

Hymans Robertson Investment Services (HRIS)

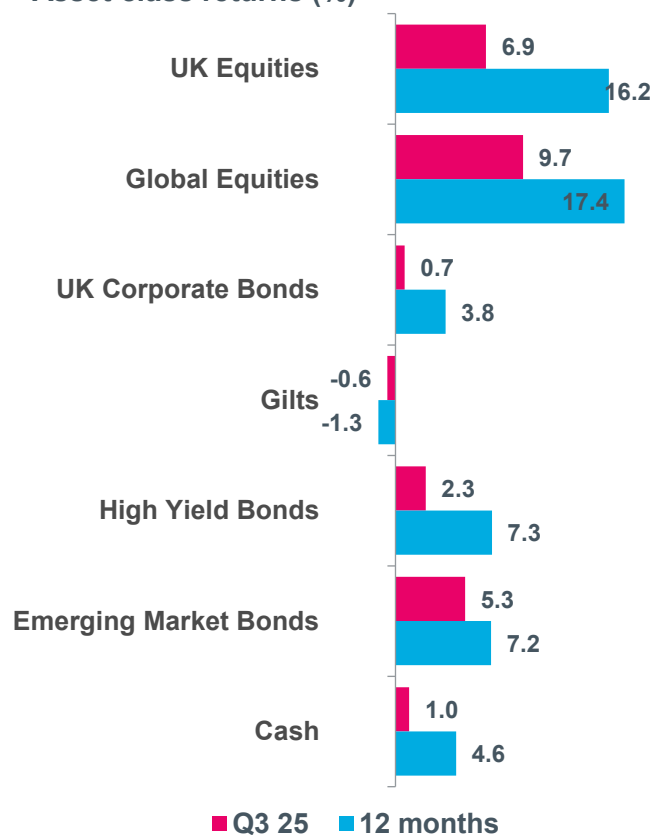
Market digest

Q3 2025

Quarterly highlights

- Q3 was marked by strong market momentum as trade tensions eased and optimism around Artificial Intelligence (“AI”) returned.
- Equities delivered strong returns while bonds were mixed, but mostly positive.
- On page 3 of this document, we provide market commentary to cover the 12 months to 30 September 2025.

Asset class returns (%)



Source: Morningstar. Figures to 30 September 2025. Returns in unhedged sterling terms except high yield bonds which are hedged. EM bonds are 50% local currency denominated, and 50% US dollar denominated bonds.

Market summary

- Our model portfolios typically invest in a combination of the asset classes shown in the left-hand chart.
- Q3 saw strong momentum across markets as trade tensions eased and investor focus shifted back to the AI theme, which continued to drive optimism and incredible levels of capital investment.
- The above created conditions for strong equity performance. Emerging markets (“EM”) ended the quarter as the strongest outperformer, boosted by strong tech-driven Chinese performance. Europe and the UK both lagged the broader market but still posted strong positive absolute returns.
- Both the Bank of England (“BoE”) and Federal Reserve (“Fed”) cut interest rates by 0.25% in Q3, but while the Fed is just restarting its cutting cycle, the BoE appears close to finishing.
- Despite lower interest rates, government bond yields remained high as concerns over expansive fiscal policy and central bank independence held back performance (bond prices fall as yields rise).
- Corporate and EM bonds fared better with strong outperformance over government bonds.
- With equities outperforming bonds in Q3, higher risk portfolios typically performed better than lower risk portfolios, over the period.

Outlook and topical market themes

- The economic outlook has improved with easing trade tensions and strong earnings, however, labour market weakness hangs over economic forecasts. Equities remain expensive, but bond yields offer more attractive value.
- A combination of weaker tax revenue, spending cut U-turns, lower economic growth forecasted, and higher bond yields have conspired to leave the Chancellor with a large fiscal black hole ahead of this Autumn's Budget.

Market outlook: AI drives growth while fiscal credibility weighs on bonds

A serious, tariff-induced, global downturn now looks to have been avoided, prompting upgrades to global growth forecasts. However, the inflationary impact on the US is still uncertain and remains a risk, especially as early signs of a slowing labour market have put the Federal Reserve in a difficult position. Strong corporate earnings have provided a platform for equity performance with a recent Fed cut providing an extra boost.

This rally has made equities look expensive relative to history, although, outside of US tech, valuations are less stretched. The incredible levels of capital investment from AI companies have powered both economic growth and corporate earnings. While much of this investment is still funded by cash flow, some AI firms are now issuing debt to keep up, adding risk (given the market's heavy tilt towards these firms). Bonds continue to offer attractive yields versus recent history, but each government bond market faces challenges. Fiscal credibility concerns affect most regions. Meanwhile central bank independence in the US, sticky inflation in the UK and political turmoil in France all highlight the importance of a globally diversified approach.

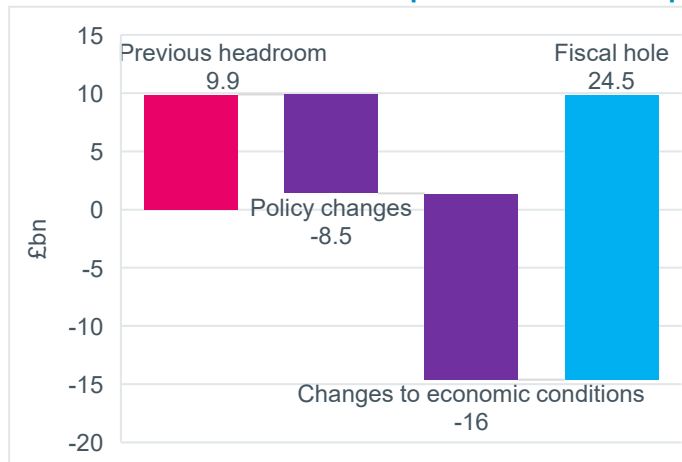
Chancellor faces tough choices to calm bond markets

Much speculation surrounds the Chancellor's upcoming November Budget. The elevated scrutiny is a consequence of the razor-thin £9.9bn headroom against her previously set fiscal rules. Pantheon Macroeconomics now estimates this headroom has swung to a near £15bn deficit, meaning almost £25bn must be found to replenish the buffer. This shortfall is partly due to government decisions, such as watering down welfare reforms and reversing winter fuel payment cuts. However, economic and market conditions have also exacerbated the situation. Tax revenues have disappointed, gilt yields have risen (increasing borrowing costs), and there is speculation the Office for Budget Responsibility ("OBR") may downgrade its economic growth forecast. All of these pressures make it harder for the Chancellor to meet her fiscal rules, likely forcing new tax rises or spending cuts.

This predicament is concerning for gilt investors. Long-dated gilt yields have been rising for several years, even as the Bank of England cuts interest rates, reflecting waning demand for gilts and doubts about fiscal credibility. While current gilt yields are attractive, we continue to favour a globally diversified exposure to government bond to guard against idiosyncratic events.

Chart of the month

Chancellor's headroom has evaporated due to both policy decisions and economic conditions



Source: Pantheon Macroeconomics

The chart shows how the Chancellor's fiscal headroom of £9.9bn at the Spring Statement has been eroded.

Policy changes (-£8.5bn) include the reversal of the winter fuel payment cuts (-£1.7bn), watered-down benefit reforms (-£3.4bn), and the anticipated removal of the two-child benefit cap (£-3.4bn). While this final policy has not yet been announced it has been strongly hinted at.

Weaker economic conditions (-£16bn) includes higher interest costs (-£2.5bn), lower tax receipts (-£6.6bn), and slower growth (-£6.9bn).



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Annual market summary: covering the 12 months to 30 September 2025

The start of the period focused on the re-election of Donald Trump. A close election result was expected, but what we got was an emphatic victory for Trump. Markets quickly pivoted towards 'Trump trades' reflecting the expected winners and losers from Trump's expected policy agenda.

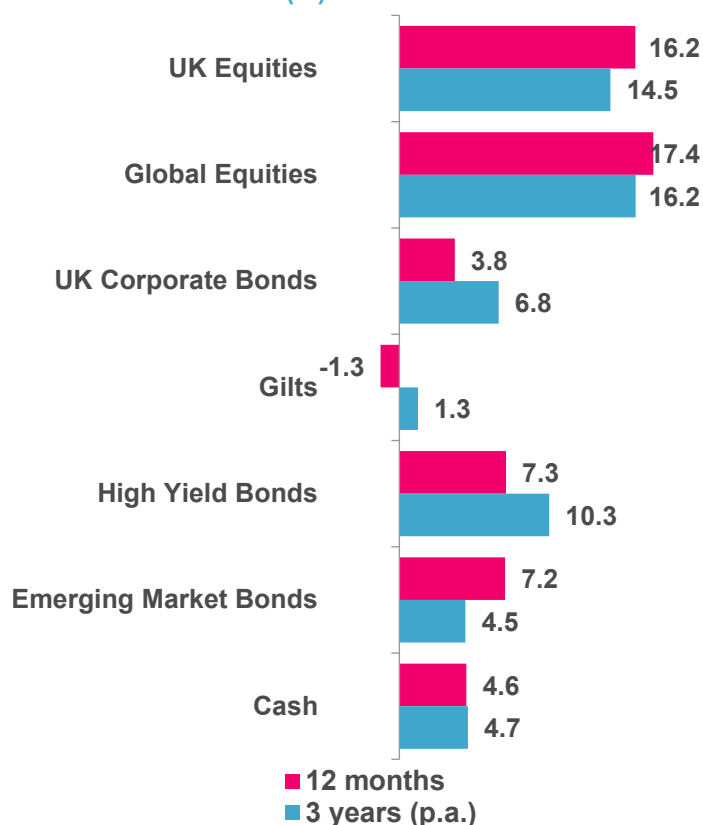
However, investors' early enthusiasm for President Trump's policy agenda started to wane in early 2025, and then completely evaporated, as Trump prioritised implementing heavy tariffs on trade partners. "Liberation Day" at the start of April further disrupted markets with no economy seemingly safe from Trump's tariffs. Markets recovered quickly following a postponement of the announced tariffs and indications of positive trade talks, but volatility persisted. This recovery continued over the third quarter of 2025 as better-than-expected corporate earnings, strong performance in the technology sector and the Federal Reserve resuming interest rate cuts increased investor confidence.

Central banks continued their path towards lower interest rates. The Bank of England cut by 1% over the period to 4%. However, expectations of further cuts this year were lowered as inflation approached 4%. In September 2025 the Federal Reserve resumed rate cutting, cutting rates by 0.25%. This was the first cut since December 2024 and marks a 0.75% reduction over the period to 4.25%. Investors are expecting additional rate cuts in the US this year as early signs of a weakening labour market appear.

Overall, the 12 months to September 2025 were positive for equity performance, despite the tariff driven volatility. The US equity market ended the period as the top performing region, recovering from the falls seen earlier this year.

Bond performance was mixed across the different markets. Government bonds struggled, as investors remain concerned over government debt levels and the ability of the Federal Reserve to manage inflation while under pressure from Trump to cut interest rates further. Corporate bonds outperformed government bonds over the period, supported by strong earnings growth. High yield bonds delivered even stronger 12 month returns as credit spreads fell over the period (bond prices rise as spreads fall) and emerging market bonds benefitted from a weakening of the US dollar.

Asset class returns (%)



Source: Morningstar. Figures to 30 September 2025. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Risk warning

The value of your investments and the income from them may go down as well as up and neither is guaranteed. Investors could get back less than they invested. Past performance is not a reliable indicator of future results. Changes in exchange rates may have an adverse effect on the value of an investment. Changes in interest rates may also impact the value of fixed income investments. The value of your investment may be impacted if the issuers of underlying fixed income holdings default, or market perceptions of their credit risk change. There are additional risks associated with investments in emerging or developing markets. The information in this document does not constitute advice, nor a recommendation, and investment decisions should not be made on the basis of it. The material provided should not be released or otherwise disclosed to any third party without prior consent from HRIS.