plans to make it more difficult for objectors to stall building and planning developments, the Chancellor has indicated that growth must trump everything and the Prime Minister has put growth at the forefront of his plans. The Chancellor has hinted that she favoured a third runway at Heathrow and expansion at Gatwick and Luton airports. It is very early days and the government will face a lot of internal opposition if it backtracks on policies like "net zero", employment law and airport expansion for instance but after the negative reaction to the measures it has taken so far resulting in low business and consumer confidence and in the wake of a very poor financial background, it may feel it has no choice. So, whilst messaging to investors in the UK has been negative, it is just possible that we are witnessing the beginning of a change of direction. We shall see. It is too early to make a more positive call on the UK but when governments find themselves in a very difficult position, in this case with the UK's finances, the absence of any alternative solution to this problem may give it the resolve to change tack on tax and regulation. Unfortunately, progress on infrastructure projects is forever being held up by judicial views resulting in additional expense and delays so the government has to clamp down on the incidence of multiple legal challenges to delay projects.

There are many possible implications arising from the change in the US political scene following last November's election results with one of the biggest potential ones being the interaction between the USA and China. President Trump is threatening China with punitive tariffs (he has just announced a 10% tariff on China's imports) and China will surely retaliate. If China's access to the US market were to be severely reduced by high tariffs, China would rationally try to direct exports to another market, the EU being an obvious area. This could further depress economic activity in the EU whilst, in China, if the drop in exports to the USA could not be made up elsewhere, there will be a negative effect on economic activity, adding to the problems of its domestic economy. Of course, if the effect is to depress the Chinese economy, then its demand for imports, iron ore for example, being just one will weaken. Without knowing exactly what will happen, it is difficult to be specific but we can be sure that the overall effect on the world economy will be negative. Always in the background is the Chinese threat to take Taiwan. It is difficult for investors to factor this into their investment policy. Markets have weathered well the serious geopolitical events of recent years, namely Ukraine and the Middle Eastern conflicts, not to mention Covid and its economic effects but an invasion of Taiwan could be at a different level in that it could bring the USA directly into the conflict. It is one of those potential issues which can always give investors a reason to stay out of markets because it would be such a dangerous event but the more pragmatic view is that an invasion looks unlikely in the short term and that staying away from markets may have negative consequences for portfolio returns because of the opportunity costs of missing equity or, less likely in our view, bond returns. On a more practical level, it is true to say that for various reasons, including the Taiwan risk, many investors have decided to avoid investing or have been disinvesting in China so further potential selling may be limited by this fact. Whilst, of course, China's growth rate, forecast by the IMF to be 4.6% this



year and 4.5% next year is high by Advanced Economies standards, these are disappointing figures for China compared with its past performances. The authorities are finding it difficult to stimulate consumption in China, there is a big property overhang and, long term, China faces difficult demographics compared to, say, India. Foreign companies which have manufacturing plants in China, have, in some cases, moved to China plus one, meaning that they have diversified their manufacturing sites in Asia with Vietnam, for example, being one beneficiary of this move.

Although some of the recent economic numbers have been disappointing, India is now seen by many as being more attractive than China and less risky. Its growth rate is likely to be well ahead of that of China. The vast potential of the market is the reason for so much investment interest, direct and indirect through the stock market. There are other Asian markets of significant interest. Indonesia, a vast country with a population of around 280 million, continues to attract attention for its potential. Overall, the IMF forecasts Emerging and Developing Asia to grow by 5.1% for this year and next.

For Japan, perhaps the biggest investor attraction is the changing shape of corporate governance with more shareholder friendly initiatives and movement on M&A activity which should produce more shareholder value together with more activity in share buybacks and more progressive dividend policies. Japan has long lagged behind in these areas and some recognition of these advances in what might generally be termed corporate governance has started to be reflected in the performance of the Japanese equity market. Last year was a strong one for Japanese equities, perhaps no coincidence, although the benefit was reduced for overseas investors because of the weakness of the Yen. To put the buybacks into figures, share buybacks by publicly traded companies hit a record high of over JPY18 trillion (c. US\$115 billion) in 2024. As well as reacting to pressures from some shareholders, the aim was to improve capital efficiency, a move requested by the Tokyo Stock Exchange in March 2023. On the dividend front, Japanese companies' payout rates rose to 67.8% in 2024 from 57.1% in 2023. These actions represent strong cultural changes from Japanese companies and are supportive of a more positive attitude to the Japanese equity market.

So, bringing this all together, what are the conclusions? Although the fixed interest market has shown some recovery in recent days, we believe that the size of budget deficits in many countries and the resulting funding requirement will put pressure on prices in the bond market. Also, the inflation outlook is unclear. If the USA puts tariffs on imports that would be inflationary. In countries, such as the UK, even though the economy may be weak, increases in state controlled pay levels, such as the minimum wage, could lead to cost push inflation in certain sectors, hospitality being an example. So, although demand may be weak, inflation could be rising, necessitating some tightening action by central banks. This is not the consensus expectation but it is possible to envisage a scenario where inflation does rise and monetary policy is adjusted accordingly. Whilst we retain cash for working and opportunistic purposes, we would only regard it as a mainstream asset if we had a seriously negative view on equities, given that we have a negative view on fixed interest securities. So, we think the case still remains for equities to be one's preferred asset class. The reasoning is that, although some markets like the USA may look expensive historically, there is still some economic growth around, especially in the USA where earnings are predicted to show a meaningful rise this year and there are some good growth stories. The key positive for the USA is the tax and, especially, the deregulation programme which, if pursued as aggressively as advertised, could give meaningful cost savings to companies and revive animal spirits. The negatives are the extension of tariffs on US imports and problems with the troubling size of the budget deficit at over 7% of GDP. So some very good potential attractions for the US equity market and some unpleasant potential threats. For Europe and the UK, mired in low growth, high budget deficits, over regulation and a certain hostility to business success and wealth, the messages are mainly negative and the economic chasm with the USA is likely to widen. Whilst, of course, we have exposure to European and UK equities, they form a far smaller part of our asset allocation than the USA. Elsewhere, as we discussed, there are positive drivers for Japan and some other Asian economies which means they merit a place in most portfolios.

With equities having outperformed fixed interest securities so significantly in recent times, the main fundamental threat to equities must be if bond markets weaken for the reasons given, namely an enormous supply of new issues to fund government budget deficits and an upward movement in inflation which causes central banks to tighten monetary policy. So, if, for example, we look at the US equity market, the earnings yield, the reciprocal of the price/earnings ratio, stands around 0.5% below that on the ten year US Treasury bond. Given that one would expect a risk premium for holding equities, one can see they are treading a fine line. So whilst we continue to favour equities with the US market being our preferred one, after such a good run for many years, it would not be a surprise to see a temporary setback but against a background where one will see equities continuing to rise over the medium term.

Meridian Asset Management (C.I.) Limited is regulated by the Jersey Financial Services Commission, under the Financial Services (Jersey) Law 1998, to carry on investment business. "Meridian" refers to Meridian Asset Management (C.I.) Limited. This document is provided for interest only. Any opinion expressed in this document is a matter of judgement at the time of writing and may be subject to change without notice. No representation or warranty, express or implied is made nor responsibility of any kind accepted as to the accuracy, completeness or correctness of the information stated herein or that material facts have been omitted. The information contained in this document is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product or service by Meridian. Various products or services referred to in this document are subject to legal and regulatory requirements in applicable jurisdictions. They may not be available in all jurisdictions. Meridian makes no representations about the suitability of the information published in this document for any purpose. It does not constitute investment advice. No information contained or referred to in this document should be construed as such. A professional adviser should be consulted with respect to your particular situation. The value of investments and the income derived from them may fluctuate and you may not receive back the amount originally invested. Past performance is no guarantee of future performance. Currency movements may also affect the value of investments. The investments and services referred to in this document may not be suitable for all investors.

© Meridian January 2025