

### Introduction

Global equities posted strong gains in the second quarter of 2025, rebounding from early volatility triggered by President Trump's sweeping "Liberation Day" tariffs. Markets recovered as most tariffs were temporarily suspended, allowing trade negotiations to proceed ahead of the deadline on 9<sup>th</sup> of July.

US equities led the gains, driven by renewed enthusiasm for AI-linked stocks and robust Quarter 1 earnings. Eurozone and UK shares also advanced, supported by interest rate cuts and sector-specific strength.

Japan performed strongly amid corporate reforms and easing trade tensions. Emerging markets outpaced developed peers, buoyed by a weaker US dollar and optimism in Korea, Taiwan and Brazil.

Bond markets reflected a shift in focus from monetary to fiscal policy, leading to a rise in long-term interest rates compared to short-term ones as investors grew more concerned about future government debt and inflation. Commodities performance was mixed, with oil remaining subdued due to oversupply and precious metals benefiting from investors seeking "safe haven" assets.

### Markets

The quarter was dynamic and eventful, shaped by a series of geopolitical and macroeconomic developments that stirred volatility across global markets.

Key events included the announcement of sweeping US trade tariffs, escalating tensions between Israel and Iran, and subtle but notable criticism of Federal Reserve Chair Jerome Powell's policy stance by President Trump.

Despite these headwinds, both equity and bond markets delivered strong positive returns, supported by resilient corporate earnings, easing inflation in key regions, and a temporary pause in tariff escalation that helped restore investor confidence.

### US

The US equity market ended the quarter on a strong note, despite increased volatility. Notably, the S&P 500 posted its strongest quarterly performance since the third quarter of 2023, returning 10.94% in USD terms but a more modest 4.39% in GBP terms.

Despite strong pressure from President Trump, the Federal Reserve maintained interest rates, adopting a wait-and-see approach as it weighed the impacts of trade policy against the underlying strength of the economy. There has been a noticeable policy shift, now showing greater caution around potential rate cuts.

Meanwhile, bond markets faced two adverse events: the introduction of a new tax bill in Congress and a US credit rating downgrade. Despite these developments, US Treasuries ended the quarter in positive territory.

### UK

UK equities posted solid gains, with both the FTSE All-Share and FTSE 100 indices advancing. The FTSE 250 mid-cap index outperformed the FTSE 100, reflecting stronger domestic momentum and less exposure to underperforming global sectors such as energy and healthcare.

The quarter saw a surge in diplomatic activity. The UK signed trade agreements with both India and the United States. While the deal with India was modest in scale, it underscored the UK's global trade ambitions. The US agreement was more impactful, easing some restrictions introduced by the Trump administration. Additionally, a new framework was established with the EU, covering key sectors such as fisheries, defence and funding access.

The Bank of England continued its monetary easing, cutting interest rates by 0.25% to 4.25% in May, as inflation remained elevated at 3.4%. Despite inflationary pressures, the UK economy demonstrated resilience, and equities benefited from global exposure—particularly in value-oriented sectors like financials and resources.

### Europe

Continental European equities extended their year-to-date gains in the quarter, with the MSCI Europe ex UK Index rising 4.09% in GBP terms. Investor sentiment was buoyed by progress in global trade negotiations and increased government spending plans, particularly in Germany. However, fiscal constraints in other major European economies and ongoing risks from US tariffs and Chinese competition continued to pose challenges.

Sector performance was mixed. Industrials and real estate led the advance, with defence stocks gaining from a NATO agreement to boost military spending. In contrast, consumer discretionary, healthcare, and energy sectors underperformed.

The European Central Bank (ECB) cut interest rates by 0.25% twice during the quarter, bringing the main policy rate to 2.0%. Inflation reduced to 1.9% in May, down from 2.2% in April, moving closer to

the ECB's target. ECB President Christine Lagarde signalled that the rate-cutting cycle is likely nearing its end.

In USD terms, European equities delivered a strong 12.7% return, aided by the weakening dollar, making the region attractive for global investors seeking diversification.

### Japan

Japanese equities posted strong gains in the quarter, with the TOPIX rising 7.5%, driven by renewed interest in growth stocks and easing global trade tensions. Sentiment improved as trade talks with China progressed, easing recession concerns. Domestically, bond markets experienced volatility due to weak demand for long-dated debt and uncertainty over issuance strategy. Stability returned after authorities reduced long-term bond supply.

Corporate fundamentals supported equities, with many firms increasing shareholder returns through dividends and buybacks, reflecting ongoing governance reforms. While earnings guidance remained cautious, efforts to improve return on equity were well received. Structural challenges persist, but the Tokyo Stock Exchange's focus on financial discipline and the return of inflation have improved the long-term outlook.

### Asia & Emerging Markets

Asian equities delivered strong gains, with the MSCI Asia ex Japan Index rising 4.39% in GBP terms, making it the top-performing region. Easing US-China trade tensions and

a weaker US dollar supported both equity and currency markets. Taiwan and Korea led returns, buoyed by strong tech sentiment and currency appreciation.

However, risks remain. China's reluctance to pursue aggressive infrastructure stimulus—despite pledges of increased spending—dampened export prospects for regional economies. Many emerging Asian markets remain vulnerable to US dollar volatility due to their external debt exposure. While trade negotiations remain a source of uncertainty, more supportive domestic and monetary policies across Asia are expected to help cushion the impact.

### Fixed Income

The quarter was turbulent for global bond markets, driven by rising geopolitical tensions, US fiscal concerns, and shifting monetary policy dynamics. US tariffs initially sparked recession fears, but sentiment improved as the US adopted a more conciliatory stance. Attention soon turned to debt sustainability following the passage of the "Big Beautiful Bill," prompting Moody's to downgrade the US credit rating.

Yields rose sharply, particularly in long-dated US and Japanese bonds—with the latter hitting a record 3.2%. Yield curves steepened upwards across major markets. Despite volatility, credit markets proved resilient: investment-grade bonds became more attractive to investors again, and riskier, high-yield bonds outperformed. A weakening US dollar helped to stabilise broader fixed income performance.

### Outlook

While downside risks have eased considerably, primary concern has shifted toward the possibility of persistently low growth alongside elevated inflation. Despite more attractive valuations, the growing volume of debt issuance is straining market absorption.

The geopolitical environment remains volatile but is not currently viewed as a destabilising force in the short to medium term. Market reactions may be sharp, but underlying fundamentals remain intact.

### Glossary

**GBP:** Pound sterling.

**Federal Reserve (Fed):** Central bank of the United States.

**GDP:** The total monetary or market value of all the finished goods and services produced within a country.

**Tariff:** A tax imposed by one country on imported goods and services from another.

**S&P 500:** A stock market trading index that tracks the performance of 500 leading companies listed on the US stock exchange.

**MSCI Indexes:** Stock indexes that track the performance of the stocks included in them. Often additional context is added in e.g. MSCI Europe ex-UK index covers Europe but excludes the UK.

**European Central Bank (ECB):** The central bank for the euro. Its main task is to maintain the euro's purchasing power.

**TOPIX:** The Tokyo Stock Price Index is an important stock market index for the Tokyo Stock Exchange.

**FTSE 100:** UK stock index. The FTSE 100 tracks large-cap companies.



# Market Update

Quarter 2, 2025

**FTSE 250:** UK stock index. The FTSE 250 tracks mid-cap companies.