HYMANS ROBERTSON

Monthly Market Brief

February 2025

FEBRUARY HIGHLIGHTS

- The US Composite Purchasing Managers' Index (PMI) suggests the pace of US growth slowed sharply as service-sector activity contracted for the first time in two years. According to respondents, uncertainty, federal spending cuts and the potential negative impact from tariffs on growth and inflation all affected output and business optimism.
- Meanwhile, surveys indicate that the recovery in US and global manufacturing activity quickened in February. But the data suggest that the rise in output and new orders is at least partly due to businesses trying to increase their inventories ahead of tariff-induced price rises and supply disruptions.
- Data released in February showed that headline CPI inflation rose for the fourth consecutive month in January: to 3.0% in the UK and US, and 2.5% in the eurozone. Core inflation, which excludes volatile energy and food prices, rose to 3.8% and 3.3% in the UK and US, respectively, and stayed at 2.7% in the eurozone.
- Despite inflationary pressures, the Bank of England (BoE) cut interest rates by 0.25% pa, to 4.5% pa. Policymakers expect inflation to rise temporarily in 2025 before falling back to the 2% target. US interest-rate expectations fell in February as markets shifted their focus to weaker growth data.
- As a result, the US led sovereign bond yields lower in February. Global credit spreads rose slightly but remain near historic lows, suggesting that markets expect growth to slow rather than collapse.
- Global equities fell 0.8% as investors weighed up slowing US growth, stubborn inflation and concerns over US trade policy. Japanese and North American stocks underperformed, while European stocks extended their strong year-to-date gains. Value outperformed growth stocks, as technology companies continued to underperform.
- The trade-weighted yen rose around 3% as persistent domestic inflation pressures and rising wages fuelled expectations that the Bank of Japan (BoJ) will continue normalising monetary policy.

Market performance to end February 2025

UK	Feb 25	Jan 25	Q1 25
EQUITIES	1.3	5.5	6.9
BONDS			
Conventional gilts	0.8	0.8	1.6
Index-linked gilts	-0.6	1.3	0.7
Credit	0.5	1.1	1.6
PROPERTY**	n/a	0.6	0.6
STERLING			
v US dollar	1.3	-0.8	0.5
v euro	1.3	-1.2	0.1
v Japanese yen	-1.4	-2.2	-3.6

GLOBAL	Feb 25	Jan 25	Q1 25
EQUITIES	-0.8	3.2	2.4
North America	-1.5	3.1	1.6
Europe ex UK	3.2	7.1	10.6
Japan	-3.9	0.1	-3.9
Dev. Asia ex Japan	-0.9	3.2	2.3
Emerging Markets	0.6	0.8	1.4
GOVERNMENT BONDS	1.2	0.2	1.4
High Yield	0.9	1.2	2.1
Gold	1.5	7.0	8.6
Oil	-4.2	2.8	-1.6

Percentage returns in local currency ($ for gold and oil). All returns to 28/02/2025, *apart from property 31/01/2025
Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, North America, AW Developed Europe ex-UK, Japan, Developed Asia Pacific ex-Japan, Emerging, Fixed Gilts All Stocks, Index-Linked Gilts All Maturities, iBoxx Non-Gilts, S&P GSCI Light Energy, Crude Oil BFO, ICE BofA Global High Yield, Gold Bullion LBM, MSCI UK Monthly Property and BBG Aggregate Government Total Return.

Fixed income markets

US yields fell materially amid weaker economic data

US 10-year yields fell by 0.3% in February, to 4.2% pa, as markets prioritised the longer-term growth impact from tariffs over their shorter-term inflationary effects. UK and German yields fell less, to 4.5% pa and 2.4% pa, respectively. Ongoing stickiness in inflation limited the fall in UK yields, while speculation that European governments may ramp up spending, and so increase bond issuance, prevented a larger fall in European yields.

In contrast, Japanese 10-year yields rose 0.1% pa, to 1.4% pa, amid faster-than-expected Q4 growth and expectations that the BoJ will continue to normalise monetary policy.

Market-implied inflation, as indicated by the difference between inflation-linked and nominal bonds of the same maturity, fell 0.2% pa, to 3.4% pa, in the UK. The same measure eased modestly in the US and Germany, to 2.4% pa and 1.8% pa, respectively.

Global credit spreads hugged historic lows

Global investment-grade credit spreads rose slightly, to 0.9% pa, and stayed close to historic lows. That riskier speculative-grade credit spreads also rose just marginally could point to markets expecting a slowdown rather than a collapse in growth. US speculative-grade bond spreads rose 0.2% pa, to 2.9% pa, while European spreads fell by 0.1% pa, to 2.9% pa. Investment- and speculative-grade credit spreads are close to historic lows, reflecting strong yield-driven demand and a benign default outlook from major credit rating agencies.

Lower Treasury yields supported hard-currency emerging market debt returns

Hard-currency emerging market debt, as measured by the J.P. Morgan EMBI Global Diversified Index, returned 1.6% in dollar terms as a fall US Treasury yields more than offset a small rise in spreads. Local-currency emerging market debt, as measured by the J.P. Morgan GBI-EM Global Diversified Traded Index, delivered a 0.7% return in dollar terms, driven by coupon income.

Global equities

North America and Japan underperformed

In February, the FTSE All World Total Return Index fell 0.8% in local-currency terms, as investors weighed up slowing US growth, stubborn inflation and concerns over US trade policy. Japanese equities were the worst-performing region, as yen strength affected the export-oriented market.

Despite hitting new highs in mid-February, North American equities fell back, underperforming the broader global equity market. Heightened political uncertainty, federal spending cuts and the potential effects of tariffs all damaged consumer, business and investor sentiment. A heavy weighting in the underperforming technology sector and downward revisions to earnings also detracted from North American equity returns.

European stocks continued their strong year-to-date returns

Europe ex UK was the best-performing region globally, continuing a year-to-date trend. The rally was driven by shifting regional market sentiment amid the growing prospect of an end to the Russia-Ukraine war, which could lead to reduced energy costs and stronger consumer and business sentiment. The recent rally in European defence and aerospace stocks also accelerated in February, buoyed by expectations that European governments will spend more on defence, given less certain US security guarantees. The improved outlook was apparent in upwards revisions to very downbeat European equity earnings forecasts. The region benefited from a relative overweight in the outperforming consumer staples, financials and health care sectors, while being underweight in the underperforming technology sector. Similarly, UK stocks benefited from being overweight in consumer staples and financials and heavily underweight in technology. Meanwhile, UK defence stocks also received a boost.

Emerging markets and Asia-Pacific ex Japan outperformed too, driven by strong corporate earnings and optimism over DeepSeek, a Chinese AI startup that could be the region's budget solution to AI innovation. However, ongoing property market weakness weighed on more domestically exposed Chinese stocks, which limited the region's gains.

Value outperformed growth, while defensive sectors topped the performance rankings

Value stocks outperformed growth stocks, with defensive and value-oriented stocks leading gains. Defensive telecoms and consumer staples sectors topped the leaderboard, followed by financials, energy, utilities, health care and basic materials, in that order. There was a continued shift to cheaper stocks, amid concerns over high equity valuations. Consumer discretionary was the largest underperformer, given concerns around inflation and weaker US growth. Technology stocks lagged, with increasing investor nervousness around high valuations and downwards earnings revisions. There were also lingering concerns about the potential disruption from low-cost Chinese AI alternatives and the implications these could have for capital expenditure, and the return on that investment, among the mega-cap tech stocks.

Currencies, commodities and property

The US trade-weighted dollar declined by a marginal 0.2% in February, as investors bet that slowing US growth would push the Fed to keep cutting rates, despite signs of some persistence in inflation. The equivalent sterling measure rose 1.2%, amid higher-than-expected inflation and growth data. The Japanese yen rose around 3% on a trade-weighted basis, as the BoJ is expected to continue normalising interest rates amid signs of sustained domestic inflation pressures and stronger-than-expected GDP growth data.

Oil prices fell by 4.2% over the month. The growing prospect of an end to the Russia-Ukraine conflict and the ongoing ceasefire in the Middle East eased lingering supply concerns, while subdued domestic activity in China and weaker US growth data weighed on demand. Gold prices reached new all-time highs in February, rising 1.5%, supported by US policy uncertainty, growth and inflation concerns, as well as a decline in real US Treasury yields.

The global economy

The second estimate of US Q4 GDP confirmed that growth slowed during the quarter. But strong consumer spending offset weak investment, so the US economy still expanded at a strong annualised pace of 2.3%.

That said, more timely PMI data suggest the slowdown could be more profound. Flash PMI data indicate that month-on-month US business activity growth almost stalled in February. The composite index, which combines activity across the service and manufacturing sectors, fell to a 17-month low, to a level just above the neutral 50-mark that separates expansion from contraction. This was driven by a sharp drop in services output, which offset slightly faster manufacturing growth. The downturn in services activity was due to growing political uncertainty, with business expectations taking a hit amid federal spending cuts and concerns over the impact of tariffs on economic growth and inflation. While the manufacturing recovery gathered pace, respondents suggest at least some of the rise in output and new orders owes to businesses seeking to increase their inventories ahead of tariff-induced price rises and supply disruptions. Furthermore, manufacturing surveys point to rising input costs and output prices as suppliers lift prices in response to tariffs.

The eurozone economy grew at 0.1% in Q4, slightly ahead of the previous estimate of no growth, but lower than Q3's 0.4% expansion. Provisional PMI data indicate the eurozone managed marginal growth in February. Services activity continued to grow, although at a slower pace, while the contraction in manufacturing production eased. Japanese economic growth expanded at 0.7% quarter on quarter, exceeding consensus analyst expectations of 0.3% and marking the third straight quarter of growth.

UK GDP growth for Q4 exceeded expectations, with growth of 0.1% beating the forecast for of a 0.1% contraction. However, wider sentiment continued to deteriorate, with pessimism over the growth outlook causing the BoE to halve its 2025 growth forecast for the UK economy to 0.75%, from its previous projection of 1.5%. PMI data suggested a marginal rise in UK private sector output, as higher levels of service sector activity helped to offset a larger-than-expected reduction in manufacturing production. Surveys highlighted that the rise in employers' national insurance contributions is driving growth and inflation in opposite directions. Businesses report that they are responding via a combination of lower margins and raising prices, while lowering headcount and wages.

Data released in February showed that headline CPI inflation rose for the fourth consecutive month in January: to 3.0% in the UK and US, and to 2.5% in the eurozone. Core inflation, which excludes volatile energy and food prices, rose to 3.8% and 3.3% in the UK and US, respectively, and remained at 2.7% in the eurozone. Data released in February also showed that UK service-sector inflation accelerated to 5.0% year on year in January, fuelled by wage growth, which rose to 5.9% year on year in the three months to end-December.

Despite this, the BoE cut rates by 0.25% pa, to 4.5% pa. While policymakers acknowledged underlying inflationary pressures and expect inflation to rise to 3.7% in 2025, they expect this to be temporary, with inflation returning to its 2% target thereafter. As a result, they felt justified in making interest rates a little less restrictive. Markets expect the BoE to proceed cautiously, anticipating around two further 0.25% pa cuts in 2025.

At the end of February, markets expected between two and three rate cuts from the US Federal Reserve in 2025, one more than the consensus in late January, as attention shifted to the weakening growth outlook. In Europe, markets expect three rate cuts from the European Central Bank, given the signs of weak growth in the region.

For and on behalf of Hymans Robertson LLP

Chris Arcari

Head of Capital Markets

chris.arcari@hymans.co.uk
0141 566 7986

Ross Rausch

Investment Research Analyst

ross.rausch@hymans.co.uk
0121 212 8109

London | Birmingham | Glasgow | Edinburgh T 020 7082 6000 | www.hymans.co.uk

Hymans Robertson LLP is a limited liability partnership registered in England and Wales with registered number OC310282. Authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities.