# Markets Review - to end May 2025.

THORNTONS INVESTMENTS

## Market Returns

| (Returns in £) | 1 month | 3 months | 6 months | 1 year |
|---|---|---|---|---|
| UK Equities | 3.6% | 0.1% | 5.2% | 5.4% |
| Global Equities | 4.8% | -4.9% | -4.2% | 5.7% |
| UK Gilts | -3.3% | -2.4% | -3.2% | -2.5% |
| UK Property | 0.5% | 1.5% | 3.0% | 5.4% |
| Gold | -1.6% | 7.6% | 16.4% | 33.1% |
| Commodities | 0.0% | -9.2% | -2.5% | -1.0% |
| Sterling | 0.9% | 1.9% | 2.1% | 3.4% |

Returns to 31st May 2025. Source: Refinitiv

## Market Overview

Trump's tariffs continue to dominate headlines, with a series of hikes, deferrals, negotiations and US legal referral at the end of May. Amongst all the to and fro the UK struck a limited trade deal with the US, as well as a new agreement with the EU and India. As markets get used to Trump's negotiating style, nerves have settled and an assumption of a low level of tariffs remaining (although notably higher than before), once the dust settles. Both bond and stock markets have recovered to levels close to where they were before Trump's Liberation Day 'reciprocal tariffs'. However, the dollar has continued to weaken, revealing underlying nervousness about the harm that may still be inflicted by tariffs and damage to US supremacy.

The OECD has just downgraded global growth expectations, directly tied to the impact of US tariffs, and other sentiment survey data indicates a slowdown. Hard economic data, however, continues to hold up quite well and first quarter company results have also been reassuring. But, there is still very little economic data that reflects activity under the new tariff regimes. It could be well through summer before there is hard evidence to base expectations on.

Bond markets have been notably volatile over the last year or two, in contrast to their designated 'risk-free' status, and the last couple of months have been no different. Moody's downgraded US government debt from its previous AAA status in May, reflecting concern over the size of the government deficit and further expansion under Trump's proposed budget. With pressure to raise defence spending, balancing the fiscal books is not solely a US problem and this is putting pressure on the cost of long term debt.

Companies continue to navigate themselves through all the macroeconomic and geopolitical concerns, which sometimes throws up opportunities. There is also real hope that AI will be a transformative productivity enhancer, helping stimulate growth that will help balance books. US stock markets reflect this, but UK equity still languishes at an unjustified discount that is starting to reverse as investors question their assumptions about US exceptionalism.

OPEC+ continues to slowly raise production quotas, with a further increase due in July. The price of oil has settled around $60+ per barrel as inventories remain quite tight. European gas prices also look to have settled down at levels below the last few years, helping the inflation outlook, of which energy is a large component. Industrial metal prices slumped on the introduction of US tariffs, only partially recovering on their deferral. Gold has surged on the back of tariff uncertainty, geopolitical tensions and moves by central banks to diversify their reserve holdings away from the US dollar. Food prices might create problems later this year and notably in Japan the price of rice has doubled in the last few months.

The extended shipping times caused by attacks in the Red Sea notwithstanding, transport availability, as well as material and component supply are mostly back to normal. The worry is that tariffs will again disrupt the global supply chain and lead to shortages of some critical components. China has become the dominant supplier in a number of crucial areas, such as rare earth metals where they control ~90% of global processed supply and have already started to restrict shipments.

A global interest rate cutting cycle (bar Japan) is still in place. Although there are different views on the pace and extent of cuts, they will help small companies' finances and households with mortgages. The yields on long bonds have declined, on economic growth concerns, but remain sensitive to the growing levels of government debt across the western world. Along with tariff uncertainty, this continues to act as a headwind against long term investment decision taking.

Property fund mergers in 2024 have been followed by a number of takeovers for property REITs as their large discounts to underlying asset value has attracted international interest. With rents continuing to rise and vacancy rates at low levels, REITs still look to offer some attractions, if share price discounts remain. Listed infrastructure trusts also trade on wide discounts, renewable energy focused ones still face uncertainty on energy prices, but new regulations should provide more certainty on long term power pricing. Despite windfall taxes and higher debt costs there is still plenty of room to grow.

The political backdrop continues to be febrile, with recent election surprises in Poland, S Korea and Holland. The clear shift towards nationalist politics was countered, to an extent, in the German election, creating a right of centre government that has enabled a large fiscal spending package. In the US the Trump administration has unleashed a raft of executive orders, but there has been some judicial pushback and many require Congressional examination before policy implementation.

Despite flirting with technical recessions (two successive quarters of economic contraction) in Europe a full-on recession has so far been avoided; the fabled 'soft-landing'. However, supporting economies through Covid and the energy price spike have a real cost and take away from other economic activity; meanwhile the tricky issue of how to fund greater levels of defence spending will need to be addressed. Softness is now beginning to emerge in the employment market, although real wages have grown after a long period of erosion and a rise in household savings means consumer finances are generally quite healthy.

The company results from the first quarter of 2025 have in general held up reasonably well, with aggregate reported profits moving ahead, however, there is considerable uncertainty over prospects for the rest of the year due to US tariffs. AI continues to be a strong structural growth driver. Consumers have been showing greater price sensitivity and some industrial companies have reported demand weakness, this is particularly true of car companies, who have been slashing their forecasts.

As conflict continues to rage across the Middle East, Africa and between Russia and Ukraine, markets appear to have desensitised to the human suffering. Efforts continue to try for ceasefire agreements and hopefully progress towards peace, but they don't appear imminent. This is creating pressure for increased defence spending, to 'be prepared'. Investing can be similar, you can't predict (tariffs?), but you can prepare by ensuring that your investments are well diversified and you don't overpay for what you are invested in.

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## Market Outlook

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|---|---|
| Equities | Stock markets recovered through May, following the tariff turmoil in April. Investors became inured to on/off/deferred status of Trump's tariffs, particularly with a Congressional legal challenge. In amongst all the changes being made, as if a toddler with a light switch, the UK struck a limited trade deal with the US, which will hopefully provide some business confidence. However, the uncertainty created will almost certainly have real world effects, but for now company results and economic data reports have provided support. |
| Fixed Interest | Enthusiasm for interest rate cuts cooled in the US with the economic uncertainty and inflationary potential created by tariff proposals, meanwhile the Bank of England cut the base rate by a quarter of a percent in May. Better than expected Q1 GDP and higher than expected April inflation might pause UK rate cuts , but further cuts are expected later this year. Long term bonds (10 years +), however, have to contend with forecasts of rising government deficits, so steeper yield curves can be expected. |
| Commercial Property | There has been a marked pick-up in M&A activity in property trusts (REITs), as market stabilisation and steep discounts to quoted asset values have attracted takeover offers. This has probably been aided by a growing consensus that debt costs (one of the key factors in valuing property) have stabilised. Supply and demand have settled down and with limited new build, and higher energy standards required, the market looks to be well underpinned. |
| Alternative Assets | Infrastructure investment funds offer benefits for exposure to physical assets, some with attractive inflation linked contracts, and growth tied to improved connectivity and de-carbonising economies; although build costs have risen. High debt costs, that weighed on the valuations of private equity and infrastructure trusts, remain an issue but de-gearing is taking place. Absolute Return strategies have shown some defensiveness but generally offer low returns and we continue to choose sparingly. |
| Cash | The investment return on cash and cash like instruments has peaked and is expected to gradually decline this year. |

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**4th June 2025**