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ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

Once again, equities have outperformed fixed interest securities in the third quarter of 2025. AI excitement has helped but concerns about some countries' fiscal positions have heightened the perceived attractions of equities relative to fixed interest securities and this is an issue on which we concentrate in this review.

The tables below detail relevant movements in markets :

International Equities 30.06.25 - 30.09.25

Total Return Performances (%)				
Country	Local Currency	£	US\$	€
Australia	+3.3	+6.3	+4.5	+4.4
Finland	+5.7	+7.7	+5.8	+5.7
France	+2.9	+4.8	+3.0	+2.9
Germany	-1.1	+0.7	-1.0	-1.1
Hong Kong	+9.6	+12.6	+10.6	+10.5
Italy	+8.0	+10.1	+8.1	+8.0
Japan	+11.0	+10.5	+8.6	+8.5
Netherlands	+10.1	+12.1	+10.2	+10.1
Spain	+12.5	+14.7	+12.6	+12.5
Switzerland	+1.4	+3.3	+1.5	+1.4
UK	+7.4	+7.4	+5.6	+5.4
USA	+8.1	+10.0	+8.1	+8.0
All World Europe ex UK	+3.1	+5.1	+3.3	+3.2
All World Asia Pacific ex Japan	+11.4	+11.9	+10.0	+9.9
All World Asia Pacific	+11.3	+11.5	+9.5	+9.4
All World Latin America	+6.3	+10.6	+8.7	+8.6
All World Emerging Markets	+11.8	+12.6	+10.6	+10.5
All World	+8.1	+9.7	+7.8	+7.6

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : -0.6%

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

	30.06.25	30.09.25
Sterling	4.49	4.70
US Dollar	4.21	4.15
Yen	1.39	1.64
Germany (Euro)	2.60	2.71

Sterling's performance during the quarter ending 30.09.25 (%)

	Quarter Ending 30.09.25
US Dollar	-2.2
Canadian Dollar	N/C
Yen	+1.0
Euro	-1.7
Swiss Franc	-1.6
Australian Dollar	-2.1

Other currency movements during the quarter ending 30.09.25 (%)

	Quarter Ending 30.09.25
US Dollar / Canadian Dollar	+2.2
US Dollar / Yen	+2.4
US Dollar / Euro	+0.1
Swiss Franc / Euro	N/C
Euro / Yen	+2.4

Significant Commodities (US dollar terms) 30.06.25 - 30.09.25 (%)

	Quarter Ending 30.09.25
Oil	+1.1
Gold	+17.4

MARKETS

- In local currency terms, nearly all equity markets showed a positive return. Indices showing outperformance were the FTSE All World Asia Pacific and FTSE Japan as well as FTSE All World Emerging Markets. Indices which underperformed, although still in positive territory were the FTSE Australia Index and FTSE All World Europe ex UK. The same pattern appeared in sterling adjusted terms.
- Fixed interest markets lagged equities with gross redemption yields on UK, Japanese and German ten year government bonds all rising and, therefore, prices falling. The US ten year bond yield was an exception as it fell slightly.
- Currency movements were not significant but sterling was mostly weaker, especially against the US and Australian dollars.
- Gold was a feature of commodity markets. This testifies to concerns about fiscal weakness in a number of countries with central banks being important buyers.

ECONOMICS

A positive quarter for equities against a background of considerable geopolitical and economic uncertainty may seem counterintuitive to some but their outperformance against fixed interest securities should not be a surprise as we have argued in our reviews for some time and will discuss again later in this review.

The geopolitical issues remain as concerning as ever and have the potential to destabilise markets. Very serious as they are, they do not appear to have become any worse during the latest quarter and have not impacted on markets. Unfortunately, these problems, which once may have caused weakness in markets, seem to be a constant feature now and investors have become more inured to them. There is a danger of complacency here and, at some stage, this may turn out to be misplaced but in the last quarter they did not affect equity markets. We will, therefore, in this review concentrate on economic issues but all the time we remain aware that geopolitical influences may be just as important and we are certainly not downplaying the human tragedies which have arisen as a result of the conflicts in Ukraine and the Middle East.

So, on the economic side, we will take a look at where we are and will use as our reference point the latest OECD Economic Outlook Interim Report published in September. Compared with its June 2025 Economic Outlook projections it has raised its projection for world economic growth in 2025 by 0.3% to 3.2% whilst, for 2026, its projection remains unchanged at 2.9%. These are obviously not stellar levels of growth but they are just about satisfactory for equity investors. As it happens, the projections for G20 growth and the changes from the OECD's June projections are exactly the same as for world growth. Breaking down the projections, the US is now forecast to grow this year by 1.8%, 0.2% higher than its forecast last June. Elsewhere, the euro area sees its 2025 projections raised by 0.2% to 1.2% with a slight reduction for Germany and a slight rise for Spain but nothing significant overall. However, the OECD has predicted quite a big increase for Japan on its June forecast by 0.4% to 1.1%. There is a small increase of 0.1% to 1.4% growth forecast for the UK this year. The OECD has raised its estimated growth rate for China by 0.2% to 4.9% for this year and for India by 0.4% to 6.7%.

On inflation, the OECD is slightly more optimistic than in June. For the G20 nations, it now sees 2025 inflation at 3.4%, 0.2% lower than its June estimate. Most differences are small but the biggest reduction is for the USA where the OECD has reduced its forecast headline inflation rate by 0.5% to 2.7%. Looking at core inflation rates, which may be of more interest to central banks, the OECD has lowered its June forecast by 0.2% for the G20 Advanced Economies to 2.6%. The biggest differences from the OECD's June forecast are for the UK with an uplift of 0.6% to 3.7% and the USA where there has been a reduction of 0.6% to 2.9%. The euro area has ticked up by 0.2% to 2.4% whilst Japan has seen a reduction of 0.2% to 1.7%. The overall 2026 projection for G20 Advanced Economies is unchanged at 2.5%.

Whilst the growth projections are below the long term average they are not catastrophic and not in themselves a threat to equities. However, any forecasts made at this stage must be subject to higher than usual uncertainty, not least because of US tariffs. The OECD's forecasts do not suggest a huge impact on US inflation but it is early days and it remains to be seen how tariffs will work their way through to prices in the USA although there will obviously be some effect. As a result of USA tariffs, trade patterns are bound to change but we don't yet know by how much. The OECD estimated that by the end of August, the overall effective US tariff rate rose to an estimated 19.5%, the highest level since 1933. However, whilst this figure appears quite daunting, it should be borne in mind that the USA is a relatively closed economy with imports accounting for only about 14% of GDP. This contrasts with that of the UK, a much more open economy, where the figure is around 32%.

At the moment, the imposition of increased tariffs on imports by the USA has not greatly affected markets. As we noted in our June review, the sharp fall in markets after the initial 2nd April announcement was broadly reversed by the end of the second quarter and markets have moved further ahead in the third quarter. The sector leaders in the third quarter were S&P Communications Services and S&P Information Technology whilst the only negative sector was S&P 500 Consumer Staples where companies were finding tariffs on imports which form part of inputs, difficult to pass on. On the other hand, AI excitement led to some strong gains in relevant technology stocks. Overall profits growth for US companies is expected to be quite satisfactory if mixed for the current year with some of the large technology companies likely to produce strong profits growth whilst other sectors which are finding it difficult to pass on cost increases having a more difficult time. However, because of the composition of the US equity market, US companies' profits outlook for 2025 is better than that in most countries.

Whilst the OECD's projections for growth in 2025 and 2026 should not frighten investors, even though they are lower than past levels in many countries, the economic issue that most concerns us is one about which we have written at length in our reviews for some time. This is the level of government borrowing in many countries and the potential for this to cause a serious disturbance in the bond markets. In this respect, we can focus on four countries, although it could be more. They are USA, UK, France and Japan, each of which has outsized budget deficits and alarming levels of outstanding public debt as a percentage of GDP. The reasons these two matter are twofold but connected. The larger a government's budget deficit, the higher the interest rate it would expect to pay on its debt. There are exceptions to this situation but it is a logical expectation. Secondly, the larger the amount of outstanding public debt in relation to GDP, the more a country's creditworthiness comes into question. At the moment, the position is very delicate for a number of these countries including those mentioned above. Paradoxically, the bond market is one of the best friends of investors because at a time when very few politicians are brave enough to spell out the precariousness of their countries' financial positions let alone take meaningful action, the one event which will concentrate even the most reluctant or economically unaware politician's mind is the threat of a bond market collapse leading to higher interest rates, a currency crisis and perhaps an externally driven austerity programme, none of which will help the relevant government's re-election chances. We have had glimpses of the influence which the bond market can wield, two examples of which are the

reaction of the US Treasury bond market to the 2nd April US tariff announcements which it is believed caused President Trump to make a partial backtrack and, just recently in the UK, the reaction of the pound and gilt market to a putative candidate for Prime Minister who urged the UK government to “get beyond this thing of being in hock to the bond markets”. That is about as dangerous a statement as can possibly be made for a country which is having to borrow very heavily to fund its budget deficit and has a significant current account deficit. Not surprisingly, it has led to a strong response from the Chancellor of the Exchequer. It is fair to say that the bond market is all powerful and the one area which can bring even the most populist politicians to face up to the problems arising from large fiscal and current account deficits.

Let us take these four countries in order. The USA has the largest budget deficit as a percentage of GDP, likely to remain at over 6% of GDP in 2025 and continue at a very high level in the future. Outstanding US government debt as a percentage of GDP is likely to be around 125% of GDP at the end of 2025. The combination of these two very high figures would normally raise the alarm amongst investors, leading to rising borrowing costs for the USA and a downgraded credit rating. In terms of borrowing costs, this is true. If we look at ten year US Treasury bond yields, they are one of the highest amongst the developed countries, not surprising given the fiscal position. It has also had a credit rating downgrade from Moody's this year from Aaa to Aa1. This is symbolic more than anything else because it remains a very high rating. However, as the world's major reserve currency the US dollar enjoys what is termed the “exorbitant privilege” which arises from this fact. US dollars are needed around the world and it's likely to be many years before the country loses its status as the world's major reserve currency so the USA can get away with borrowing and debt levels that other countries can't. However, whilst the chances of a collapse in the US dollar are much less than would be the case for a less traded currency with similar stretched ratios, the threat to interest rates which the US government has to pay remains. There is a particular issue which at present is causing concern to investors and this is President Trump's attempt to get the Federal Reserve to do his bidding on interest rates through putting his candidates in a position to gain a seat on the interest rate setting committee of the Federal Reserve. The independence of a central bank is of paramount importance for investors and any attempt at political interference to get the central bank to bend to the will of the executive would be negatively received in markets. This is why President Trump's attempt to get the Federal Reserve to cut interest rates sharply is so concerning for investors. With the US economy moving along at a satisfactory pace, attempts to move the Federal Funds rate to well below the current rate of inflation would be considered an inflationary move with implications for Treasury bond yields and the US dollar. It is important, as an investment manager or investor, to look at the actions of politicians through the eyes of a mainstream economist who is also market aware in the sense of understanding what markets might make of their decisions or statements. Most economists, given that the US economy is growing at a reasonable pace, would see both the economic and market risks mentioned above which would arise from moving official interest rates to significantly negative real levels. President Trump's attempts to remove Federal Reserve governor, Lisa Cook, is playing out in the courts, so far without success for the President, but this and his disobliging remarks about the Chairman of the Federal Reserve, Jerome Powell, are dangerous from an economic and investment perspective and, in the context of our discussion of the US budget deficit and overall government borrowing level, very risky. Investors who buy US Treasury bonds do not want to see interference in matters reserved for the Federal Reserve and which threaten its independence. The Federal Reserve is there to provide assurance for investors in US government debt. Once the politicians start interfering in areas which are not in their domain, they heighten the risk of investing in that particular economy. Having said that, the “exorbitant privilege” of the US dollar is a powerful support even when the fiscal and debt position of the US government is so bad.

The UK does not have such an advantage and we regard its fiscal position as very concerning. On the face of it, its position is not as serious as that of the USA in terms of the size of budget deficit or level of outstanding public debt as a percentage of GDP. The budget deficit is around 4.8% of GDP and the outstanding level of public debt as a percentage of GDP is about 96%. So, whilst these percentages are high, they are not at US levels but that is as favourable as the comparison gets.

Sterling is not a significant reserve currency so has no “exorbitant privilege” like the US dollar. Like the USA, the UK has a significant current account deficit, around 3.0% of GDP (about 3.9% in the USA), but it is a more serious issue for the UK as it does not have the USA’s reserve currency advantage. When Mark Carney was governor of the Bank of England he described the UK as being “reliant on the kindness of strangers to finance its deficits” and this is never more true than now with the country’s significant twin deficits. And there is a third problem, the UK’s above average inflation rate. The latest OECD Interim Economic Outlook projects the UK’s headline inflation rate at 3.5% for 2025 and 2.7% for 2026 with core rates projected at 3.7% and 2.7% respectively. These inflation levels are particularly problematic for the UK because around a quarter of the UK government’s debt is index linked. Also of concern is that around 30% of UK government debt is owned by foreigners so one can see what Mark Carney meant. So, apart from these obvious vulnerabilities, why should the UK be a source of concern for investors? We don’t do politics in these reviews, rather we try to take an objective view which a mainstream economist might take. What that would be likely to show is that, firstly, public spending needs to be addressed and, secondly, that the measures taken so far to address the fiscal position have been counter productive as they have hit the private sector hard and also sent out a negative message about the UK’s attitude to business and wealth with the measures to end non dom status sending out a particularly negative message. It is also deeply concerning that a putative Prime Minister can say as we mentioned earlier that the government should “get beyond this thing of being in hock to the bond markets”. With the UK so vulnerable because of its poor fiscal and external position, it is no wonder that the UK bond and currency markets were temporarily spooked by these remarks. One of the issues in many countries is that politicians appear to have a poor grasp of economics and cannot understand that without fiscal discipline, a country is highly vulnerable to economic crises. On the other side, the idea that the answer to fiscal problems is to tax business or the wealthy more shows a lack of understanding of what drives economic growth, which is the best way to deal with fiscal problems. Most mainstream observers would say that the UK is at the limit of what can be borne from tax increases without increasing the danger to the economy and introducing a doom loop. In this respect, the budget at the end of November will be a crucial signal for investors about the attraction of the UK as an investment area, direct and indirect. The UK government has not been able to get the support of its MPs for its attempts to tackle public spending so the budget will be a pivotal moment. Because of its fiscal problems and relatively high inflation rate, the UK has to pay more than almost any developed country for its borrowing and tough decisions have to be made to deal with its problems. For the moment, we find it difficult to be optimistic about the UK as an investment area and this is reflected in our asset allocation.

But, if there is a lack of reality in the UK about the fiscal position and what needs to be done to stave off a bond market crisis, the situation in France is of even greater concern. Although the French government does not have to pay as much to borrow as the UK, its relative interest costs amongst the eurozone economies tells the story. Its borrowing costs, as measured by ten year government bond yields, are higher than those of Italy, a very highly indebted country, for the first time. Three years ago gap was 1.8pp. The yield is also above those of Greece, Portugal and Spain. The French budget deficit is around 5.7% of GDP, well above ECB limits and its outstanding government debt as a percentage of GDP is around 116%. These percentages reflect a serious position but the political vacuum in France arising from the result of the last parliamentary election, means it is proving almost impossible to deliver what is needed to start to address the fiscal situation. The last but one Prime Minister, Mr Bayrou, tried to spell out what needs to be done but, for whatever reason, there is no acceptance of the need to address the fiscal crisis other than by moves to tax the wealthy more with a significant wealth tax which in terms of the signals it sends out about France as a country in which to invest is completely counterproductive. It is no surprise that the French stock market, although slightly higher so far this year, has significantly underperformed most other European markets. Apart from recognising the seriousness of the situation, it is difficult to know how the French situation will play out. Neither the right wing nor left wing bloc recognises the need to rein in public spending and make difficult choices to set France on the road, rather they appear to want to relax it. As we say, the wealthy and big business are the targets for raising more money but the results can only be expected to be counterproductive. It is easy to see how the French bond market can come under more pressure

and, of course, it has wider implications for the euro if the second largest eurozone economy faces more problems. The ECB does have its Transmission Protection Instrument (TPI) whereby it can intervene in the bond market to buy a member's bonds. The idea is that if member states experience unjustified increase in borrowing costs, the ECB can now buy their bonds under the TPI. The key is "unjustified increases in borrowing costs" so it would be difficult to justify intervention if the relevant member country was not taking steps to put its house in order. As France is part of a monetary union, the risk of a major economy getting into serious difficulty would threaten contagion. The French situation is very difficult. As we have seen recently, any serious attempt to try to address the country's budgetary problems leads to social unrest with politicians usually backing down although, ultimately, the bond market may have the final word. If assistance came with strings attached, the question of sovereignty would be a major issue almost certainly.

Japan doesn't often feature in those parts of our economic review dealing with current economic problems and rather slips below the radar but there have been significant developments this year. The country has run consistently high budget deficits, estimated to be about 3.4% of GDP this year whilst the outstanding government debt to GDP ratio is around 237%, far bigger than that of any other major economy. This would normally have brought about a bond market crisis originating from foreign sellers of its debt, of which there are relatively few. However, whilst there has not been a crisis there have been some significant economic developments. Deflation has been the traditional problem for Japan but, for several reasons, that is no longer the issue, at least for the foreseeable future. Going back to the OECD Interim Economic Outlook, its headline inflation projection for 2025 is 3.1% and 2.1% for next year. The respective core inflation figures are 1.7% and 2.0%. So, Japan is having to grapple with difficult issues and this has been reflected in the bond markets. If we look at the movement in Japanese Government Bonds (JGBs) so far this year, we note that for 10 year bonds the gross redemption yield has risen by about 56 basis points (currently 1.635%) whilst the 30 year bond has seen its gross redemption yield rise by 86 basis points to 3.126%. By Japanese standards, these are extraordinarily high percentages. Whilst there is not an immediate fiscal crisis, Japan has to address serious demographic challenges arising from an aging population and the resulting financial issues. The significant domestic ownership of JGBs, including about 52% owned by the Bank of Japan, means there is not the same level of concern as there is about the other three countries' debt but it does indicate the problems building up for Japan.

So, where does this all leave investors? There are always some things for investors to worry about and there are more of these than usual at the moment on the geopolitical and economic front. But, if one allowed one's investment policy to be dictated by negative news and theoretical concerns and therefore stayed out of the markets, history shows us that the opportunity costs would be substantial given how world equities have performed over the long term. In this review, we have concentrated on what we consider the most important economic issue, the over indebtedness of many countries and the implications which this could have for the bond markets. Some readers may be surprised that we have not put tariffs at the forefront of the economic worries. Economically, they are not good news for they introduce economic inefficiencies, raise price levels above what they would otherwise have been and slow down world economic growth. However, the process is likely to be gradual rather than providing an immediate economic shock. The threat to the bond market could be more immediate and we have already seen indicators of jitters in the US, French, UK and Japanese government bond markets in the face of potentially unsettling news. In the four countries which we have concentrated upon in this review, the fiscal positions are extremely challenging and are threatening to get out of control with the most immediate threats possibly to France and the UK. For investors and many economists, but not many politicians, the problem is easy to identify, excessive public spending although there are many different thoughts as to how this might be addressed. It's easier if you are not having to make decisions, of course. But what will concern many investors is the unwillingness of many politicians to recognise the cause of the problem either for ideological reasons or because, whilst understanding the problem, they find it too difficult politically. There will also be some who are unaware of the consequences of rising deficits until what is now commonly referred to as a "fiscal event" occurs.

However, even if this seems a depressing prospect, investors have one source of hope, the disciplines of the bond market which a “fiscal event” would bring into play. If there is one development which would bring politicians to face the reality of the fiscal problem, it would be a collapse in the bond market with the resulting rise in interest rates and perhaps a fall in the currency bringing a dose of reality to their re-election prospects. This is a real possibility in some countries and imposing strong fiscal discipline of fiscal profligacy would be a strong positive signal for investors even if it is born out of a crisis.

Against this background, bonds still lack attraction for us and, almost by default, equities seem a better home for investors given that we think they have enough support from growth projections for the world economy. It is, however, a relative call. There are positives and negatives for equities but not many positive one for bonds as we have explained. Whilst, it’s pleasing to see a positive quarter for equities, we recognise that it will be an uneven path upwards given the negative issues around.

All countries and regions have their problems but in defining our asset allocation, we still favour the USA. We look at the relative attractions of each country and region as we do for each asset class and, despite the imposition of tariffs, the USA scores well, say, compared with the UK and Europe with its generally pro business attitude, a more accepting view of business success which informs a less aggressive tax policy and a much wider range of companies and industries for investors to consider. All this has contributed to a better productivity record, a prerequisite of growth, than, say, the UK and Europe where excessive regulation and sometimes hostile tax policies dampen the attraction of these areas although, of course, there are world class companies based there. So, for these reasons, despite the higher ratings on which US equities stand, the USA remains our favoured area.

Whilst it is always pleasing to note a positive quarter, we have to be realistic and accept as part of the pattern of long term appreciation in equities, markets will have their setbacks and the unsettled geopolitical and economic situation could trigger a short term setback. For that reason, in client portfolios where income tends to be retained rather than paid out, we have been allowing cash to accumulate ready to use opportunistically if there is a significant setback in markets. Against a position where client portfolios are significantly invested in equities, the opportunity cost risks arising from equities continuing to rise would be quite low but it seems a prudent tactical balance.

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