

Monthly Market Commentary

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International Equities Strongest Year in Nearly a Decade

Global equities ended 2025 near all-time highs, driven by earnings strength despite persistent political and macro uncertainty. The outperformance of non-U.S. equities and the AI investment narrative remained focal points in December, though with growing complexity beneath the surface.

AI leaders Oracle and Broadcom posted strong results but suffered share price declines as investors questioned capital expenditure and the sustainability of revenue growth. Investors are increasingly differentiating between AI companies rather than buying the sector indiscriminately. The enthusiasm that propelled valuations to three-year highs now faces scrutiny over returns on AI-related investments.

The US Federal Reserve cut policy rates by 25 basis points to 3.75%, its third consecutive reduction. Chair Powell adopted a cautious stance towards further easing, however. Delayed macro data in the US show a slowing labour market, with unemployment rising to 4.6%, falling inflationary pressure, as core CPI is at its lowest since early 2021, and weakness in manufacturing. Payroll growth stalled, with job losses in three of the last six months. Despite this, third-quarter GDP expanded 4.3%, its strongest pace in two years. This contrast makes monetary policy difficult, and we need to be mindful of this in our asset allocation decisions.

UK GDP contracted 0.1% in October, marking a second consecutive monthly decline. Consumer weakness compounded disinflationary pressures, with CPI easing to 3.2%. The Bank of England cut rates by 25 basis points in a narrow 5-4 vote but signalled future reductions would be "closer calls". Business activity showed modest recovery following the Autumn Budget, with the composite PMI improving to 52.1.

The ECB held rates steady despite modest upgrades to growth and inflation forecasts for 2026. The Bank of Japan proceeded with normalisation, lifting rates to 0.75%. Long-dated yields climbed across developed markets despite widespread easing. This reflects persistent fiscal pressures complicating the transition to neutral policy.

The macro picture is one of near-term weakness, though market participants remain hopeful that reacceleration of global growth is achievable in the second half of 2026. This optimism underpins current positioning but leaves a limited margin for disappointment given elevated valuations and compressed credit spreads.

Commodities presented a mixed picture. Gold rose 1%, capping a 54% gain over the year. Copper rallied 8% on AI infrastructure investment themes. This stands in stark contrast to oil, which posted its worst year since the pandemic. Brent fell 24% (£ terms) over the year amid a persistent supply glut. Even the unexpected capture of Venezuelan President Nicolás Maduro by U.S. forces on January 3rd failed to push energy prices materially higher.

The historic linkage of geopolitical unrest to markets has been rendered largely ineffectual through the lack of energy price pass-through. This phenomenon persisted throughout 2025, with geopolitical developments and market performance notably diverging. The implications for portfolio construction are significant as some hedges against geopolitical risk have proven less effective.

As we exit 2025, several factors support risk assets. Earnings growth is accelerating from high single digits to low double digits year-over-year. Policy rates are falling, which is supportive for both bonds and equities. Corporate balance sheets remain strong. These fundamentals underpin current valuations despite stretched multiples. However, we are monitoring economic data carefully and

remain mindful that weakness in manufacturing and consumer spending may worsen in the near term. The next three to six months are expected to deliver uncomfortably slow employment growth. This creates an uncomfortable backdrop for broadening equity participation until clear signs of reacceleration emerge.

Digesting the data – Asset Class Performance

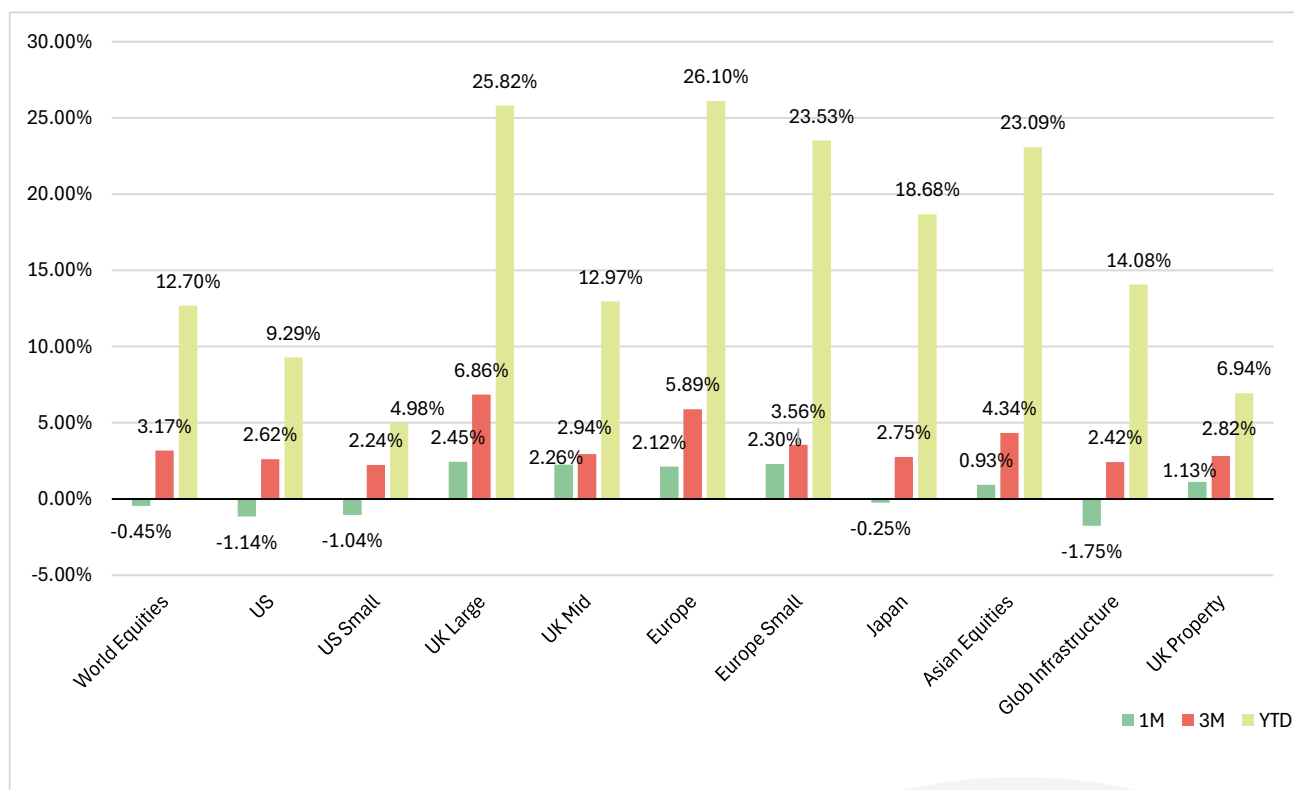
U.S. equities declined 1.14% in December as market leadership rotated from technology mega-caps towards more cyclical industrial and material companies. Small-capitalisation stocks fell 1.04%. Full-year returns reached 9.29%, respectable but trailing international developed markets. Current technical indicators favour large caps over small, suggesting caution about recovery breadth.

UK and European equities delivered December's strongest returns. UK large-caps advanced 2.45%, finishing the year up 25.82%, the strongest performance since the global financial crisis. UK mid-caps rose 2.26%, ending up 12.97%. European indices rose 2.12%, capping a 26.10% gain. Asian equities gained 0.93%, with Korea and Taiwan recovering strongly from November weakness.

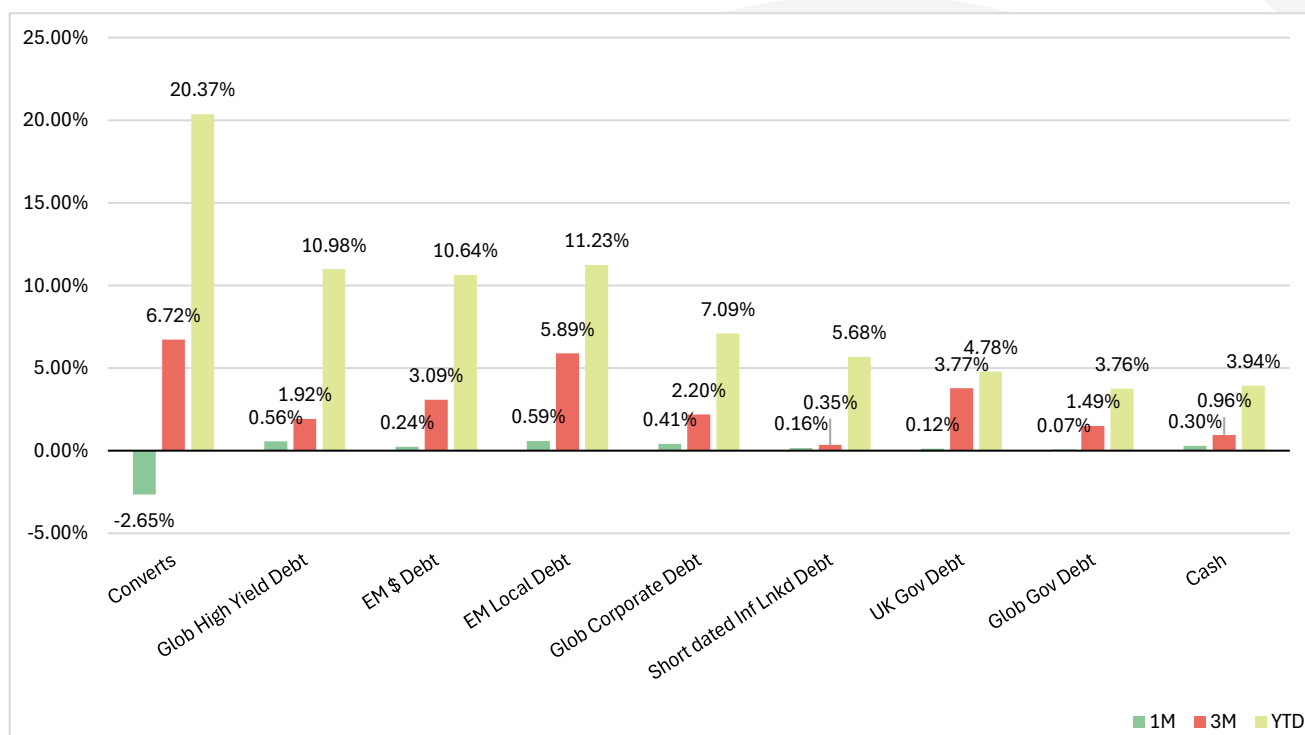
Fixed income showed sector bifurcation. Government bonds posted negative returns as yields rose. Credit sectors outperformed. High-yield debt returned .89%. Tight spreads reflect limited default risk, looser monetary policy, and abundant capital access, but present valuation challenges.



Asset Class Performance: Equities & Alternatives



Asset class performance: Bonds & Cash



Source: Bloomberg, data to 31/12/2025 in GBP

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