

### LEARN FROM THE PAST, PLAN FOR THE FUTURE

#### Introduction and Market Overview

The second quarter of 2025 was marked by heightened volatility, driven by geopolitical uncertainty and shifting trade dynamics, most notably from the United States. Despite considerable noise surrounding tariffs and geopolitical risks, most major asset classes delivered positive returns, buoyed by resilient economic data and solid corporate earnings.

Markets were jolted early in the quarter by President Trump's unexpectedly high announcement of trade tariffs on 2 April, known as "Liberation Day." The move triggered a sharp selloff across equities and bonds. One useful barometer of market anxiety is the VIX index, sometimes called the "fear index," which measures expected stock market volatility over the next 30 days based on options pricing. It briefly spiked above 50 following the announcement, a level not seen since the pandemic. However, investor sentiment recovered quickly after the administration softened its stance, pausing reciprocal tariffs for 90 days and proposing a framework for a deal with China. By quarter-end, developed market equities had rebounded, helped by easing recession fears, with the VIX Index ending the quarter comfortably below its starting point.

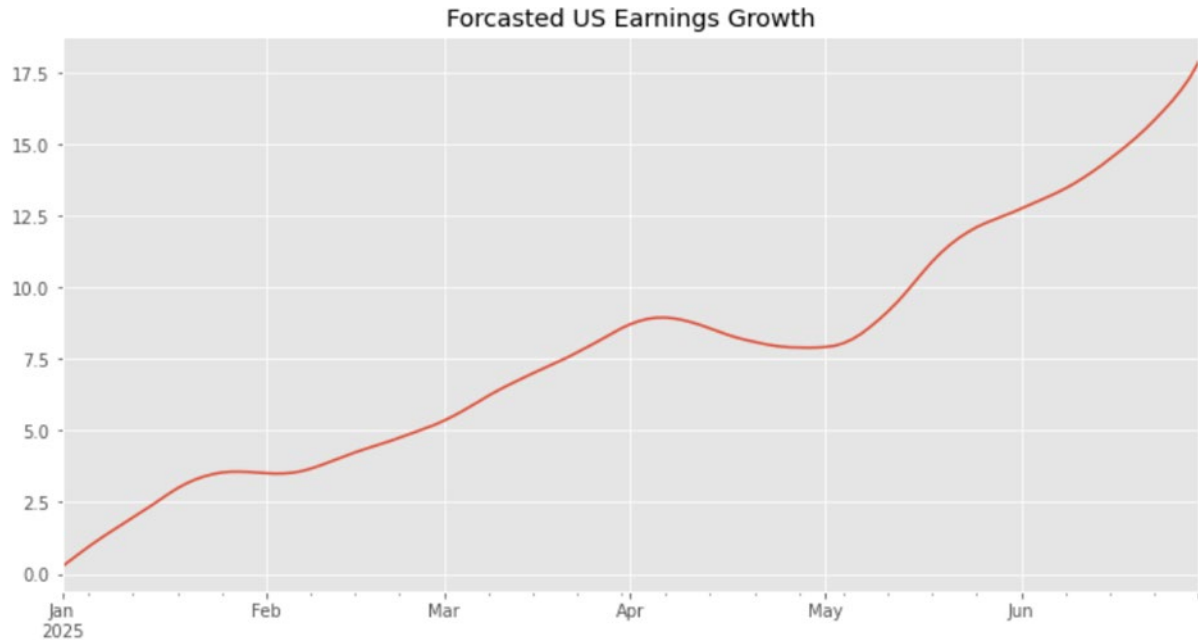
#### Chart of VIX Index



Source: Bloomberg

Confidence was further buoyed by a strong US corporate earnings season, as Q1 earnings growth of 13 percent was well ahead of expectations. While tariff concerns were noted by CEO's, most firms maintained a business-as-usual tone and highlighted continued investment in AI as a long-term strategy to boost productivity. The 'Magnificent 7' tech stocks, which had lagged in Q1, outperformed in Q2 despite their high valuations.

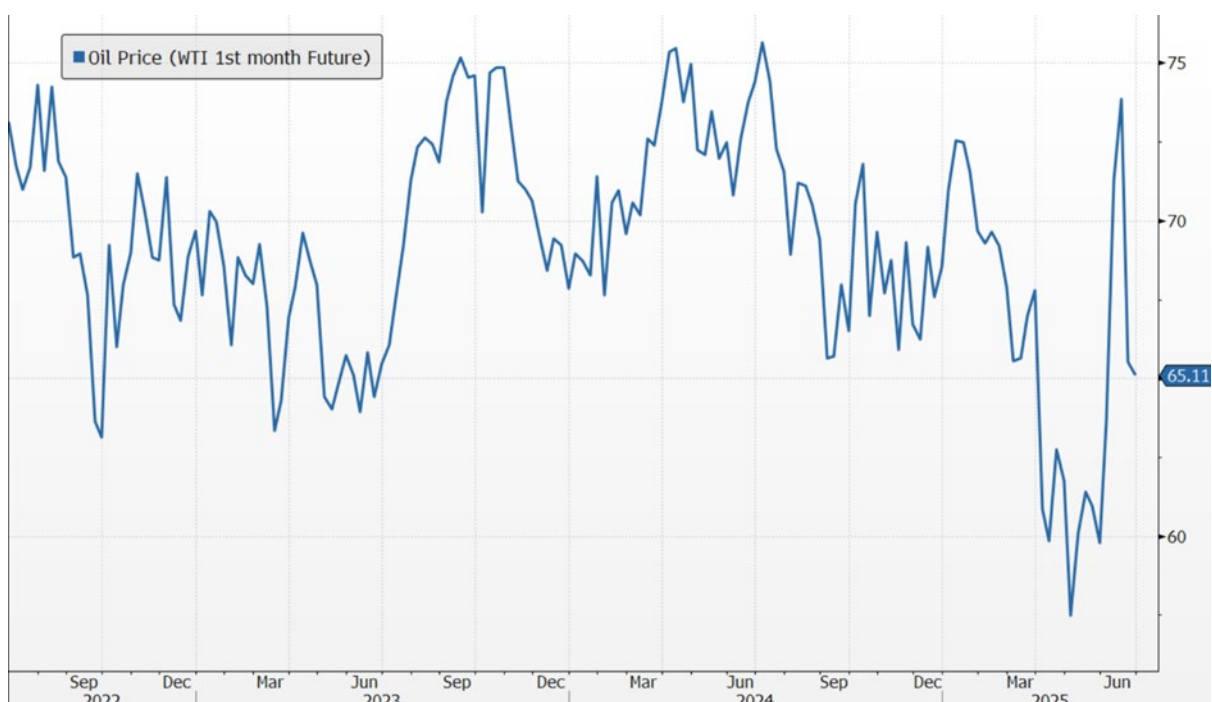
### US Corporate Earnings Growth



Source: Bloomberg

The long-expected conflict between Iran and Israel caused a brief spike in geopolitical tensions, but the market impact was limited. Oil prices initially rose but resumed their previous downward trend as Saudi Arabia increased production. By the end of the quarter, prices were well below April highs, contributing to easing inflationary pressures.

### WTI Crude oil price over past three years



Source: Bloomberg

Currency movements were also notable. The US dollar weakened by 5.9 percent against Sterling over the quarter, acting as a headwind for UK-based investors with US exposure. Meanwhile, emerging markets and Asia benefited from the softer dollar and easing trade tensions.

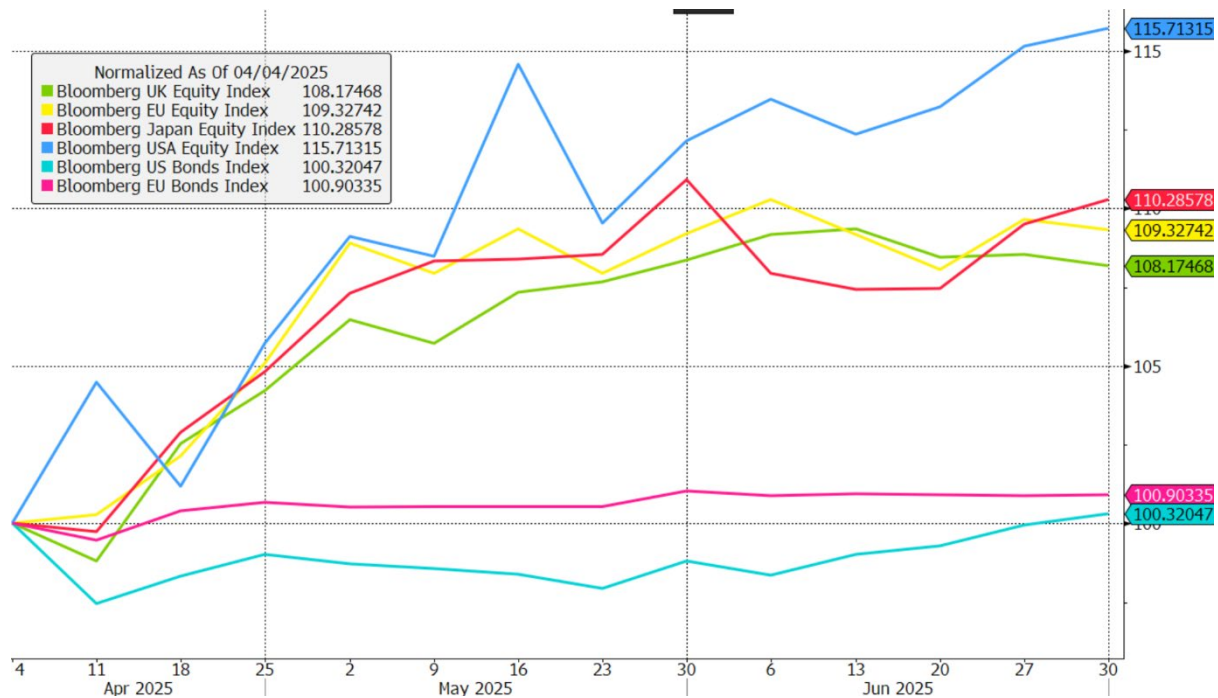
### UK GDP Growth (% YOY)



Source: Bloomberg

European equities continued to perform well, helped by inflows from investors seeking to diversify away from the US. UK equities lagged, held back by weakness in the energy and healthcare sectors, with the former hit by the falling oil price and the latter by the Trump administration's determination to lower drug prices. UK mid-cap stocks, with less exposure to these sectors and the weakening dollar, delivered solid gains.

### Major Markets Total Return in Q2 2025 (% rebased to 100)



Source: Bloomberg

In the US, GDP reported during Q2 showed a 0.5 percent fall in Q1 due to higher imports, likely driven by tariff concerns. The Federal Reserve held interest rates steady, resisting pressure to cut from the White House. In contrast, the Bank of England did cut rates to 4.25 percent, despite UK inflation remaining sticky, with the May CPI reading coming in at 3.4 percent. The rate cut supported UK government bond performance, with the 10-year gilt yield falling 20 basis points, to end the quarter at 4.5 percent.

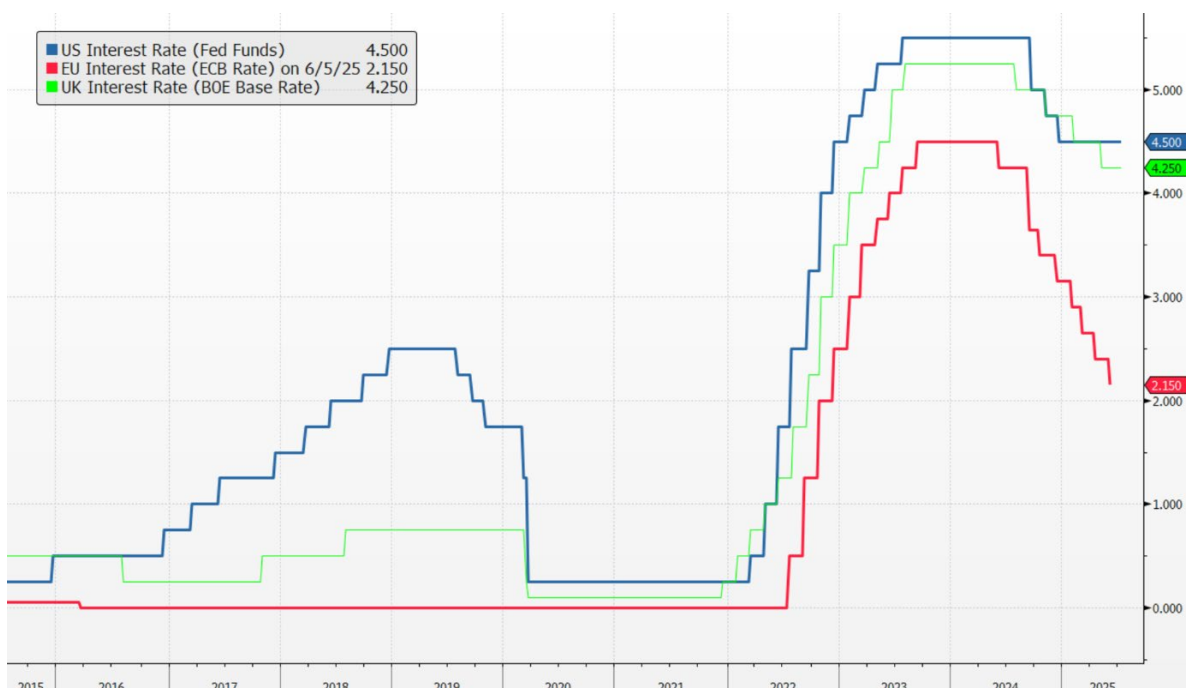
### UK CPI Inflation (% YOY)



Source: Bloomberg

The European Central Bank took a more dovish approach, cutting interest rates twice and outlining expanded fiscal plans to stimulate growth. Germany, in particular, showed signs of pivoting toward a more supportive fiscal stance.

### Major Central Bank Interest rates (%)



Source: Bloomberg

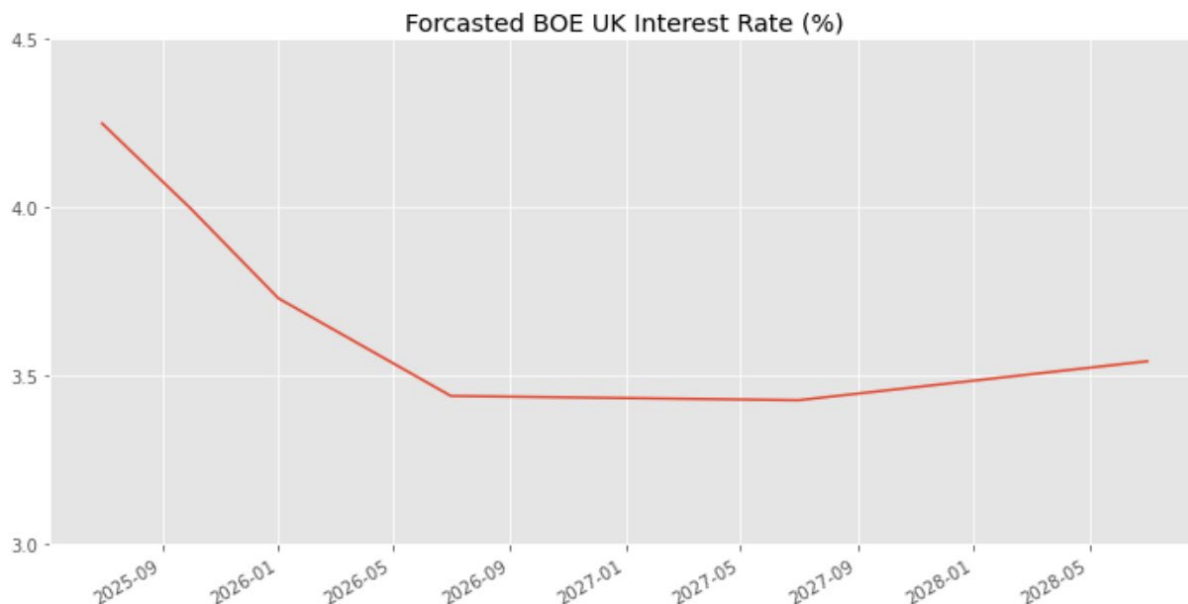
Late in the quarter, investor focus began shifting from monetary to fiscal policy, as President Trump's expansive tax and spending package, dubbed the "One Big Beautiful Bill", raised fresh questions about US debt sustainability. If passed, the bill is expected to add \$3-5 trillion to the US national debt, likely putting further downward pressure on US bond prices and the dollar. With the US fiscal risk deemed to be building, credit rating agency Moody's responded by downgrading the US sovereign credit rating.

### Looking Ahead to Q3 and Beyond

Global growth remains positive but has slowed, with 2025 and 2026 forecasts revised slightly lower, with trade tensions and policy uncertainty weighing on business investment and consumer confidence. Inflation remains sticky in most regions, hovering around 2.5 to 3 percent, though Europe stands out as it moves closer to the ECB's 2% target. Lower energy prices are helping to ease global inflationary pressures.

Central banks, including the US Federal Reserve, face a difficult balancing act between slowing growth and persistent inflation. Markets are currently pricing in two rate cuts in the US and UK by year-end, which would likely be welcomed by investors, provided they're not triggered by a sharper economic downturn. However, the timing and magnitude of rate cuts are unclear amid mixed data and political pressures.

### Forecast Bank of England Base Rate



Source: Bloomberg



In contrast, US fiscal policy is highly expansionary. Tax cuts and new spending plans are expected to push the budget deficit to 6 to 7 percent of GDP and national debt towards 120 percent. While this should help to support growth in the short term, offsetting weakness in the private sector, it raises longer-term risks for US bond markets and the dollar. Europe is also seeing improving sentiment, particularly as Germany adopts a more active fiscal approach. China is also providing domestic support.

We believe US trade policy will remain the key market driver through the rest of 2025. Despite \$400 billion in annualised tariff revenues, inflation has yet to rise meaningfully and hard economic data has remained relatively stable. We expect the effects of tariffs to become more visible in the second half of the year, as inventories built ahead of tariffs run down. This could potentially weigh on growth. The greater risk may be margin compression if companies absorb higher costs rather than pass them on to consumers. With earnings season approaching, we will be watching closely.

While headlines remain negative, companies continue to invest in productivity and AI, and we see no signs of a downshift. We expect a further pick-up in infrastructure spending in 2026, supported by fiscal policy around the world.

We remain constructive on the outlook for markets. Elevated geopolitical tensions and rising fiscal uncertainty underscore the importance of the global diversification that is embedded in our investment process. Large cash balances still on the sidelines and optimistic investor sentiment may lead to a slow grind higher in risk assets. Against this backdrop, our portfolios remain diversified and resilient, well-positioned for a range of macroeconomic outcomes.