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# Investment Committee Series

Q1 Outlook - March 2025

Q1



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# 01

## Introduction

Equities performed well in 2024 on the back of resilient global growth. This stronger backdrop challenged bond returns, however. The US powered global growth, with the US consumer having another bumper year. A solid labour market, strong household balance sheets, and fiscal largesse led to above-trend GDP growth. Lower manufacturing activity dampened growth across the rest of the world. Trade uncertainty and non-tech goods production continue to constrain the sector.

The European economy grew modestly; low productivity, higher energy prices and weaker global manufacturing were challenges in 2024. However, at the end of 2024 European consumer spending picked up, with lower interest rates and lower inflation supporting consumer confidence. The UK experienced similarly modest growth. The Chinese economy was below historic growth rates in the first half of the year, but fiscal stimulus supported strong growth in the second half.

Global inflation fell in 2024, albeit at a gradual pace. Services inflation, led by strong wage growth, remained the key driver of inflation, remaining above target in many economies. UK is a case in point, despite goods inflation only rising 0.7%, the rise in core services inflation (4.4%) has meant core inflation remains well above target at 4.2%. US Core Consumer Price Index (CPI) has now been above target for three and a half years. Recent data reveal promising trends in the stickier parts of US Core CPI, however, there is potential risk for rising inflation expectations from Trump's fiscal policies.

Into 2025, we think domestic growth factors will lead to more divergent inflation profiles across the globe. And this is likely to lead to more divergent monetary policy, in contrast to 2024, where we saw an extremely synchronised interest rate cutting cycle. The number of central banks cutting rates last year was similar to levels seen in the pandemic.

**Eren Osman**  
Managing Director,  
Wealth Management



# 02

## Decisions we made

Over the past quarter we have made four key changes to our portfolios. We have:

- Increased our allocation of high-quality corporate bonds
- Shifted money to US stocks within our equity holdings
- Increased our exposure to property
- Reduced our positions in copper and oil

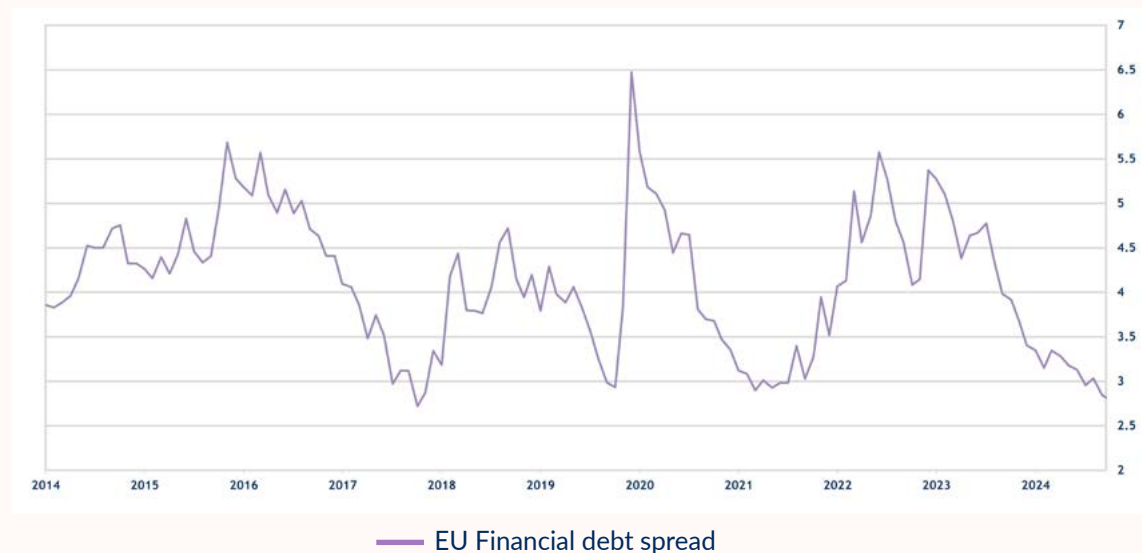
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We decided to decrease our UK equity allocation due to weak economic growth and the deterioration of sentiment among domestic companies since the tax increases announced in the Budget.”

**Peter Doherty**  
Director, Head of Investment Research



### Additional compensation of European debt over government bonds is unattractive



Source: Bloomberg

### Within Global Corporate Bonds we increased credit quality and duration

The strong global growth outlook has led to a significant rise in bond yields. With US 10-year bond yields above 4.5% and modest rate cut expectations for 2025, we think bond valuations are attractive. And expected progress on disinflation could cap the upside risks to bond yields. More promising trends in US shelter inflation and wage growth, which have been the more persistent components of US inflation are encouraging. Falling inflation, coupled with attractive valuations, has led us to increase sensitivity to interest rates in our portfolios. Our preferred position is to increase exposure to high-quality corporate debt for its attractive yield.

Additionally, we have reduced our allocation to European financial debt due to less attractive valuations, with spreads (see chart above) - the additional compensation you gain above government bonds - nearing all-time lows. We have also added Brazilian bonds to our portfolio, as we see an attractive opportunity given the yields above 15% and the real is an extremely undervalued currency.

## Flat manufacturing data points to weak outlook for EU small companies



Source: Bloomberg

**We have maintained our overall allocation to equities, but reduced our exposure to Europe, UK and Asian Emerging Markets, and rotated to US**

**We have maintained our overall weight in global equities, though we reallocated capital to the US, given the country's continued growth exceptionalism and pro-US Trump policies expected to benefit domestic companies. To capitalise on this trend, we have added to an existing US smaller companies fund that has allocations to underlying companies with significant domestic revenue exposure. This manager has also increased their industrials allocation to benefit from Trump's policies.**

To fund the increase in the US allocation, we have reduced our exposure to Europe, the UK, and Asia ex-Japan. We decided to decrease our UK allocation due to weak economic growth and the deterioration of sentiment among domestic companies since the tax increases announced in the Budget. In Europe, we exited our small company allocation due to the weak growth outlook, further evidenced by a lack of improvement in manufacturing data. Above, we show their performance relative to manufacturing activity, which has been rangebound since 2023.

Lastly, we reduced our Asia ex-Japan exposure, taking profits from this position after it performed strongly due to robust growth in the tech industry driven by semiconductor demand.

We have maintained our exposure to Japan as the economy experienced resilient growth, supported by an uptick in domestic consumption and investment, despite global demand headwinds. We rotated capital from one of our active growth managers into the index because we identified a drift in the manager's style, causing us to question adherence to their process.

**Increased our allocation to property**

We have increased our property allocation based on the rationale that when interest rates decline, global property tends to do well in this environment. Additionally, the fundamentals of the property sector appear robust. Rental growth is proving to be strong. This, combined with an attractive yield, should remain supportive of the asset class.

**Maintained our allocation to hedge funds**

We have maintained our weighting to hedge funds as they continue to provide diversification for our portfolios, with good overall performance above cash.

**Reduced our allocation to copper and oil**

Both of our commodity positions have performed well, prompting us to exit the positions and realise the gains. We remain structurally bullish on copper, although some of the key drivers have been delayed. Regarding oil, we have observed a recent rise in Brent prices, but we expect oil to continue trading within a range due to supply dynamics posing headwinds for oil prices.

# 03

## What does the future hold for investors?

We expect US growth to remain resilient, but we continue to monitor Trump's policies, which are expected to shape the outlook for growth and inflation. Overall, we anticipate that supply shocks from restricting immigration and raising tariffs could be offset by pro-growth policies and deregulation. Strong labour markets and increasing incomes are expected to continue supporting consumers.

Outside the US, Chinese and European growth is expected to be impacted by tariff threats. A potential trade war highlights the importance of fiscal stimulus for China. In December, China's leaders announced stimulus measures that point to a more proactive fiscal policy. However, bond yields remain at low levels, indicating that we should not expect growth fireworks in the next few quarters.

In Europe, there is limited prospect of significant near-term fiscal stimulus and the region is struggling with industrial headwinds and a lack of competitiveness. This leaves the European Central Bank with rate cuts as its main tool to encourage growth.

The market anticipates higher inflation, especially in the US. However, recent data reveal promising trends in the stickier parts of the US Core CPI, such as a decline in shelter inflation to the lowest level since March 2022. While Trump's policies are generally seen as inflationary, one of his main priorities is to bring inflation down, which might lead him to moderate some policies. Nevertheless, if fiscal largesse continues, it will likely mean that the Fed will maintain a higher-for-longer stance and potentially create a dilemma as some central banks cut rates while the Fed pauses, leading to potential currency weakness in comparison to USD.





# 04

## Around the world

### **South Korea**

South Korea's President Yoon Suk Yeol declared martial law in December, an unprecedented move since the country became a democracy in 1987. Yoon claimed it was to protect the country from "anti-state" forces, but it likely stemmed from his own scandals. Opposition lawmakers quickly filed a motion to impeach Yoon, succeeding on their second attempt. Yoon was suspended from office and is now awaiting a decision from the Constitutional Court, expected in February.

### **Canada**

Canada's Prime Minister Trudeau resigned after pressure from his political party due to his unpopularity among Canadian voters. Trudeau will remain in power until the next election on 24 March.

### **Germany**

The German government collapsed in November due to a budget dispute, resulting in Chancellor Olaf Scholz losing a vote of confidence. Elections took place on 23 February. The economy played a crucial role, given the recent weak economic performance. Immigration policies were also a critical issue for voters.

### **China**

The annual Chinese Central Economic Work Conference provided guidance on growth objectives for the year. The key tasks for 2025 include efforts to vigorously boost consumption, improve investment efficiency, and expand domestic demand on all fronts.

# 05

## How global politics could shape markets

2024 was the year of elections, with around 50% of the global population heading to the polls. In 2025, we're on policy-watch. As world leaders take office with mandates to govern, we'll start to see their policies in action.

We will also see the first full calendar year under Kier Starmer's administration here in the UK.

### United States

Trump has a narrow majority in both chambers of congress. While it is true that President Trump is a known entity, there are a few distinctions between his first and second term.

In 2016, his victory caught many by surprise. This time around, Trump has no such re-election concern, and he comes to office significantly more prepared, both for what being president entails but also for how to get things done. He will want to leave an indelible mark on history for his second term, ensuring that nobody forgets he was there.

### What are we watching?

- **Tariffs:** One of President Trump's key campaign promises was to implement a flat tariff on all imports to the USA. If enacted, there are two things to consider: inflation and global growth.
- **Fiscal spend:** Trump's campaign promises are firmly on the side of spending, rather than fiscal prudence. The US fiscal deficit is already at a historically high level, with the debt ceiling needing to be debated and a raise agreed by congress each year. Trump's spending plans mean that we're anticipating high levels of US government debt issuance throughout the next four years, which will impact global bond markets.

### United Kingdom

Following Labour's landslide victory in 2024, Kier Starmer's majority is such that he can remain comfortably in power until 2029. 2024 saw the first Labour Budget, bringing in tax rises and spending cuts. Importantly, Chancellor Rachel Reeves also announced Labour's new fiscal rule, which is that the forecast for public debt should be falling, relative to the size of the UK economy. Since the start of the year, we've seen gilt yields rise globally, which has put this new rule under pressure; rising gilt yields increase the cost of borrowing for the government.

### What are we watching?

- **Budgets:** Eyes remain firmly on Chancellor Reeves and her upcoming spring statement; it's possible that to keep to her self-enforced rules, we will see further fiscal tightening. This means more spending cuts or tax rises.
- **Currency:** Sterling was one of the strongest performing currencies throughout 2024 and, while we have seen some weakness since the start of 2025, there is potential for more steps backwards yet.
- **Rate cuts:** With UK inflation coming in marginally below expectations in January, which influenced a Bank of England rate cut in February. We anticipate rates coming down over 2025, which will ease conditions and may help to boost businesses that have been hit by budget changes coming into effect in April (higher National Insurance, higher rates, higher minimum wage).

### Europe

2024 was a year of turmoil for European politics, with the two biggest players in the bloc, Germany and France, experiencing a breakdown in their respective governments. European economic growth has also been faltering, with many sectors being hit by low and slowing demand from China in recent years.

### What are we watching?

- **International trade:** As an open economy, with high exports of goods and services, Europe could be hurt by the tariffs that Trump is promising. Some of this, we think, has already been priced in with European markets remaining relatively weak through the end of 2024.
- **Rates:** It is expected that the European Central Bank (ECB) will continue to ease monetary policy in 2025 with further rate cuts. The perennial problem remains that the ECB needs to balance the needs of all its constituents, which all face different economic conditions.

### China

The last few months of 2024 saw the Chinese government announce significant stimulus measures to try to boost the economy's lagging growth. The measures focused on equity and property markets in the first instance, with policymakers also committing to improving domestic demand.

### What are we watching?

- The response to 2024's stimulus measures has, so far, been somewhat subdued. Chinese policymakers have historically done whatever it takes to support the domestic economy and we may see further stimulus measures announced in the coming 12 months.
- If we do see Chinese demand pick up again, it's likely that China's trade partners (including Europe) will benefit. The other side of this coin is that Trump's promised tariffs could dampen the globally significant supply side of the economy. The prospect of a renewed trade war is a major headwind for Chinese growth in 2025.

### Managing opportunities and risks

At Arbutnot Latham, one of the key pillars to our investment philosophy is Active Management. We are continuously reviewing the global landscape to identify areas that may either provide opportunities for client portfolios, or which we may need to protect against.

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