

Investment Views

June 2025

Strategy:

Spotlight on the UK

Fixed Income:

Risk rally builds, yields inch higher

Equities:

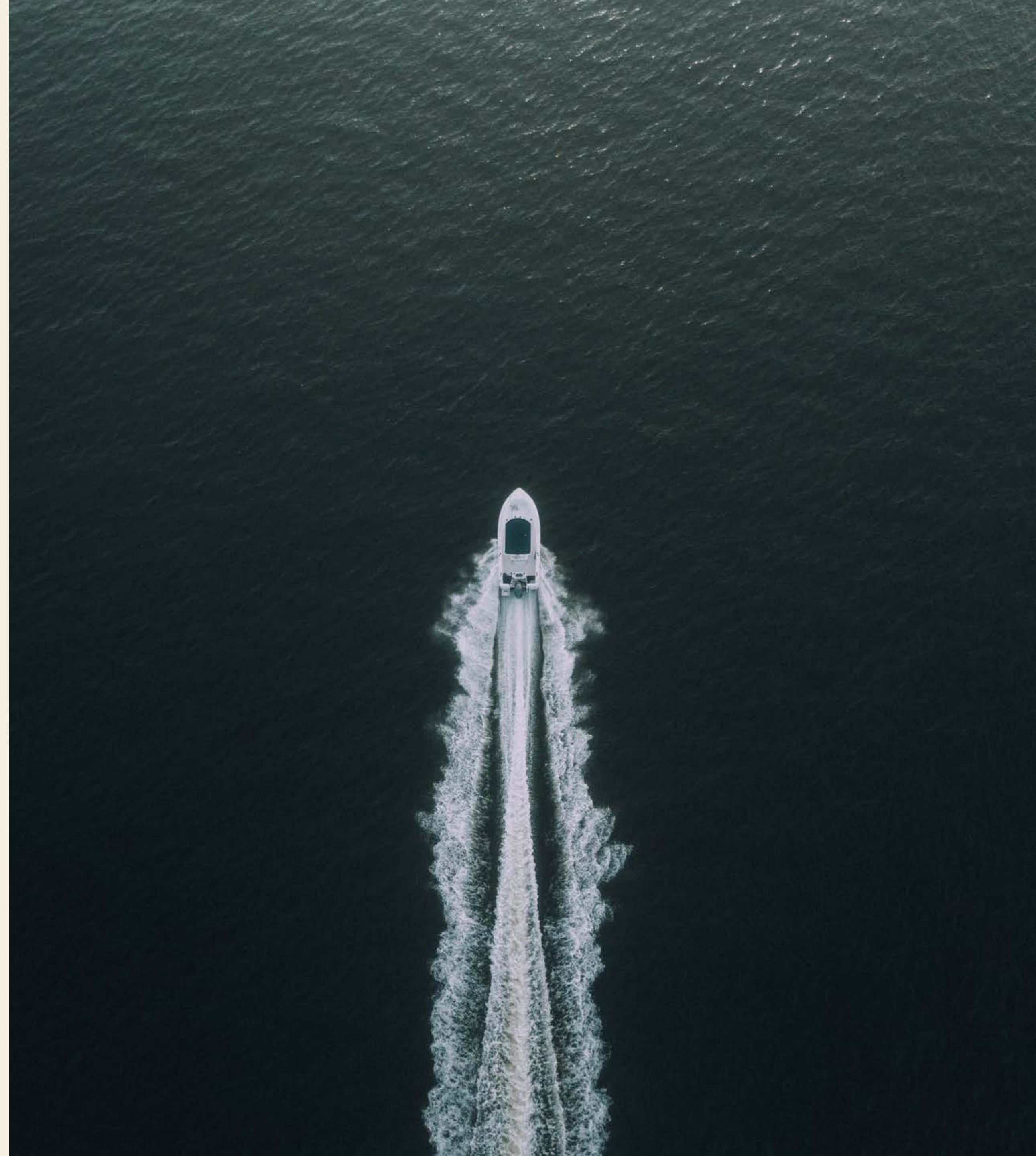
Return of the Tech

Spotlight on the UK

- The UK economy continues to struggle with low growth
- Deep-rooted structural issues require long-term reform
- A focus on tech and innovation is encouraging

Before turning to the UK, it is worth noting that the US, China and the Eurozone have dominated headlines so far this year. Trade policy was an early focus for the US administration and we have already seen many twists and turns. Tariffs were imposed on all trading partners, and then in many cases were paused or lowered, all while negotiations continue to take place behind the scenes. In addition to trade policy, a substantial bill is making its way through Congress. Although not yet finalised, the “One Big Beautiful Bill Act” covers a wide range of measures across taxation and spending – this is something we will be following closely to provide an update on in the near future.

Despite the news agenda, the UK remains an important region for investors. Although the UK only represents around 3.2% of the global economy, and around 3.4% of global equities, the country



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is a dominant provider of global services and punches above its weight in advanced manufacturing. This makes it home to some good global companies. The UK also consistently ranks as the third largest region in the world for Venture Capital investment, behind only the US and China. Nvidia CEO Jensen Huang recently spoke about the strengths of the UK during London Tech Week, noting that the UK has “one of the richest AI communities anywhere on the planet [with] amazing start-ups... and incredible thinkers in computer science”. He further noted that the “ecosystem is really perfect for take-off... just missing one thing... its own [AI] infrastructure”.

Despite its many advantages, from an overall economic standpoint, the UK has unfortunately lost its way and struggled to recover from the Global Financial Crisis. Challenges with business investment, trade, building, and infrastructure development have all held back growth. An influential essay published in 2024 called “Why Britain has stagnated” highlighted some of the factors at play. One example noted that “the planning documentation for the Lower Thames Crossing, a proposed tunnel under the Thames connecting Kent and Essex, runs to 360,000 pages, and the application process alone has cost £297 million. That is more than twice as much as it cost in Norway to actually build the longest road tunnel in the world.”

The essay also highlighted the lack of energy investment; electricity generation per capita is just two thirds of what it is in France and only a third of the United States. This combination of high energy costs, planning regulation and trade frictions have held back growth and put upward pressure on inflation. As an example, Britain has not built a new reservoir since 1992, over which time the population has grown by 10 million. This lack of investment helps explain why the average water bill for a UK household has had to rise by 26% over the last year according to Water UK.

Since 2016, the UK has had five different Prime Ministers. All have struggled to navigate a complicated economic and political

26%

The percentage that the average water bill for a UK household has risen.





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backdrop in the UK, and the current Labour Party is no exception. In their first Budget last October, they tried to balance fiscal responsibility, support workers, and be pro-business, but this turned out to be an almost impossible trinity. A wide range of tax increases on corporates and wealthy individuals hit confidence hard. Chancellor Reeves has since spoken extensively about improving the supply side of the economy to help kickstart growth, but these are structural challenges and solutions will take time to implement.

Sterling has had a good start to the year, appreciating from 1.25 to 1.36 versus the US dollar. However, this is largely a story of global US dollar weakness. A more relevant measure is sterling versus the euro, which is slightly lower year-to-date. The UK government bond (gilt) market has fluctuated this year, and still shows evidence of an embedded risk premium (higher yields) after the 2022 stress following unfunded tax cuts, which were subsequently reversed. The Bank of England has cut interest rates twice this year, but has been cautious about signalling future cuts due to still elevated services inflation. UK equity markets have performed well in the first five months of the year, with the large-cap FTSE 100 returning 10.7% in sterling terms and the mid-cap FTSE 250 5.0%. Both outperforming global equities in sterling terms, which were down 1.6%.

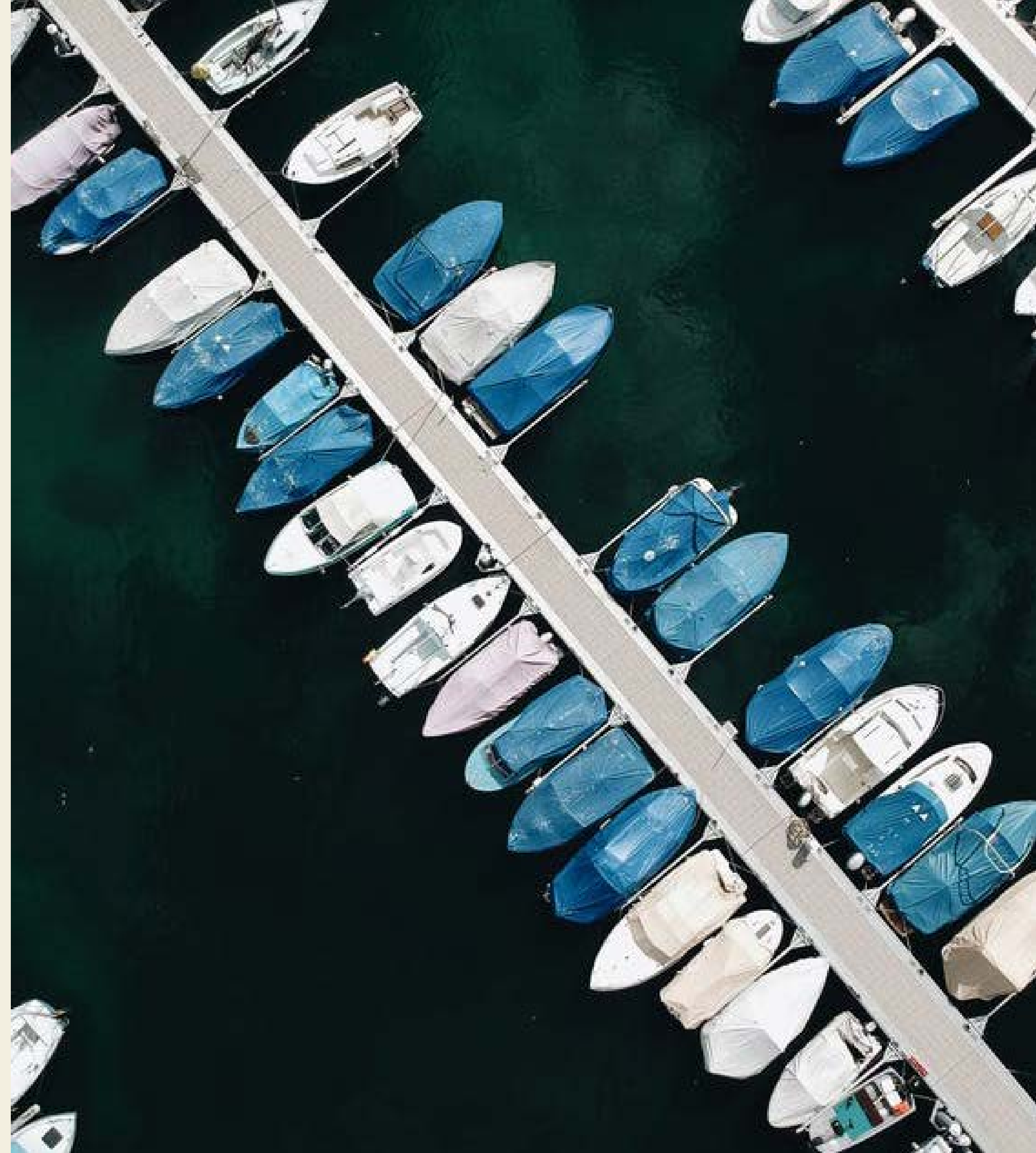
Overall, the UK is in a challenging economic position, and the labour market has started to weaken. The Bank of England should be able to cut rates further to support economic growth, but inflation pressure is likely to remain elevated over coming months. The UK is leaning into areas where it has a competitive advantage, and Prime Minister Starmer delivering a keynote speech at London Tech Week is evidence of this. Opportunities exist in the UK, but they tend to be industry or company specific. The structural impediments to growth require longer term solutions, but they have been identified and can now be tackled.

Risk rally builds, yields inch higher

- Credit spreads tighten reflecting broad tariff optimism
- US Treasury yields edged higher, market volatility retreats
- Weaker US dollar continues to ease global financial conditions

The “risk-on” rotation continued in May, as the pause in tariff rhetoric, upside surprises in growth data and more attractive valuations coincided with still-dovish central bank guidance. This coaxed investors back toward credit and risk. US high yield spreads tightened by 70bps, mirroring similar moves in the equity markets. However, beneath the calm, markets quietly repriced term-premia, with 10 and 30-year US Treasury yields rising meaningfully, and long-run interest rate expectations also creeping higher. Volatility fell across asset classes and the US dollar weakened for a fifth straight month, leaving markets to question whether too much optimism has already been priced in.

The Federal Reserve left policy unchanged for another month, acknowledging uncertainty around trade policy and signalling a wait-and-see approach. While we have maintained our forecast for two 25bps rate cuts this year, given that tariffs have so far done



little damage to the domestic US economy, there is a possibility that no cuts are delivered this year. US inflation breakevens widened, as energy and industrial metals rebounded. Treasury auctions met with strong demand, helped by a sharp drop in interest rate volatility and signs that there may be some dilution of the spending requirements in President Trump's budget bill.

In Europe, where 75bps of rate cuts have been delivered so far this year, macro-economic data surprised positively. This has led ECB officials to downplay the need for further monetary easing. These hints that the ECB's cutting cycle may be close to an end has also provided additional fuel for the rally in the Euro, which has appreciated by around 10% year to date. In the UK, a hotter-than-expected CPI print forced the market to temper rate-cut bets, lifting gilt yields and widening spreads to the euro area. In addition, sterling rallied past key technical levels, as markets reassessed the Bank of England's path.

Asian central banks struck a cautious tone. The Bank of Japan held policy steady and played down inflation risks; this lack of urgency led Japanese bond yields higher, with the 30-year rising to 3.17% (a 25-year high), while the yen also weakened. China's data remained stable although there is still some uncertainty due to the front running of imports ahead of the tariffs. In Switzerland, the rapid appreciation of the franc is likely to force the central banks to lower base rates back into negative territory and potentially resume quantitative easing. This could leave the currency positioned to become the next favoured carry trade short.

Corporate credit markets enjoyed the calmer tone in markets. Average US investment-grade spreads tightened to 88bps, while emerging market and high-yield spreads compressed sharply amid strong inflows buoyed by supportive macro data and a softer US dollar. Spreads on agency mortgage-backed securities narrowed

75bps

The amount of bases points that the ECB has cut interest rates this year.

as issuance slowed amid stable 30-year fixed mortgage rates and a lower probability of rapid US base rate cuts. The US real estate market remains bifurcated with a lack of supply and shortage of new construction in the northeast providing buoyancy to prices, but with opposite dynamics in the southern states where real estate investment is likely to contract sharply.

Commodities sent mixed signals, with the weaker US dollar continuing to provide a positive tailwind. Oil prices rebounded modestly after April's drop, joined by gains in copper and natural gas, helping lift medium-term inflation expectations. Gold, by contrast, fell to \$3,289 per ounce, as real yields rose and safe-haven demand ebbed. The broader commodity index slipped, suggesting cyclical enthusiasm hasn't yet spilled over into a full reflation trade.

By month-end, markets were confidently pricing resilient 4.4% US nominal growth, as inflation remains sticky, coupled with accommodative monetary policy to be delivered later in 2025. As a result, portfolio positioning remains neutral interest rate duration. The risk of a broader slowdown remains, but the worst-case scenarios are unlikely to materialise barring a black swan event. Therefore, it is too early in the cycle to overweight bonds and we prefer to wait for the noise surrounding the fiscal deficit, and with it the risk of higher US long end yields, to cool down. On the credit front, we continue to hold the opportunistic risk added during April in US dollar bond funds. However, summer months often magnify shocks and May's exuberance leaves little margin for disappointment should another surprise knock sentiment, so we remain nimble. For now, we remain comfortably close to neutral, capturing carry at the short end of the yield curve.

Return of the Tech

- Rapid equity rebound driven by Technology
- Spending on Artificial Intelligence still going strong
- Company earnings have been resilient

The MSCI World Index rallied 5.9% in May, erasing the 4.5% loss in March. This is the best monthly return since November 2023. A robust earning season and better than feared guidance helped propel the markets forward. Progress on trade negotiations also fuelled the rally, with Trump now pivoting from tariffs to tax cuts. A key takeaway this month is that the Artificial Intelligence (AI) related capital spending boom is still intact. In fact, Information Technology was the best performing sector this month. The last time this happened was June 2024, a reminder that after the rebound in 2022 and the optimism in 2023 and early 2024 that lately the sector has lost its shine. This was partly due to the DeepSeek announcement earlier this year. However, hyperscalers and large market capitalisation technology companies have reaffirmed their commitment to spending on AI and the technology sector is back in favour.



Other sectors that performed well this month include Communication Services, Consumer Discretionary, and Industrials. Healthcare underperformed materially, falling 3.6% in May, which is disappointing. Typically seen as a defensive sector, the fact that Healthcare underperformed in 2023 and 2024 made sense as the equity markets notched above average returns. However, given the volatility seen this year, the recent underperformance is unexpected. The US administration's latest focus is on large market capitalisation pharmaceutical companies and bringing down drug prices, which is another risk to the sector

All regions performed well this month, with the lowest monthly dispersion since October 2023. This is a sign of a broad market rally and indicative of a risk-on environment. The large market capitalisation technology companies were dominant this month. Nvidia and Tesla posted 20%+ returns, Microsoft and Meta 15%+ returns, and Amazon and Alphabet also performed well, but to a lesser degree. In contrast, Apple keeps on lagging, partly due to not delivering on AI, but also due to higher exposure to trade tariffs. These companies grew earnings by 28% in aggregate in the first quarter, far outstripping the 9% earnings growth achieved by the remaining 493 stocks in the S&P 500 index. Consensus points to the earnings growth gap narrowing, however the latest earnings revisions are moving in the other direction.

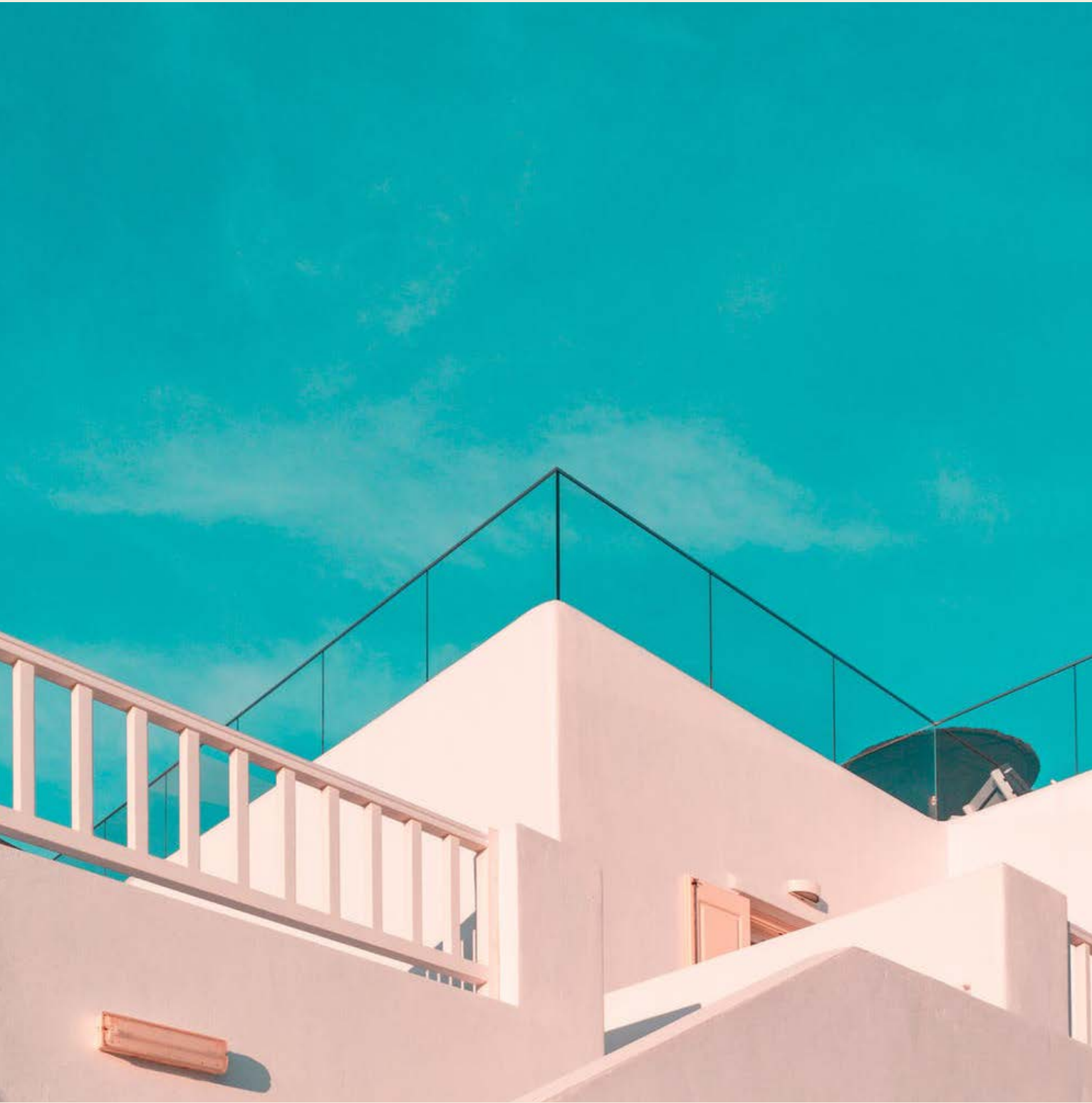
The hyperscalers reiterated capex guidance and in some case increased guidance. With cloud computing growing at double-digits and the AI segment leading the charge there is little doubt that the AI story is intact. Oracle's recent numbers is just one example of this. Oracle Cloud Infrastructure grew by 62% year-on-year in the first quarter with guidance of 70%+ growth for next year. An even better example is Meta. Meta recently increased its capex guidance for this year by 6-10% to \$64B-\$72B with most of it going towards AI. It has plans to build out a 2+ gigawatt datacenter in Louisiana, has signed a 20-year deal with Constellation Energy,

62%

The percentage that Oracle Cloud Infrastructure grew year-on-year in the first quarter.

and has recently invested \$15B in Scale AI, a company that provides data-centric infrastructure to accelerate the development of AI applications.

As we look to the second half of the year, equity investors are worried that the impact of tariffs could lead to a slowdown. This coupled with high valuations is making investors jittery. That said, high valuations are rarely a catalyst for corrections and if the AI story keeps on delivering it is very possible that investors focus on the upside, with next year earnings growth projected to be double digits.



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Global Asset Allocation

The chart below details our 6-12 month tactical investment strategy

