



Quarterly review

LGT GBP Global Medium Strategy

Market highlights

Q1 2025

Summary

President Donald Trump was inaugurated in January and set out to swiftly implement his agenda. He has kept most of his campaign promises, applying tariffs on long-standing trading partners, imposing sweeping cuts across the US government and pulling back support from America's long-established global alliances. This has led to a sharp reversal for US equities over the quarter.

Long-standing European allies were stunned as Trump's desire to end the war in Ukraine led to the US putting pressure on Ukrainian President Volodymyr Zelensky, while offering concessions to Russia. This spurred the continent into action as they agreed to boost defence spending in response to the shifting of alliances. After its election, Germany's coalition announced a historic, new fiscal regime, a remarkable reversal for a country known for its cautious spending.

In January, Chinese start-up DeepSeek released a new AI model rumoured to be as good as US AI models and cheaper. This led to questions around US technology companies' valuations, wiping billions off the Magnificent 7 companies' value. The Magnificent 7 companies fell 16% in the first three months of the year, reversing post-election gains.

It was a tough quarter for US equities, with the aggressive threat of tariffs and the DeepSeek-driven selloff in market-leading technology stocks, roiling markets. The widespread tariff announcements began in late January after the Trump administration's arrival in Washington, when they announced 25% tariffs would be placed on Canada and Mexico. Investors relaxed somewhat when these tariffs were delayed, resulting in the S&P 500 hitting new highs in mid-February.

While US equities struggled, European markets boasted a solid performance. Economists upgraded growth forecasts for the region as Germany led the way in rewriting the continent's historic fiscal regime rule book, with a marked shift towards higher defence and infrastructure spending. The first quarter witnessed the biggest quarterly performance gap between the Stoxx Euro 600 Index and the S&P 500 in a decade.

UK equities had a solid quarter, gaining 6.1%. The outlook for the UK remains challenging however, with inflation continuing to prove sticky and weakened business and consumer sentiment ongoing, following the first Labour budget. The Office for Budget Responsibility (OBR) adjusted their 2025 growth forecasts down to 1% from 2%. With this backdrop, Chancellor Rachel Reeves delivered her Spring Statement, which included welfare cuts, departmental savings and increased defence spending.

Asian equities meanwhile were buoyed over enthusiasm surrounding DeepSeek, underscoring the valuation differences across global technological firms as China and India ramp up their AI capabilities. The more technology-focused Hang Seng Index rose 16.1% in the quarter, but the Shanghai Composite fell 0.2%, as tariff concerns weighed on the market. Meanwhile in Japan, the Nikkei dropped 9.9%, partly due to the strengthening yen.

The divergence among central banks' interest rate cutting regimes picked up steam in the first quarter. The Federal Reserve (Fed) held interest rates steady at their first two meetings of the year. The Bank of England (BoE) meanwhile lowered rates in February but held them steady in March, as the UK faces a lack of clarity over global trade and inflation. The European Central Bank (ECB) began the year by lowering interest rates, in line with market expectations which had forecasted the ECB would cut interest rates at every meeting until June. The Bank of Japan (BoJ), which is embarking on a rate-hiking cycle, delivered another hike in January, bringing interest rates to 0.50%. The BoJ signalled more hikes are ahead given elevated wage pressures.

Fixed Income

Over the first quarter of the year, fixed income markets experienced significant volatility, driven by the interplay of key macroeconomic data releases and unexpected fiscal policy decisions. In particular, trade policy developments added an additional layer of uncertainty to the market environment.

Starting with the US, the Fed left interest rates unchanged at their January and March meetings, pausing their rate cutting regime amid an uncertain political and economic landscape. The decision to hold rates steady follows the Fed consecutively cutting rates three times since September 2024.

Despite leaving interest rates unchanged, yields on US government bonds declined significantly over the quarter over fears that US trade policy would lead to a material slowdown in economic activity. The yield on the 10-year US Treasury bond fell by 36 basis points to 4.21% over the quarter. Furthermore, in the Fed's March meeting, the central bank revised their summary of economic projections as uncertainty around the economic outlook increased as a consequence of Trump's trade policies. The Fed is still expecting to cut interest rates two times this year.

In the UK, the BoE cut rates for the third time in six months in February, sticking to their 0.25% cut-per-quarter pace, before pausing in March. The BoE halved their 2025 growth forecast as the British economy edges closer to stagflation but upgraded growth forecasts for 2026 and 2027 to 1.5%. The hawkish shift from the BoE sent yields on government bonds higher. The UK 10-year finished the quarter 11 basis points higher at 4.67%.

The ECB lowered interest rates by 0.25% in both council meetings in the quarter. Sluggish growth in the Eurozone, combined with the potential for tariff hikes, makes it likely the ECB will cut rates at every meeting until mid-June, despite a German fiscal reform package loosening the nation's debt brake mechanism, facilitating an increase in defence spending and borrowing €500bn for infrastructure projects over the next 12 years. The moves mark a structural shift in fiscal policy for Germany. Yields on the German 10-year climbed by as much as 55 basis points following the announcement as the market priced in higher German growth.

From a portfolio perspective, the fixed income component was the strongest performing asset class over the quarter. The portfolio's holdings of US Treasury bonds were the best performers as a shift in investor behaviour towards safer assets, owing to the market instability, supported bonds. Our holdings of Inflation linked US Treasury bonds protected well against the market's rising expectations for inflation and finished the quarter as the best performing fixed income holding. However, our position in the long-dated UK gilt finished lower as stagflationary fears (concerns over slow economic growth coupled with rising inflation) impacted the bond market.

Turning to credit markets, credit spreads widened over the quarter as the deterioration of economic growth expectations, coupled with rising expectations of future inflation weighed on markets. Despite the widening of credit spreads however, the portfolio's holdings of corporate bonds performed well over the period. Muzinich Global Tactical Credit, a strategic bond fund comprised mostly of investment grade credit, yielded positive returns while offering downside protection in a volatile global interest rate environment. AXA US Short Duration High Yield, our preferred credit fund, continues to offer an attractive yield as robust corporate earnings limit defaults in high yield.

Equity

Equity markets have seen a volatile start to the year as US policy decisions and the rise in geopolitical tensions became more dominant drivers of market sentiment. This had a wide range of consequences for the performance of different market segments depending on region, sector and style.

Within the US, the Magnificent Seven, the group of large technology companies that led the market for the past two years, saw a significant reversal. The combined group was down over 15% in the first quarter due to a combination of macro concerns,

elevated valuations, and the launch of the competitor AI chatbot DeepSeek from China. The latter raised questions over the strength of US leadership in AI and whether the vast amounts being invested by US companies into AI are justified. This had a large impact on T Rowe US Structured Research due to its significant positions in most of those companies. T Rowe US Smaller Companies also struggled as small caps are more exposed to the US domestic economy and the rise in economic uncertainty is leading to weaker hiring, delayed investment plans and a larger reduction in earnings growth expectations for this part of the market. In contrast, the performance of Snyder US All Cap was more robust as the concentrated fund does not hold the Magnificent Seven and saw strong performance from underlying holdings such as refuse collection provider Waste Connections and biotechnology company Halozyme Therapeutics.

Amongst our core global managers, Lazard Global Equity Franchise, Fidelity Global Dividend, and Schroder Global Recovery were the strongest performers. These three funds have significantly less exposure to the US, more exposure to Europe, and have biases to the cheaper stocks and those who are less sensitive to economic cycle. These attributes benefitted from the regional divergence in returns and the broad shift from growth to value, and cyclicals to defensives. In comparison, Blackrock Global Unconstrained, which has a bias towards companies with the fastest growing earnings, suffered from a combination of both style rotation and stock specific weakness from some of its largest holdings. Novo Nordisk fell sharply following another disappointing result from the trial of its latest anti-obesity drug, meanwhile ASML was weaker due to the potential effect slower GDP growth would have on the semiconductor cycle, and Microsoft's performance reflected concerns over a slowdown in its Cloud business.

In Asia, Chinese markets delivered good positive returns, but the market rally was narrow and concentrated in the largest technology stocks and therefore our diversified Asian managers did not fully participate. Schroder Asia Total Return saw strength in holdings in the Communications Services sector, such as gaming and social media conglomerate Tencent and electronic gaming company NetEase, but this was outweighed by weakness in semiconductor stocks TSMC, Chroma ATE and ASE Group. Morgan Stanley Asia Opportunities primarily lost performance in the Consumer Discretionary sector through falls in travel stocks such as Trip.com. Japan was relatively resilient with the strength of the Yen offsetting some of the negative market return for the Sterling investors.

Blackrock Natural Resources was one of the few funds to produce a positive return during the quarter due to strength in metals prices which were beneficial for its overweight to the Mining sector. A rise in inflation expectations over the quarter was also supportive as commodities have historically acted as a hedge against inflation.

Despite the challenges of the current economic environment, punctuated with bouts of volatility, the equity component of the portfolio outperformed the benchmark during the quarter. We continue to believe that a consistent focus on constructing diversified portfolios with a targeted bias to quality is the best approach to producing a durable return profile from the equity component over the long term.

Alternatives

The first quarter of the year has seen mixed performance within the Alternatives allocation. The Bloomberg Commodity Index delivered +8.8% in USD terms driven largely by the positive appreciation of gold which hit another record high of \$3,126 / ounce on the final day of the quarter.

Performance across other sub asset classes was more mixed with other precious metals delivering positive returns along with natural gas which soared +21% in the quarter on concerns that a colder winter has run down surplus inventories. However crude oil was flat, and many other industrial metals and agricultural commodities were flat or negative on concerns that a slowdown in growth will have a knock-on effect on demand.

The Winton trend fund has struggled so far this year delivering a -3.3% return largely due to unclear directionality in terms of market fundamentals and themes, making it challenging to achieve consistent returns. Earlier in the quarter, there were sharp reversals in fixed income with bond yields rising sharply which whipsawed the fund's short fixed income positioning. Commodity trading was challenging for the most part with the exception of gold, with initial uptrends in many commodities reversing mid-way through the quarter whilst many other sectors remained range bound.

The Brevan Howard Absolute Return Fund was flat in the quarter again, struggling against the fast-paced action in the fixed income markets. The team's holistic macro positioning, coupled with their expert risk management are second to none and we retain high confidence in their ability to deliver stable positive returns over the long run.

Graham Macro was the best performing alternative strategy delivering +2.8% with the fund displaying a good ability to navigate the tricky macro environment and further demonstrating the importance of conservative risk management and tactical trading expertise within the team.

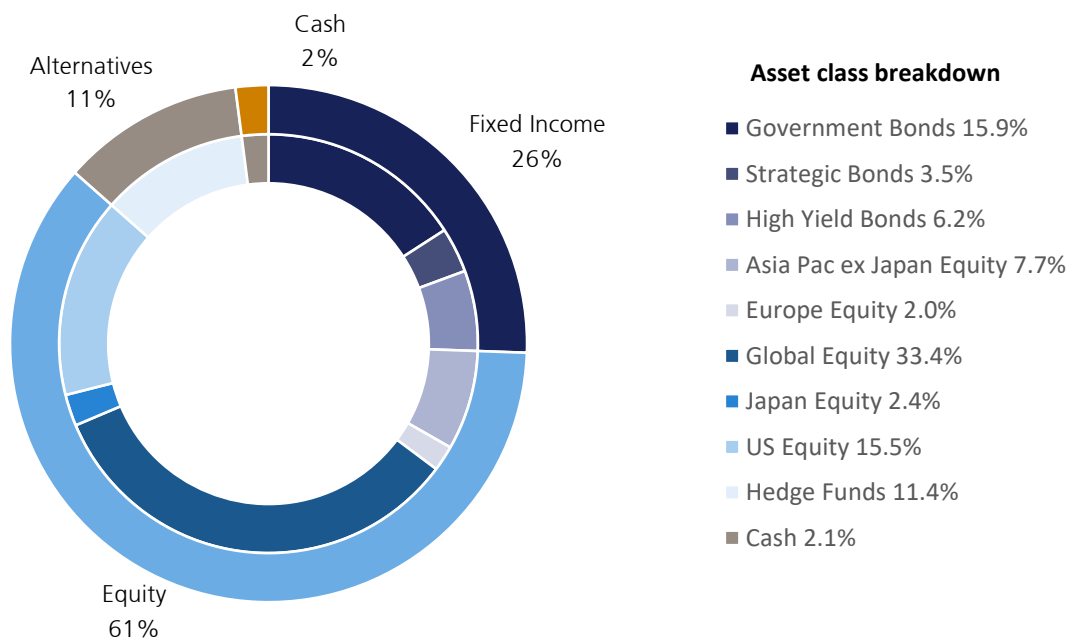
Portfolio Changes and Asset Allocation

In February, credit spreads tightened to levels not seen for some time. To maintain stability and enhance yield potential, we shifted focus towards interest rate-sensitive positions. As part of this approach, we exited our holding in Jupiter Strategic Bond due to concerns over the manager’s ability to adapt to evolving market data. The fund remained positioned for a hard landing despite indicators suggesting otherwise, prompting us to reallocate capital to the UK 2035 gilt to maintain portfolio duration and enhance risk-adjusted returns.

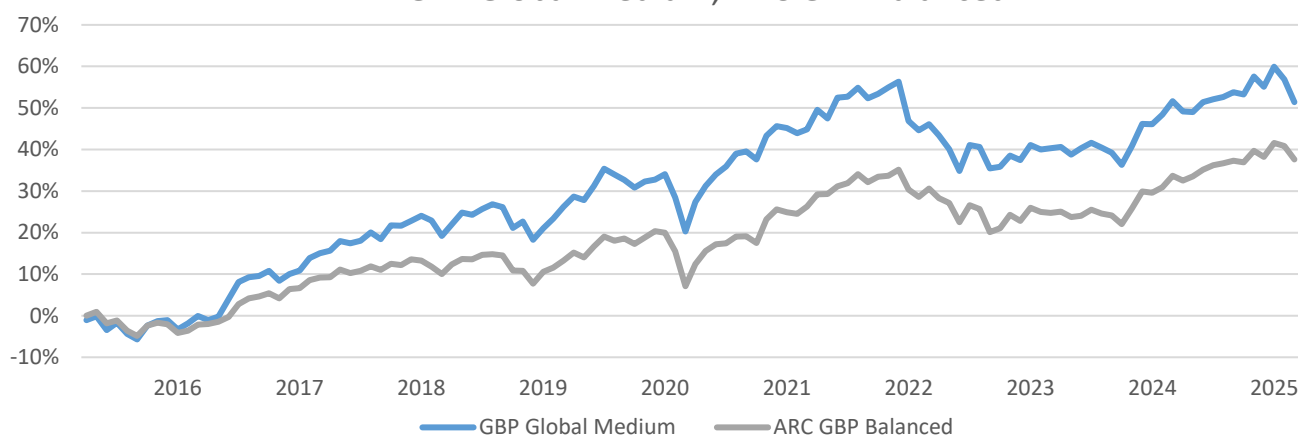
On the equity front, we maintain a balanced strategy that integrates core equity managers with various thematic and opportunistic investments, allowing us to capitalise on market movements. With Trump’s administration and its tariff rhetoric dominating headlines we have witnessed challenging headwinds for US smaller companies. While this segment remains a structural part of the portfolio, we identified an opportunity to reduce exposure and reallocate capital to European cyclicals. The decision was driven by attractive valuations in the region as well as global dynamics supporting fiscal loosening under new leadership, supportive monetary policy and an improvement in sentiment into European cyclical sectors. We initiated a position in Ardtur Continental European, funded from reducing our holdings in T Rowe US Smaller companies. The fund delivers strong diversification benefits due to its focus on undervalued, yet fundamentally solid, companies through careful stock selection.

In addition to this, we refined our growth exposure to maintain a balanced mixture in both factor and regional weightings, by adding the Jennison US Growth Fund. The fund manager offers us active management in a segment that suffered weak relative performance at the start of the year. This trade was funded from a reduction in Blackrock Global Unconstrained Equity, along with taking some of the profits from our core value funds comprised of Schroder Global Recovery and Lazard Global Equity Franchise, both of which enjoyed a strong start to the year.

Portfolio Positioning



GBP Global Medium, ARC GBP Balanced



Conclusion

Global equity markets seemed complacent at the end of last year but were swiftly shaken up by geopolitical activity in the first quarter and at the start of the second quarter, culminating with President Trump's announcement of wide-ranging tariffs. The market has now swung to a state of pessimism with global markets in a state of extreme nervousness, hoping for a partial softening of the measures announced over the coming days and weeks.

Volatility will be higher from here regardless. Geopolitics and markets are often surprisingly unrelated fields but at times of great global change they can become very closely linked. The election of President Trump has accelerated certain areas of international relations, advancing them by years within just a few months. Our portfolios will always have a large allocation to the US due to the nature of capital markets, but the strength of the private sector's balance sheets will make this storm weatherable. The market's initial optimism, believing Trump would boost business confidence and economic activity, has shifted with him now being perceived as a source of discomfort for businesses and individuals.

Europe on the other hand is reinvigorated. We speak a lot about individuals and intuitional factors, but in Europe only two things matter currently – 1) Europe is a wealthy continent and, 2) Europe currently feels under-defended militarily. The announced increases in defence spending, combined with broader fiscal stimulus in Germany and renewed emphasis on European competitiveness are reasons to be cautiously optimistic about the continent's economic prospects over the medium and long term, even if the impacts of tariffs need to be considered in the short term.

Our commitment to, and belief in long-term equity market investing is unwavering. Each market event has its own unique story and defining characteristics that often make it appear worse than the last, but external shocks are anticipated and considered when we are assessing our clients' willingness and ability to take on risk – they are an integral part of the plan. Markets have gone through periods of historical change on many occasions and consistently the equity market has generated strong returns – now is a time for holding firm and sticking to the plan.

Thus, from a portfolio perspective our fundamental trust in markets generating over the long-term is unchanged. We mitigate short term volatility by being diversified. The government and corporate bond allocation in our portfolios pays an annual yield of around 5% and protects us when the equity markets get skittish, as has been the case of late. We charge our hedge fund exposure with generating returns in all environments, and we think will be particularly useful should inflation reaccelerate.

We split our exposure to the stock market into two arms. The first, larger portion we call the core–this is a collection of mainly global, best-of-breed, high conviction active fund managers with a combination of different styles but with an overall focus towards higher quality companies–those with high margins, low debt and revenue streams that are not as sensitive to the economy. We expect this part of the portfolio to be robust in times of stress such as this.

In the second arm of our portfolio, which we call the satellite sleeve, we have more specific themes and ideas. We recently reduced our position in US smaller companies, adding a position to European equities in a high conviction manager. This resulted in an increase in our already sizeable position in European equities. With our allocations in Asia and Europe, we believe that we are well positioned for the multi-polar world we now find ourselves in.

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