



## Quarterly review

### LGT GBP Global Medium Portfolio

## Market highlights

### Q3 2025

#### Summary

US equities climbed higher in the third quarter led by artificial intelligence (AI)-related technology companies, although the rally extended beyond the US, with China, Japan and the UK all posting strong returns. Europe, after a strong first half the year, lagged other markets as political turmoil in France impacted investor sentiment.

A combination of strong earnings, easing tariff tensions and falling US bond yields helped lift equities globally. In September, the Federal Reserve (Fed) cut rates for the first time this year and signalled further cuts were imminent, reflecting concerns the US labour market is softening. Short-dated bonds delivered strong returns, while long-dated government bonds lagged.

The S&P 500 finished the quarter up 8.1% and the tech-heavy Nasdaq rose 11.4%. However, a disappointing July jobs report weighed heavily on equities in early August, as the US added fewer jobs than expected and unemployment rose. Previous months' payroll gains were revised lower, amplifying concerns about the labour market as President Trump's economic plans took hold.

Jobs growth remained muted with nonfarm payrolls – an important measure of monthly job creation – increasing by just 22,000 in August, down from 79,000 in July and below the 75,000 expected. Additionally, the Bureau of Labor Statistics revised down employment figures for April 2024 to March 2025 by nearly one million jobs, an average of about 75,000 fewer jobs per month.<sup>1</sup>

UK and European equities had a solid quarter, with the FTSE 100 rising 7.5% and STOXX 600 3.5% in Q3, but the standout was China. The Shanghai Composite advanced 13.9% in the third quarter and Hong Kong's Hang Seng gained 12.5%, as renewed optimism over Chinese technology companies buoyed equities. Japan also posted solid performance after the country's ongoing corporate reform and shareholder-friendly policies gained momentum, led by new government incentives to target shareholder returns. The Topix rose 11% in local terms.

Alongside weak jobs data, the Fed faced inflationary pressures from tariffs, which became more evident in pricing data. The latest Consumer Price Index (CPI) figure published on 11 September rose to 2.9% from 2.7%, underscoring ongoing Fed challenges in bringing inflation back to its 2% target. While tariffs typically cause a temporary rise in inflation, the jury is still out on what impact tariffs will have on inflation.

Despite persistent challenges such as softening US labour markets, ongoing inflationary pressures and global trade uncertainty, equities delivered strong returns in the third quarter due to robust corporate earnings and easing tariff concerns. Central banks signalled a more accommodative stance, yet divergences remain as policymakers navigate a complex macroeconomic backdrop. As we enter the final quarter of the year, investors will be watching closely for further clarity on monetary policy, the robustness of corporate profitability and the evolving impact of geopolitical developments.

## Fixed Income

During his speech at the Federal Reserve's annual Jackson Hole conference in August, Fed Chair Jerome Powell signalled a shift in focus, away from concerns around inflation, towards the deterioration in the US jobs market. As expected, the Fed cut rates at its September meeting, marking the first reduction since December. The move boosted sentiment and triggered a rally in short-dated US Treasuries, with yields falling sharply. The yield curve steepened, with one-year yields falling by 0.44% and the 30-year yield falling by 0.07% over the quarter.

The Bank of England (BoE) lowered rates to 4% from 4.25%, bringing the cost of borrowing to the lowest level in more than two years. This is the fifth cut since August last year but was only narrowly backed by the bank's policymakers and took two voting rounds to reach a decision. The unprecedented second vote suggests future interest rate cuts will be finely balanced over concerns of rising prices, although BoE Governor Andrew Bailey maintained the path for rates continues to be "downwards". Inflation in the UK is now forecast to peak at 4%, twice the bank's target rate and above the 3.8% rate predicted in its May report. UK Government bonds have performed poorly over the period, with the 30-year yield at over 5.5%. Yields at the long end of the UK yield curve are the highest among G7 nations.

In Europe, the European Central Bank (ECB) held rates steady, with President Christine Lagarde signalling that the 2% deposit rate reached in June may well mark the end of the easing cycle. The ECB may still cut later this year, but some economists expect the next move will be a hike in late 2026.

From a portfolio perspective, the fixed income component achieved modest positive returns over the quarter. Our holdings in US Treasuries contributed to performance as yields in the middle of the US yield curve fell by over 10 basis points. Our position in inflation-protected Treasury bonds was the best performing government bond position, protecting against the market's growing concerns that tariffs would contribute to higher inflation. Our holdings in UK government bonds detracted from performance as growing fiscal concerns were coupled with the prospect of fewer interest rate cuts. We see our Gilt holdings offering exceptional value given the recent steepening of the UK yield curve and the increase in value we should experience as these bonds mature.

Resilient corporate earnings meant that credit spreads, which are the additional premium companies pay when borrowing money compared to governments, declined over the quarter. In the portfolio, Muzinich Global Tactical Credit was the best fixed income position in the portfolio, a strategic bond fund comprising mostly of investment grade credit. AXA US Short Duration was also a decent performer as high yield bonds in the US have benefitted from falling Treasury yields and robust earnings.

## Equity

The third quarter saw a re-emergence of several key themes that have driven markets throughout the year. AI-related stocks rallied strongly again as companies were rewarded for making significant capex announcements including Nvidia's \$100bn investment into OpenAI and OpenAI awarding \$300bn of AI contracts to Oracle. Collectively, the Magnificent Seven (Mag 7) outperformed the broader US market but there was some underlying divergence in the performance of stocks with strong recoveries in Alphabet and Apple, whilst Amazon and Meta were relative laggards. This benefitted our dedicated US managers PGIM US Growth and T Rowe US Structured Research, which have combined exposure to Technology and Communication Services of 59.7% and 45.1% respectively.

Our other growth manager, Blackrock Global Unconstrained, did not benefit to the same extent due to its concentrated nature which meant that stock selection was the primary driver of performance. Within the Mag 7, the fund owns large positions in Microsoft, Amazon and Meta which lagged other large Technology stocks. It also holds large positions in Visa and MasterCard which have been impacted by the potential threat of alternative payment rails such as Stablecoins.

Materials and Energy saw an improvement in performance to the fourth and fifth best performing sectors during the quarter. This was supported by a rise in commodity prices as the expectation of a renewed monetary easing cycle could lead to higher global growth whilst precious metals such as Gold continued their strong rally as economic uncertainty remained heightened. Blackrock Natural Resources benefitted from this dynamic and was one of the top performing equity holdings. Mining is the largest sector in the fund (41% of the fund) and includes holdings in the gold miners Wheaton Precious Metals and Newmont Corporation.

The strength in cyclical sectors also benefitted Schroder Global Recovery, which was the strongest performing amongst our core global managers. The fund benefitted from its deep value style bias, and significant exposure to Consumer Cyclical and Communications Services which performed well.

In contrast, lower beta defensive sectors such as Healthcare and Consumer Staples struggled. Sentiment towards Healthcare remained weak due to ongoing political risk in the US surrounding drug pricing and future tariff announcements. Whilst Consumer Staples faced headwinds as economic uncertainty weighed on demand and there were continued concerns that new emerging trends such as the rise in GLP-1 usage could disrupt growth in certain categories. Lazard Global Equity Franchise and Evenlode Global Opportunities have significant exposure to these areas of the market and hence their performance was more challenged on a relative basis.

In Asia, there was a large divergence in returns between two of the largest markets, China and India. China witnessed a reacceleration in its bull market and was the best performing major market in the third quarter. The rally was driven by strong performance from beneficiaries of key trends within Technology such as AI and Robotics. Whilst India was one of the only major markets to register a negative return in the quarter due to a deterioration in the macro-outlook and corporate earnings momentum. Schroder Asia Total Return was the strongest performing equity fund during the quarter supported by the outperformance of Technology holdings TSMC and Tencent. Morgan Stanley Asia Opportunities also benefitted but to a lesser extent due to its higher exposure to India, which is primarily through holdings in Indian banks.

Our dedicated European fund Ardtur Continental European continued to perform strongly aided by the outperformance of its European bank holdings Commerzbank and Deutsche Bank. In Japan, Chikara Income & Growth participated well in the rally but underperformed the broader Japanese market due to its greater allocation to domestically focussed companies in contrast to the strength in large exporters within the automotive and electronics industries following the agreement of a trade deal with the US in July.

## Alternatives

The Winton Trend Fund was the standout performer in the quarter delivering returns in excess of 5%. The fund seeks to capture trends and the high levels of volatility had caused it to struggle earlier in the year. Since then, trends have emerged and the fund made profits on currency trading benefiting from long exposures to the Euro, Swiss Franc and British pound which all strengthened relative to the US dollar. Commodities have also been profitable due to long trends in gold and other precious metals.

Both the Brevan Howard Absolute Return and Graham Macro delivered negative returns in the quarter, struggling with a difficult macro environment. The Graham Fund had made some good gains on some of its fixed income and currency trading earlier in the quarter and on long positions in gold. Later in the quarter, losses in some commodity trading, particularly on a long position in Crude oil, which fell in the quarter more than offset the gains made elsewhere.

## Portfolio Changes and Asset Allocation

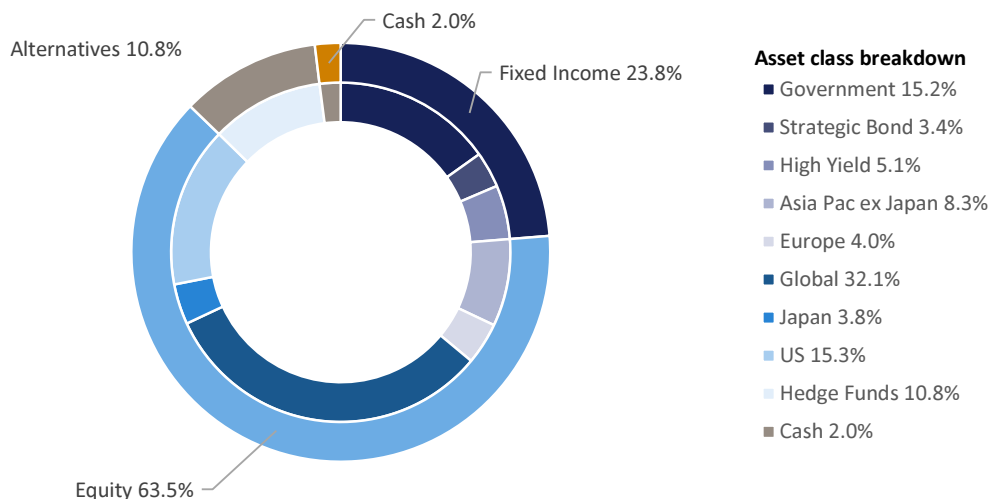
We sold our position in the Fundsmith Equity Fund – a position we have been reducing over the past eighteen months. The proceeds were reinvested into a mix of T.Rowe US Structured Research and a new fund Evenlode Global Opportunities. We believe this fund is more nimble and represents better value for money for our clients, whilst maintaining a quality bias. It focuses on companies that are delivering high returns on capital while growing revenues and operating margins faster than the broader market.

Our allocation to Japan is benefitting from real wage growth, rising inflation, a competitively valued currency and an inexpensive equity market, and reforms at the Tokyo Stock Exchange are improving corporate earnings and returns. In July we switched our implementation from a passive ETF to an active manager. The Chikara Income & Growth strategy's process targets companies where management is driving improvements in price-to-book ratios, return on equity and the reduction of excess cash.

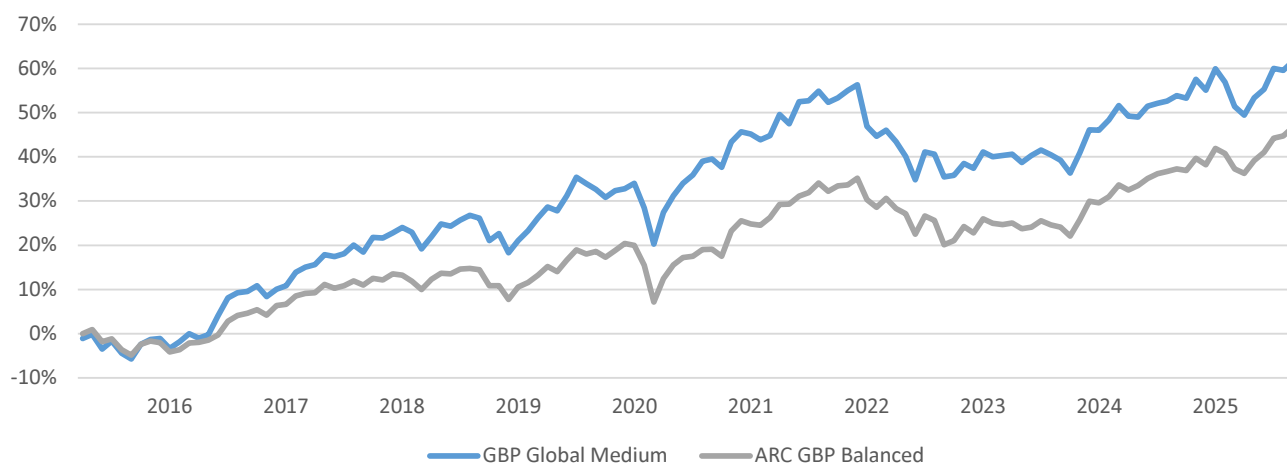
During the height of tariff concerns in April, the US dollar sold off in unison with the equity market. The dollar has typically rallied in equity market drawdowns as US investors repatriate capital, and for the most part we expect this phenomenon to remain intact. US policy uncertainty has increased, however, and so a repeat of April cannot be ruled out. In August we switched a portion of our Snyder US All Cap Fund holding into a hedged share class to reflect this, in effect reducing our US dollar exposure. This is on top of our gradual diversification away from the US equity market over recent month, a de facto reduction of our US dollar exposure, in favour of the European and the Japanese markets.

Having seen strong performance from our 3–7-year US Treasury holding, as the market has priced in new US interest rate cuts, we took the opportunity to replace this position by increasing exposure to UK gilts. We added an 8-year UK Gilt which is not pricing in any interest rate cuts, giving us clear asymmetry if things slowdown from here.

## Portfolio Positioning



GBP Global Funds Medium, ARC GBP Balanced



## Conclusion

Two key elements have driven the stock market since the lows in April – the perceived winners of artificial intelligence and lower quality, higher volatility stocks. The stark outperformance of the AI winners has been a huge challenge to active equity investors, whose preference for diversification has prevented them from participating to the same extent as passive investors. In September, 80% of the market's return came from just three AI-related sectors and the equal-weighted S&P 500 returned 1.1% over the month, versus 3.6% for the market-capitalisation-weighted index, indicating that the largest stocks performed considerably better than the average stock.

This comes despite a significant shift in the narrative around AI. OpenAI's \$1tn of announced investments (despite having revenues of only \$20bn) has attracted scrutiny. So-called vendor financing, where the provider of the product provides finance to the purchasers is suddenly rife in the sector. These large cap technology companies have generally been light on capital expenditure but the race for infrastructure and hardware has flipped this on its head. In their widely shared note, *Dotcom on Steroids*, GQGs noted that monetisation of AI has, so far, been pretty modest, despite Microsoft, Amazon, Alphabet and Meta all spending in excess of 50% of the gross earning on capital expenditure. Our internal analysts note that whilst capital expenditure in assets does not hit profits at inception, the depreciation of those assets certainly will over the coming three to five years – in that sense, the clock is ticking for the so-called hyper-scalers to see a return on all that investment.

Some of the comparisons to the late nineties look overdone – these companies have a diverse set of well-established product ranges - but excessive and imprecise investment is a natural part of any revolutionary technology’s lifecycle. As global investors we have exposure to these companies, but crucially via active managers who can be selective, in contrast to just passively taking whatever the index or exchange-traded fund gives us. We are also more diversified than the passive indices and therefore have smaller position sizes, remembering that we are long-term stewards of capital and what feels right now may look foolish over the coming months. While this stance has detracted from relative returns (and could continue to if enthusiasm builds further), we believe it reflects a disciplined balance between participating in innovation and recognising the risk of excess.

The other theme has been the market ignoring the virtues of robust balance sheet, predictable earnings, stable share prices and high returns on invested capital. To bring this to life – the 20% *highest* quality stocks (as measured by five-year average return on equity) have *underperformed* the MSCI ACWI by over 10% in the year-to-date. Conversely the 20% *most* volatile stocks have *outperformed* the index by 10%.

This speculative, low-quality rally has been driven by stronger-than-expected economic growth and the prospect of US interest rate cuts. While this has been challenging for our core managers – where we deliberately express a preference for quality – it also means our equity allocation has never been cheaper relative to the market. We see this not as a reason to capitulate, but as evidence of the scale of opportunity building in precisely the kinds of businesses we want to own: highly profitable, disciplined and consistent compounders that the market is currently overlooking.

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