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Market Update

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Q3 2025 Macro

Q3 2025 has been a period of cautious optimism, tempered by clear risks. Disinflation is underway in many places, but sticky components of inflation such as wages, services, and energy have made central banks cautious around rate cuts. Global growth is positive but uneven; labour markets have shown resilience but there are some signs of weakness lately whilst uncertainty over trade, energy, and policy loom large. Global growth is projected at around 3.0% for 2025, with a mild uptick to around 3.1% in 2026 (1). This is an upward revision from earlier in the year, partly driven by heightened economic activity ahead of tariff changes, some easing of trade tensions, and government fiscal stimulus in certain jurisdictions, such as Germany.

- In the U.S., growth has been uneven so far this year. The first quarter saw a contraction, then a strong rebound in the second quarter whilst more modest growth is expected across Q3.
- The euro-area economies are seeing more moderate growth. Labour markets have remained relatively resilient, but weak business/investment sentiment and global trade frictions are weighing on the pace of growth.
- Emerging markets show a mixed picture: some such as India and parts of SE Asia are still growing relatively strongly; whilst others including China (2) are showing signs of slowing in investment, exports, and domestic demand.

Inflation globally is gradually easing, but core inflation which excludes energy, food, services, & wages remains sticky in many places. There's also variation across economies with goods price inflation having come down more sharply; whilst food, housing and services prices have proved more resilient.

- In the U.S., inflation remains above the U.S. Federal Reserve's (Fed's) target. Some recent data suggest inflation is moderating, but pressures from wages and rents continue to keep inflation sticky.
- In the U.K., inflation remains elevated at around 3.8% (3) which is still well above the Bank of England's 2% target. Persistent pressures include energy, food, and household bills.
- In the eurozone, inflation is moderating more visibly, though again the core metrics excluding food and energy are declining more slowly.

Unemployment remains relatively low in many advanced economies, though signs of cooling are more visible. In the U.S., hiring has slowed; job gains in recent months are smaller and job openings have declined (4).

- In the U.K., labour market slack is creeping in, though not yet showing severe weakness. Bank of England commentary suggests concern over whether inflation will fall without worsening labour market conditions much further.
- Consumer sentiment, while recovering in some cases from earlier in the year, remains cautious. High inflation, elevated borrowing costs and general uncertainty in areas such as geopolitics, trade, & energy are restraining consumption growth.

A major theme in Q3 has been uncertainty about how fast central banks will reduce interest rates. Many central banks have held policy rates at or near peak, seeking clearer evidence of inflation maintaining deceleration before cutting.

- The U.S. Federal Reserve made a modest rate cut (25 bps) in mid-September 2025, moving the Federal Funds rate to 4.00-4.25% (5). The Fed's commentary has been emphasising particular concern over labour market softness whilst acknowledging that inflation is not yet under full control.
- The Bank of England has held rates at 4%, citing persistent inflation pressures and uncertainty. It has also decided to slow down quantitative tightening (QT) by reducing the scale of gilt sales in response to bond market volatility.

Trade tensions remain a risk with tariffs, export curbs, global supply chain disruptions or uncertainty over trade agreements weighing on investment and exports especially in economies reliant on international trade.

- Fiscal policy is also mixed. Some countries are promoting growth through investment and stimulus, but many are limited by high debt, budget pressures, or political constraints. In some cases, domestic political instability such as in France, may be weighing on both business confidence and investment.

Sources: (1) World Bank / IMF; (2) Financial Times; (3) Reuters; (4) Philadelphia Fed; (5) Reuters.

Q3 2025 Equity Markets

Global equities continued their positive run heading into and through Q3, building on a strong rebound from earlier in the year, especially after sharp declines in Q1-Q2 triggered by trade/tariff concerns. The strongest performing areas in the third quarter were in Asia including both China and Japan. In terms of investment style, growth led the way whilst smaller companies generally outperformed their larger counterparts.

- Developed markets outside the US and in emerging markets, have generally outperformed. The weakening US dollar has helped this trend in 2025 (1).
- There is significant investor optimism around rate cuts in the US, driven by softening inflation indicators and tentative signs of weakening in the labour market. But central banks including the Fed who cut rates in September have signalled that any further easing in interest rates will be undertaken slowly and cautiously.
- Large caps in the US have rallied sharply off their April lows and delivered solid returns in the third quarter. The strongest returns were to be had from China, Asia and the Emerging Markets in the third quarter aided by a weak dollar, relatively cheap valuations and with greater clarity around US tariffs.
- UK equities had a solid quarter and have had an excellent 2025 so far helped by a considerable number of companies announcing 'buy-backs' and renewed interest in the UK equity market by overseas investors including from the US.

There have been several major themes underpinning equity market performance in Q3:

- The anticipation of rate cuts, especially by the US Federal Reserve has been a powerful tailwind. Markets typically respond well when a central bank seems ready to shift from tightening or holding to easing interest rates (2).
- There has been a degree of rotation in the stock markets with some investors selling down highly valued "growth" or mega-cap stocks particularly in the US and reallocating toward value-oriented sectors, such as financials and into Europe, Asia and the Emerging Markets or into smaller cap names.
- Developed non-US markets including Europe and parts of Asia appear to be benefiting from relatively low valuations and attractive local economic/fiscal policy developments such as those seen in Germany.
- The US dollar which had weakened against other currencies earlier in the year appeared to stabilise in the third quarter thereby helping US equity returns when translated into sterling
- The earlier shock from tariff announcements especially "Liberation Day" in the US in April caused big volatility; and which impacted stock markets so much in the second quarter started to ease in Q3 as some tariffs have been delayed or moderated, which has eased downside risk (3).

Technology and artificial intelligence (AI) related stocks continue to play a starring role globally. Investors are generally betting on these firms generating continued strong revenue/earnings growth, and many of those stocks have led index performance so far this year and have performed well in Q3.

- Other sectors which caught the attention of investors in the third quarter and generally led the global equity markets include consumer discretionary, real estate, energy and financials.

Sources: (1) T Rowe Price; (2) Reuters; (3) Blackrock.

Q3 2025 Fixed Interest Markets

Market participants entered the 3rd quarter wondering whether the conflicting signals between inflation and economic growth would prompt central banks to change their stances on interest rate policy. A big driver of yield curve movement, and general bond performance, were the subtle differences in these regional data points. The following shows these differences over the quarters:

- U.S. Treasury yields occasionally spiked on surprises to inflation, payrolls, and Fed commentary as the decision to ultimately cut rates was finally made on 17th September. However, whilst the 10-year Treasury settled in the low-to-mid 4% range (1), the 2yr Treasury showed more sensitivity to the rate cut leading up to the event. The longer end of the curve, whilst volatile ended the quarter close to where it began.

- In the euro area, central bank communications and domestic fiscal dynamics drove bund moves. The ECB kept policy rates on hold as inflation hovered nearer to target in mid-September, which helped contain volatility in core euro yields, however, let's not forget that the ECB has cut rates 8 times in the past 12 months down to today's 2.15% (2).
- By contrast, the Bank of England's more cautious stance and ongoing quantitative tightening pushed gilt yields higher at points, although later in the quarter the BoE slowed its QT programme reducing gilt market stress, particularly at the longer durations. The BoE has cut rates 3 times this year, bringing rates down to 4% (3), with the last cut made in August. The Monetary Policy Committee is somewhat divided however, with some participants suggesting a further cut should have been made in September. This will keep the gilt market on its toes, especially in light of upcoming parliamentary budgets and the reduction of government debt burdens, and its associated ceiling.

Corporate bonds broadly showed resilience in Q3 as spreads remained relatively contained versus historical periods, reflecting adequate liquidity and continued demand from yield-hungry investors - although pockets of dispersion emerged where issuer fundamentals were weak or sector cyclical risks were high (e.g., some parts of leveraged consumer and retail credit). Investment-grade indices benefitted from stronger coupon income while high-yield produced mixed results tied to growth expectations and oil/commodity swings. Again, higher yielding bond markets continued to outperform.

Emerging-market sovereign and corporate bonds outperformed in countries where policy became demonstrably pro-growth or where local yields were attractive and currency stability held. That said, EM performance was mixed with those nations with sound policy frameworks and foreign currency reserves attracting inflows, while those facing fiscal stress or weak currencies saw outflows and wider spreads.

Source: (1) JP Morgan (2) Statista.com (3) Trading Economics.

Q3 2025 Markets Outlook

What to Expect in 2025 and Beyond

- While equities are likely to deliver solid long term returns overall, we expect increased levels of dispersion and want to ensure that portfolios are suitably diversified. Regions like the UK, Europe and specific emerging markets could outperform. US equities may continue to do well especially growth and tech sectors, assuming rate cuts and inflation easing occur without a hard landing. But increased volatility is expected.
- Fixed Income markets are offering yields which are higher than they've been for many years. Total returns may not be stellar unless inflation comes down and yields fall, but income will likely be meaningful. Credit sectors look better placed to outperform sovereigns in many places but do carry additional risk.
- Interest rates are likely to decline from current peaks, but cuts will be cautious. Governments spending and any upside inflation surprises may force central banks to pause further cuts in interest rates as these developments may prove inflationary.
- There are risks from a few possible downside outcomes including inflation proving more persistent, global recession/sharp growth slowdown, geopolitical shocks, or fiscal crises. But upside surprises could come from faster productivity growth, stronger demand recovery in emerging markets, or technological/structural tailwinds such as AI, or clean energy transitions.
- Global growth is expected to be moderate in 2025. The U.S. economy is forecast to grow around 2.0%, Eurozone lagging behind (roughly 0.8-1.0%), China and some emerging markets somewhat stronger but still below pre-pandemic norms (1).

Overall, we're in an environment where neither equities nor bonds are particularly cheap but there are still selective opportunities. The winds have shifted from a regime of ultra-low interest rates and easy money toward one of more normalised rates, higher carry, and greater sensitivity to inflation and macro risk. As such, we continue in our stance to ensure the portfolios are not overly exposed to any near-term risks that we can foresee.

Sources: (1) JP Morgan.

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