SARIKA DHANJAL Head of Asset Management ◆ **IAN HOOPER** Chief Investment Officer

Financial markets had a mixed start to the last quarter of 2025, as developed market equities rose by 2.8% and the bonds fell by 0.3%.

The gains in growth assets were driven by another solid US corporate earnings season and signs of easing trade tensions between the US and China.

In the short-term, ample liquidity, the prospects of Federal Reserve (Fed) rate cuts and positive Q3 earnings growth have offset numerous worries. AI remains a key driver and companies are being rewarded for sales and capital investment, rather than profits currently.

Starting with the economic picture, the key headline was the crucial late-month trade talks between the US and China which lifted global sentiment, with both sides progressing a one-year trade deal that would pause steeper US tariffs and limit China's export controls on rare earth minerals which are a critical constituent in the AI supply chain.

Economists have decided that the world economy is not slowing as much as earlier feared. The International Monetary Fund (IMF) now expects global growth of 3.2% this year, then marginally lower at 3.1% for the next. In broad terms, the world economy has recovered from the tariff shock, helped by easier fiscal & monetary policy and the absence of US trade retaliation by other countries.

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Amongst the other major economies, the UK is on course for GDP growth of about 1.0-1.25% in both 2025 and 2026. However, overall consumer spending remains under pressure, which reflects the squeeze on real incomes and employment.

In the US, inflation continued to surprise to the downside. While there was some evidence of tariff impact, its effect has been more moderate than many feared, and the softer inflation backdrop gave the Fed the conviction to deliver another 0.25% cut, bringing their target range to 3.75-4.00%.

While the Fed is cutting rates, Europe, the UK and China are keeping policy on hold. The ECB's latest minutes show the bank is in no hurry to move and will wait for a clear shift in growth and inflation before acting. The Bank of England will wait to see the stance of fiscal policy before deciding where rates should go next. In China, the central bank indicates that monetary policy will be guided by domestic priorities, so there is speculation that interest rates and reserve requirements may eventually be eased to support consumption and real estate.

In the UK, attention is now turning to the upcoming Budget. UK bond yields are already among the highest in the G7, with reports suggesting the Chancellor needs to find £20–30 billion through tax rises or spending cuts. Some right-wing commentators are warning that the country is drifting towards a fiscal crisis, so the details on tax, spending and the impact on inflation will be important.

Recently growth assets have continued to press higher on expectations of more AI spending, lower interest rates, and in the case of China some government organised liquidity.

Japan led performance in local currency terms over the month due to the appointment of their first female prime minister, Sanae Takaichi, who aims to pursue expansionary fiscal and monetary policies, which markets viewed as largely positive.

The latest rally in the US stock market was helped by buoyant company profits. Recent results from a stream of banks and then technology companies have generally exceeded expectations. Previous forecasts of 7-8% year on year profits growth are in the process of being upgraded. Gains were also supported by third quarter earnings: at the end of the month 320 companies (71% of market capitalisation) had reported, with 82% having beaten consensus earnings expectations (vs 73% on average), and earnings had come in 6.4% above those expectations.

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Asian markets were boosted by progress in US-China trade talks, while the UK market rose 3.7% over the month, beating most other developed markets. Falling Gilt yields gave support to UK sectors that benefit from lower interest rates, and stronger commodity prices helped mining stocks. A weaker pound also lifted the value of companies that earn most of their profits overseas.

Turning to factor performance, unsurprisingly against this backdrop, growth stocks increased their outperformance versus value stocks which were lifted by renewed enthusiasm for AI.

Turning to defensive assets - both France and the UK have been under pressure, with some of the highest government bond yields in the G7 due to political and fiscal worries. Recent events at First Brand and Tricolor also reminded investors that credit risk still exists, even when the economy is growing.

UK Gilts were the standout performer among developed government bond markets in October. The 10-year yield fell approximately 0.3%, supported by a dovish (rates are likely to fall) shift from Bank of England Governor Andrew Bailey. Weaker inflation data and a more cautious tone on growth prompted investors to increase their expectations for rate cuts next year, with markets now pricing in 0.6% of cuts by the end of 2026.

In summary, October was a broadly positive month for markets, but renewed optimism has driven US equity markets back to near all-time highs, indicating that much of the good news may already be priced in and this leaves little margin for error. Given this, we're keeping portfolios well-diversified and not relying too heavily on the US. We're adding exposure to areas with a more balanced outlook, while keeping protection in place in case inflation rises because of US tariffs.

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theprogenygroup.com ◆ @theprogenygroup ◆ +44 344 225 0660