HYMANS ROBERTSON

Quarterly Market Brief

Q1 2025

Q1 HIGHLIGHTS

- Data released in Q1 showed the US economy grew strongly in the final quarter of 2024. However, more recent survey data suggest the economy slowed in Q1: post-election optimism waned as tariff uncertainty affected consumer and business sentiment. European growth remained weak in Q4, but recent PMIs signal a modest improvement amid expectations of increased defence and infrastructure spending.
- In March, headline inflation cooled to 2.8% in the US and the UK, and 2.5% in the eurozone, after rising since September. That said, policymakers on both sides of the Atlantic expect inflation to quicken temporarily this year before easing towards the 2% target over the forecast horizon.
- Despite inflationary pressures, the European Central Bank (ECB) cut rates twice in Q1, to 2.5% pa, while the Bank of England (BoE) reduced the base rate 0.25% pa, to 4.5% pa. The US Federal Reserve (Fed) held rates steady at 4.5% pa, but rate expectations fell as markets focused on weaker survey data.
- As a result, US 10-year treasury yields fell while their European counterparts rose in anticipation of higher issuance and a boost to growth from higher government spending. Credit spreads generally rose but remain low relative to history. European investment-grade spreads, meanwhile, fell during Q1.
- Global equities fell 1.9% as investors weighed concerns over US growth, inflation and trade policy. North American and Japanese equities notably underperformed, while European stocks outperformed, buoyed by expectations of higher government spending and investors' preference for cheaper, value-oriented sectors.
- The trade-weighted US dollar fell 2.3% while the yen rose 3.3% as interest-rate differentials narrowed. Gold prices jumped a further 19%, reaching fresh record highs, as investors sought safety amid heightened economic uncertainty and a decline in the US dollar and US real yields.

Market performance to end March 2025

UK	Mar 25	Feb 25	Q1 25
EQUITIES	-2.3	1.3	4.5
BONDS			
Conventional gilts	-1.0	0.8	0.5
Index-linked gilts	-2.1	-0.6	-1.4
Credit	-0.9	0.5	0.7
PROPERTY**	n/a	0.6	1.3
STERLING			
v US dollar	2.5	1.3	3.1
v euro	-1.3	1.3	-1.2
v Japanese yen	1.7	-1.4	-1.9

GLOBAL	Mar 25	Feb 25	Q1 25
EQUITIES	-4.2	-0.8	-1.9
North America	-5.6	-1.5	-4.1
Europe ex UK	-3.8	3.2	6.4
Japan	-0.1	-3.9	-3.9
Dev. Asia ex Japan	-1.6	-0.9	0.7
Emerging Markets	0.6	0.6	2.0
GOVERNMENT BONDS	-0.6	1.2	0.7
High Yield	-0.9	0.9	1.2
Gold	9.6	1.5	19.0
Oil	1.7	-4.2	0.1

Percentage returns in local currency ($ for gold and oil). All returns to 31/03/2025, *apart from property 28/02/2025
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 while European yields rose

US 10-year yields fell 0.4% pa in Q1, to 4.2% pa, as investors focused more on the risks to growth from tariffs than their potentially shorter-term inflationary impact. In contrast, German bond yields rose 0.4% pa, to 2.7%, driven by expectations of higher bond issuance across the eurozone, to finance government expenditure on defence and infrastructure, and the positive impact this may have on growth and inflation.

Japanese 10-year yields rose 0.4% pa, to 1.5% pa, amid moderate economic recovery and signs of persistent domestic inflationary pressures: the Bank of Japan (BoJ) is expected to continue to normalise monetary policy, after raising rates 0.25% pa, to 0.5% pa, in January. UK 10-year yields edged up 0.1% pa, to 4.7% pa, as the Chancellor's Spring Statement outlined new spending cuts, and the DMO's gilt issuance forecast came in lower than expected.

UK 10-year implied inflation (the difference between nominal and inflation-linked bonds) fell 0.1% pa, to 3.4% pa, as real yields rose more than nominal. Equivalent US implied inflation rose marginally, to 2.4% pa, as real yields fell more than their nominal counterparts, while German implied inflation rose 0.2% pa, to 1.9% pa.

Credit spreads generally rose, but eurozone credit markets outperformed

Global investment-grade credit spreads rose 0.1% pa, to 0.9% pa, but remain low relative to history. US spreads widened amid waning optimism over the economic outlook. In contrast, European investment-grade spreads fell 0.1% pa as expectations of higher government spending and potential glimmers of a Russia-Ukraine ceasefire supported the corporate outlook. Sterling investment-grade credit produced positive returns as income more than offset a 0.1% pa rise in spreads, to 1.1% pa.

Speculative-grade credit spreads rose more significantly: US spreads rose 0.6% pa, to 3.5% pa, while equivalent European spreads rose a much smaller 0.2% pa, to 3.3% pa. While spreads have risen, they are low relative to history, with the market perhaps reflecting surveys and forecasts that suggest growth will slow as opposed to collapse. Meanwhile, markets are not pricing in a sharp rise in defaults. US speculative-grade credit markets delivered positive total returns as income and a fall in underlying treasury yields more than offset the rise in spreads.

Lower yields and dollar weakness supported emerging market debt

Hard-currency emerging market debt, as measured by the J.P. Morgan EMBI Global Diversified Index, returned 2.2% in dollar terms, a fall in US treasury yields more than offset a 0.2% pa rise in spreads. Local-currency emerging market debt, as measured by the J.P. Morgan GBI-EM Global Diversified Traded Index, delivered a 4.3% return in dollar terms, as index currencies, on average, strengthened 2.1% against the US dollar and yields fell 0.1% pa, to 6.3% pa.

Global equities

North America and Japan underperformed

Global equities fell in Q1, with the FTSE All World down 1.9% in local-currency terms. US equities underperformed, registering their worst quarter since 2022, as anticipation of tariffs and federal spending cuts fuelled concerns about slower growth and higher inflation. The US's exposure to the underperforming technology sector affected the region, with lofty valuations coming under pressure as earnings forecasts were downgraded. Japanese equities also underperformed as yen strength weighed on the export-oriented market.

European and UK stocks outperformed, followed by emerging and Asia Pacific ex Japan equities

Europe ex UK was the best-performing region globally in Q1, as souring sentiment towards the relatively expensive US market, and the technology sector in particular, benefited the more value-oriented European market. European stocks were also buoyed by EU and national government pledges to increase defence and infrastructure spending, amid less certain US security guarantees. Investors welcomed the prospect of further fiscal stimulus, and the improved outlook was apparent in upward revisions to downbeat European equity earnings forecasts. Additionally, glimmers of a potential Russia-Ukraine ceasefire lent a further tailwind to sentiment in Europe. UK equities benefited from the broader pattern of value stocks outperforming their growth counterparts.

Emerging markets and Asia Pacific ex Japan also outperformed. Chinese stocks rallied thanks to a combination of less punitive US tariffs than anticipated and optimism over DeepSeek, an AI start-up that could provide the region's budget solution to AI innovation. A weaker US dollar and lower treasury yields also supported sentiment towards emerging markets.

The major growth sectors notably underperformed while value stocks outperformed

Investors favoured lower-valued stocks over expensive US tech, locking in past gains. Tech was the worst-performing sector in Q1, followed by consumer discretionary, amid US growth and inflation concerns. Value stocks outperformed growth, with the energy sector topping the rankings, followed by consumer staples, telecoms, financials, utilities, basic materials and health care. Industrials also modestly outperformed.

Currencies, commodities and property

The US trade-weighted dollar fell 2.3% as the Fed raised the prospect of further rate cuts, despite higher near-term inflation forecasts, while the equivalent euro and sterling measures rose 1.5% and 1%, respectively. The trade-weighted yen gained 3.3% as signs of sustained domestic inflationary pressure and expectations of ongoing BoJ policy normalisation led to narrowing rate differentials.

Gold was the best-performing major asset in Q1 as prices rose 19% to reach fresh all-time highs: heightened economic uncertainty, a weaker US dollar and a decline in real US treasury yields all lent support.

The global economy

The final Q4 GDP reading showed the US economy slowed, but to a still-solid annualised pace of 2.4%, supported by continued consumer and government spending. However, optimism about the US outlook waned in Q1 amid trade-policy uncertainty and concerns over federal spending cuts. Weak consumer and business survey data signalled a deteriorating outlook. Manufacturing's early-year rebound proved short-lived, slipping back into contraction in March after tariff-driven front-loading. Meanwhile, the composite PMI pointed to a March recovery, led by services, but surveys flagged the steepest rise in input costs in two years, with businesses passing tariff-related supplier price hikes on to consumers. While US survey data released over Q1 is indicative of slowing GDP growth compared to the end of 2024, the data still point to economic expansion.

European growth remained weak in late 2024, but recent business survey data signalled a modest recovery. In March, the eurozone's manufacturing output expanded for the first time in two years, marking an improvement for three consecutive months. The increase in output was supported by customers front running US tariffs, while future European spending on defence and infrastructure could provide a more sustained boost. UK business surveys suggest modest Q1 growth, with a March rebound in services. Across Europe, business confidence and the outlook for the year ahead continued to deteriorate, running at two-year lows. In the UK, added costs from the Autumn Budget, US tariff uncertainty and Spring Statement cuts led the OBR to halve its 2025 growth forecast to 1%. Price pressures in Europe are easing but remain above long-term averages, with UK businesses passing higher vendor, labour and raw material costs onto consumers.

Headline CPI inflation cooled in March to 2.8% in the US and the UK, and 2.5% in the eurozone. This modest easing comes on the back of steady increases since September last year. Policymakers on both sides of the Atlantic expect inflation to temporarily quicken this year before returning to the 2% target over the forecast horizon. The upward drift in inflation forecasts is partly due to potential supply disruption from US tariffs, expected increases in energy prices and sticky domestic inflation, with the last of these pointing to persistency in domestic price pressures, particularly in the UK. Core CPI remains above headline inflation across the three regions, at 3.5%, 3.2% and 2.6% in the UK, US and eurozone, respectively.

Despite inflation pressures, the ECB cut rates twice in Q1, to 2.5% pa, while the BoE opted for a cautious 0.25% pa cut, to 4.5%. Given elevated uncertainty, the Fed held rates steady at 4.5% pa, but policymakers hinted at future rate cuts, suggesting they are more concerned about risks to growth than temporary rises in inflation. Market expectations for rate cuts grew amid weaker-than-expected US data. At the start of the year, markets were pricing in between one and two 0.25% pa rate cuts from the Fed in 2025; by the end of March, they were pricing in close to three. Markets expect the BoE to deliver two further 0.25% pa cuts in 2025, one more than they anticipated at the start of the year.

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