Winter 2025

market outlook.

Brought to you by the Investment Management Team

affinity financial awareness
part of the Wealth at Work group

contents.

Written by:

The Investment Management Team

affinity financial awareness
part of the Wealth at Work group

The UK Economy

Domestic data over the quarter has been disappointing—consumer confidence has been falling, GDP growth has been sluggish, and unemployment is ticking up. With higher employment taxes coming into force in the second quarter of 2025, the short-term outlook for domestic corporates and the UK economy remains challenging.

Relative to other regions, the UK central bank has been behind the curve with regards to its monetary policy stance. Fortunately, the equity market is forward-looking and has already priced much of this into valuations. Some investors and corporations have been seizing on this disconnect, as reflected in the elevated number of UK company acquisitions recently.

As we progress through the year, if inflation remains under control, we can expect further interest rate cuts. While these cuts will take time to have an impact, they should help lift sentiment among consumers and corporations, particularly those sensitive to prevailing interest rates.

The European Economy

The European Central Bank (ECB) continues to maintain a supportive stance, acting independently while closely monitoring economic developments. In January 2025, the ECB reduced interest rates by 25 basis points in response to weak economic data, notably zero growth in the Eurozone during the fourth quarter of 2024. Some may view the rate cut as premature amid US tariff uncertainty, but lower borrowing costs should prove supportive for markets and businesses, particularly those lower down the market cap spectrum.

Political risks remain a concern, particularly in two of Europe's largest economies. France faces ongoing challenges in passing a budget due to its divided government, raising concerns about fiscal stability and the long-term direction of policy. In Germany, the political landscape is also uncertain as the country prepares for a snap national election on 23rd February, following the collapse of Chancellor Olaf Scholz's three-way coalition. While this political turbulence may be short-lived, it has the potential to create noise as investors await clarity on the future direction of leadership and policy.

European equity valuations remain relatively attractive compared to other global markets, offering an appealing opportunity for investors. However, these opportunities must be considered alongside ongoing structural challenges and trade tensions. Europe's complex trade negotiations with China are ongoing, with the European Union (EU) working to safeguard its critical industries, while concerns about potential US tariffs continue to affect market sentiment. While no tariffs have been imposed yet, the threat of trade barriers—particularly targeting vulnerable sectors like autos and luxury goods—remains a significant concern.

Europe continues to feel the ongoing impact of Russia's war in Ukraine. While there is some optimism that President Trump's historically cordial relationship with President Putin could help facilitate a resolution, Trump's recent posturing and controversial remarks about US interests in Greenland, the Gaza Strip, and the Panama Canal suggest that addressing the Russia-Ukraine conflict may not be his immediate priority. While these statements have sparked widespread criticism and led to short-term market fluctuations, it's important to remember that such provocative comments from Trump rarely result in tangible actions and should be viewed as noise rather than meaningful policy shifts. Historically, markets have shown resilience even amid periods of heightened political rhetoric, with long-term trends driven by fundamentals, not fleeting headlines.

The US Economy

President Donald Trump has returned to the Oval Office for a second term. Known for his pro-business policies, he is focused on stimulating economic growth, reducing regulations, and supporting domestic industries. His administration has already implemented executive orders aimed at boosting corporate profitability, with a focus on tax cuts, deregulation, and trade policies that prioritise American interests. These measures are expected to create a favourable outlook for US equities.

The Federal Reserve has reaffirmed its commitment to maintaining independence. Chair Jerome Powell has affirmed that policymakers will not be influenced by external forces despite ongoing calls from Trump and other major central banks to cut interest rates particularly as incoming economic data continues to show a resilient economy, a strong labour market, and steady wage growth. Policymakers are expected to proceed with caution, waiting for greater clarity on fiscal and trade policies before making any significant changes to interest rates.

Trump's proposed tariffs, which include a 25% levy on goods from Mexico and Canada and a 10% tax on Chinese imports, are intended to address trade imbalances and protect US industries. While these tariffs could disrupt supply chains and increase costs in the short term, they also create opportunities for trade negotiations that may benefit the US in the long run. Domestic companies, particularly smaller businesses, could see a competitive advantage from reduced foreign competition. Although retaliatory measures may introduce short-term volatility, these actions can be viewed as part of a broader negotiation framework which could advance US interests and establish more equitable trade relationships, potentially benefiting global equities over the long term.

The "Magnificent 7" continues to be a key driver of US equity performance. President Trump’s pledge of $500 billion in support of Stargate, a new initiative designed to expand AI infrastructure within the US, is expected to further strengthen the dominance of major tech firms, ensuring their continued leadership in market growth this year. However, we remain aware of noise in the tech sector that isn’t driven by fundamentals. A recent example was the market’s initial reaction to DeepSeek, a new AI entrant from China. The US markets quickly rebounded, as it became clear that DeepSeek’s technology was less advanced than expected and still reliant on US leaders like Nvidia, highlighting the strength of US-based tech giants in AI.

The US dollar has maintained its strength, continuing to act as a safe haven for investors, particularly amidst ongoing volatility in the yield curve. With President Trump’s emphasis on domestic policies and tariffs, coupled with the Federal Reserve's cautious stance on interest rate cuts, this trend of dollar strength/stability is expected to persist in the near term.

The Japanese Economy

In January 2025, the Bank of Japan raised its benchmark interest rate to 0.5%, the highest level since 2008, signalling confidence in achieving stable inflation. However, much of this inflation remains imported, and Japan's interest rates remain significantly below those of other major economies. This continued divergence in monetary policies poses risks, especially as fluctuations in the yen can significantly impact Japanese equities.

The weaker yen has helped boost Japan's export-driven economy by making its goods more competitive internationally. However, the Bank of Japan's more hawkish stance could put upward pressure on the yen, which would reduce the competitiveness of Japanese exports. Japan's trade surplus with the US presents a potential risk of tariffs, particularly with President Trump's focus on addressing trade imbalances. Tariffs could negatively impact the profitability of Japanese exporters by dampening demand for their products. Considering these factors, this could introduce some short-term volatility to markets.

Political challenges continue to mount for Prime Minister Ishiba's government as it grapples with the looming risk of having its budget rejected by Parliament unless it satisfies the demands of the opposition. Despite his recent appointment to the role, Ishiba's approval ratings have notably declined, signalling a growing dissatisfaction with his leadership. This has created an atmosphere of political instability as the country heads into the critical Upper House election on July 27. The uncertainty surrounding the government's ability to pass essential legislation has cast a shadow over its prospects, and this potential instability could undermine market confidence.

We maintain no exposure to Japan at this time due to ongoing risks related to currency fluctuations, trade dynamics, and political developments. Mid- and small-cap stocks remain under researched and may benefit from stimulus support and a more favourable macroeconomic backdrop. However, we are awaiting these conditions to materialise before considering potential opportunities in this space.

Emerging Markets & Asia Economy

The People's Bank of China's monetary easing and fiscal support have lifted stock market valuations, yet they remain attractive by historical standards. Record stimulus continues to filter through into the economy, and with markets typically rising after the Lunar New Year, the outlook is positive. Key policy announcements are delayed until mid-March, but we expect clearer insight into government spending and further stimulus after the National People's Congress.

The 10% tariffs on Chinese goods are significantly lower than the initially proposed 60% during President Trump's campaign. China has imposed retaliatory tariffs on US products like coal and crude oil. Despite these tensions, the deep economic ties between the US and China suggest opportunities for constructive trade negotiations going forward. The People's Bank of China is also well-equipped to mitigate tariff effects, which could be supportive for markets.

Enthused by US semiconductor export controls, China has made notable progress in AI development, with companies like DeepSeek and Alibaba's Qwen entering the market this quarter. These new players have attracted attention, but their reliance on Nvidia chips and less advanced technology limits their potential to challenge the dominant market leaders in the near future, particularly from the perspective of Western consumers.

India's economy is poised for sustained growth, driven by robust domestic consumption, a growing middle class, and ongoing infrastructure development. President Modi's focus on economic reforms coupled with the recent budget that prioritises consumption driven by announced tax cuts for lower earners, further strengthens the economic outlook. Additionally, India's strategic role as a counterbalance to China, coupled with strong US-India relations under the previous administration, positions Indian equities for potential growth this year.

Trump's proposed tariffs on Mexican goods, along with his firm stance on immigration, could significantly affect economic relations between the US and its southern neighbours. While the attractive valuations create an appealing backdrop for long-term investment in Latin America, we have adopted a more selective and disciplined approach allowing us to identify opportunities with favourable risk-reward profiles while minimising exposure to those markets and industries that could be negatively impacted by short-term external factors.

Fixed Interest

In the UK, government bond yields have been volatile throughout the quarter. However, despite this fluctuation, the overall change from the beginning to the end of the period has been modest, with yields ending slightly higher than where they started.

Nearly all the volatility in fixed income markets has come from government bonds. Meanwhile, spreads on corporate bonds have remained tight and have not displayed any material volatility.

While uncertainty surrounding growth, inflation, and government deficits has driven volatility in government bond yields, companies, by contrast, have generally demonstrated strong financial discipline. With solid balance sheets and ample liquidity, they are well-positioned to navigate short-term challenges.

Overall, yields remain attractive despite tight spreads, with market dynamics continuing to provide support.

If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on 0800 049 2011, Monday to Friday 9am-5pm or you can email us at affinity.advise@wealthatwork.co.uk

affinity financial awareness
part of the Wealth at Work group