Oxfordshire County Council Pension Fund

Quarterly Investment Report

Q3 2024

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Key Indicators at a Glance

	Index (Local Currency)	Q4	YTD
Equities		**Total Return**	
UK Large-Cap Equities	FTSE 100	-0.18%	9.63%
UK All-Cap Equities	FTSE All-Share	-0.35%	9.47%
US Equities	S&P 500	2.41%	25.02%
European Equities	EURO STOXX 50 Price EUR	-1.83%	11.01%
Japanese Equities	Nikkei 225	5.35%	21.33%
EM Equities	MSCI Emerging Markets	-8.01%	7.50%
Global Equities	MSCI World	-0.16%	18.67%
Government Bonds			
UK Gilts	FTSE Actuaries UK Gilts TR All Stocks	-3.10%	-3.32%
UK Gilts Over 15 Years	FTSE Actuaries Uk Gilts Over 15 Yr	-7.15%	-10.63%
UK Index-Linked Gilts	FTSE Actuaries UK Index-Linked Gilts TR All Stocks	-5.98%	-8.32%
UK Index-Linked Gilts Over 15 Years	FTSE Actuaries UK Index-Linked Gilts TR Over 15 Yr	-10.11%	-15.40%
Euro Gov Bonds	Bloomberg EU Govt All Bonds TR	-0.10%	1.86%
US Gov Bonds	Bloomberg US Treasuries TR Unhedged	-3.14%	0.58%
EM Gov Bonds (Local)	J.P. Morgan Government Bond Index Emerging Markets Core Index	-6.70%	-2.40%
EM Gov Bonds (Hard/USD)	J.P. Morgan Emerging Markets Global Diversified Index	-1.94%	6.54%
Bond Indices			
UK Corporate Investment Grade (1)	S&P UK Investment Grade Corporate Bond Index TR (1)	-0.91%	1.29%
European Corporate Investment Grade	Bloomberg Pan-European Aggregate Corporate TR Unhedged	0.80%	4.99%
European Corporate High Yield	Bloomberg Pan-European HY TR Unhedged	2.00%	9.14%
US Corporate Investment Grade	Bloomberg US Corporate Investment Grade TR Unhedged	-3.04%	2.13%
US Corporate High Yield	Bloomberg US Corporate HY TR Unhedged	0.17%	8.19%
Commodities			
Brent Crude Oil	Generic 1st Crude Oil, Brent, USD/bbl	4.00%	-3.12%
Natural Gas (US)	Generic 1st Natural Gas, USD/MMBtu	24.29%	44.51%
Gold	Generic 1st Gold, USD/toz	0.19%	27.47%
Copper	Generic 1st Copper, USD/lb	-11.56%	3.50%
Currencies			
GBP/EUR	GBPEUR Exchange Rate	0.61%	4.77%
GBP/USD	GBPUSD Exchange Rate	-6.42%	-1.69%
EUR/USD	EURUSD Exchange Rate	-7.01%	-6.21%
USD/JPY	USDJPY Exchange Rate	9.45%	11.46%
Dollar Index	Dollar Index Spot	7.65%	7.06%
USD/CNY	USDCNY Exchange Rate	4.00%	2.81%
Alternatives			
Infrastructure	S&P Global Infrastructure Index	-2.53%	14.94%
Private Equity	S&P Listed Private Equity Index	3.23%	25.33%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index	3.25%	10.22%
Global Real Estate	FTSE EPRA Nareit Global Index TR GBP	-3.23%	3.39%
Volatility		**Change in Volatility**	
VIX	Chicago Board Options Exchange SPX Volatility Index	3.71%	39.36%

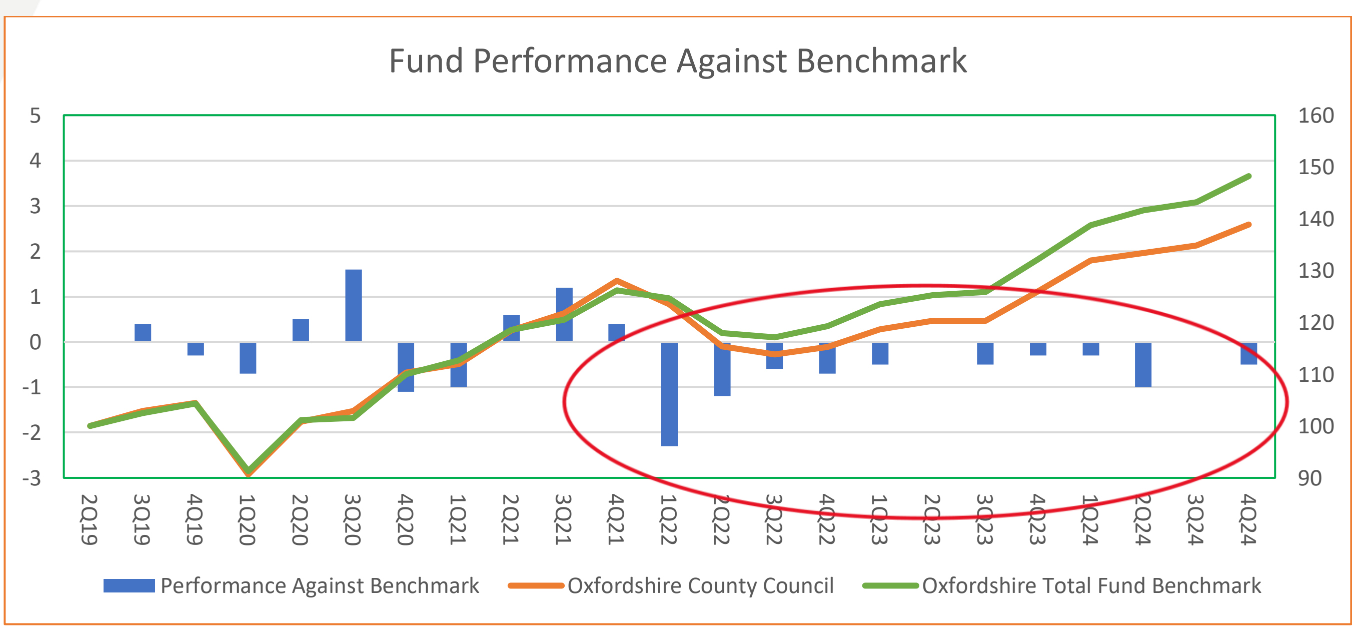
Source: Bloomberg. All return figures quoted are total return, calculated with gross dividends/income reinvested and in local currency.

Performance

The Fund rose by 3.0% in the fourth quarter of 2024 to a value of £3.715bn. Markets were more difficult in Q4 and, although Japanese and US equity markets rose in local currency terms, EU and UK equities fell slightly and globally bond markets were weaker. Performance across Alternative sectors was also mixed with a positive return from Private Equity but more difficult trading in Infrastructure with some signs of an adjustment down in both solar and wind generation assumptions. The US Dollar was strong, rising over 6% against Sterling, aiding returns for a Sterling investor in what would otherwise have been a negative return for the quarter.

The Fund underperformed its benchmark in Q4 by -0.5%. Approximately 0.75% of the underperformance in the quarter came from the two active Global Equity mandates, Global High Alpha and Sustainable, which both continued their run of poor performance. It was, however, a difficult quarter for all active equity managers as the US equity market in particular was swayed by speculation over which companies would be winners and losers from their relationship with the new president, Donald Trump, and it felt like this speculation outweighed any fundamental investment analysis. If this is the case this effect should unwind in the current quarter and active managers outperform.

Chart 1: Oxfordshire Pension Fund Performance



The chart above shows the cumulative performance of the Total Fund against its Strategic Benchmark rebalanced to 100 (the lines) on the right hand scale and the Fund's quarterly relative performance against its strategic benchmark (in blocks) on the left hand scale. All of the Fund's underperformance has occurred since the transfer of assets to Brunel and, in particular, since the Russian invasion of Ukraine in 2022 and the subsequent rise in inflation and then interest rates and it is this that has driven the poor performance of their selected managers, particularly within the main active equity portfolios. Because of this the Fund continues to lag its benchmark over the longer term, underperforming over 1 year (by-1.9%) over 3 years (by -2.6%); 5 years (by -1.2%) and 10 years (by -0.2%).

Over the last 3 years the performance of the underlying managers selected by Brunel has been disappointing with over half the total underperformance of -2.6% relative to the Strategic Benchmark coming from the poor performance of the two main Global Equity portfolios, Sustainable and Global High Alpha. However, I believe this to be heavily influenced by the strong environmental slant which is a core part of Brunel's ethos. I continue to support this environmentally focused slant for the

longer term, however, the poor performance is showing no signs of recovery at present and the fourth quarter was again disappointing.

US equity performance in the fourth quarter was focused on the election of the new US president, Donald Trump, and which stocks would gain whilst he is in power given the more radical political agenda and his history of rewarding those close to him. To illustrate the extremes this went to during Q4, the chart below shows the performance of Tesla which is 13% owned and led by Elon Musk, close confidant and cheerleader for Donald Trump.

Chart 2: Tesla share price over the last 12 months

This stock more than doubled in the month post the presidential election as market participants sought to buy shares which they believed would benefit from the support of the President. I would note that in the past it has only been common in emerging markets for the support of the governing party to be essential to the wellbeing of a business. It is, to me, unbelievable that the potential support of the President should be worth approximately USD700bn on the market capitalisation of Tesla at the peak. If this turns out to be a fair reflection of the benefits of a close relationship to the US president then the rules of capitalism have changed and the role and reach of the US Government is vastly different from what we have experienced in the past.

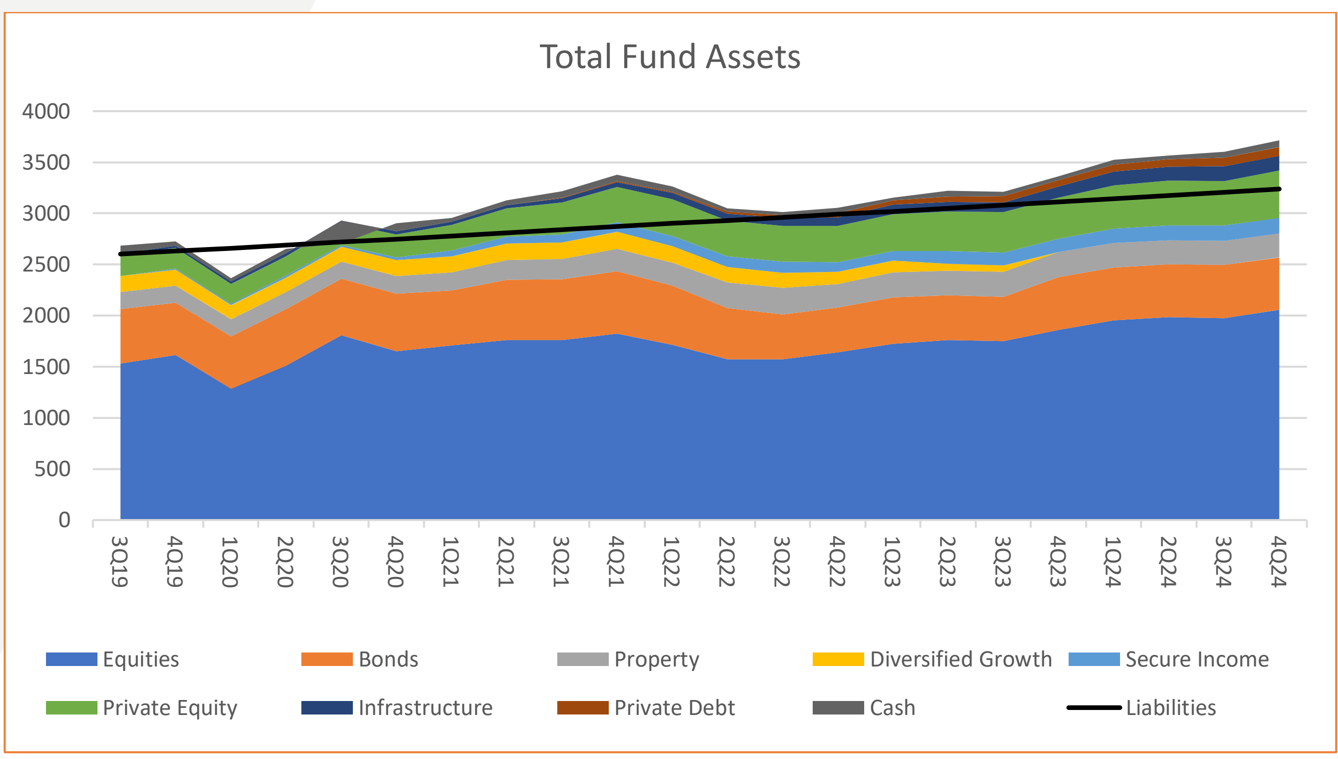
As can be seen in the right hand side of the chart above, this is beginning to unwind post quarter end and I would hope that long-term fundamental analysis will reassert itself in the coming quarters to the benefit of the active equity managers selected by Brunel.

Returns of 7.6% per annum over the last 10 years, being above the Fund's actuarial discount rate assumption for future investment returns, will have helped improve the funding ratio between the triennial actuarial revaluations.

I note the recent resignation of Brunel CIO David Vickers, this is a disappointment and underlines the rapid turnover in senior posts experienced across the LGPS pools. Given the Government's intention to push further responsibilities into the pools this raises a concern.

Chart 3 shows the assets of the Fund by asset class with the Fund currently at an all-time high valuation of £3.715bn as at 31/12/24. I have also shown a black line which is the assumed valuation of the liabilities. Please treat this with some caution, the liabilities are valued by the actuary every three years. At this time they calculate the value of all earnt pension benefits plus the expected value of all future pension entitlements by the existing membership. This future liability is discounted back to today's value using a discount rate which reflects market conditions on the day of the valuation so, in essence, a snapshot once every three years. At the time of the actuarial revaluation, the actuary also calculates the future investment return which gives them the required probability of maintaining full funding into the future. To create the line in the chart, I have compounded up the valuation of the liabilities in March 2022 by the required investment return for each quarter.

Chart 3: Oxfordshire Pension Fund Assets



As bond yields have risen since the last actuarial revaluation it is likely that the actuary will use a higher discount rate to value future pension liabilities when they revalue the liabilities on 31/3/25. this will reduce the current valuation of future pensions in today's money and, thereby, reduce the value of the liabilities and increase the funding level of the Fund all else being equal, but, in addition, the actuary is likely to require a higher investment return going forward. There are also a number of other assumptions that the actuary makes when calculating the value of the pension liabilities including longevity and I have not made any estimation for these.

Comment

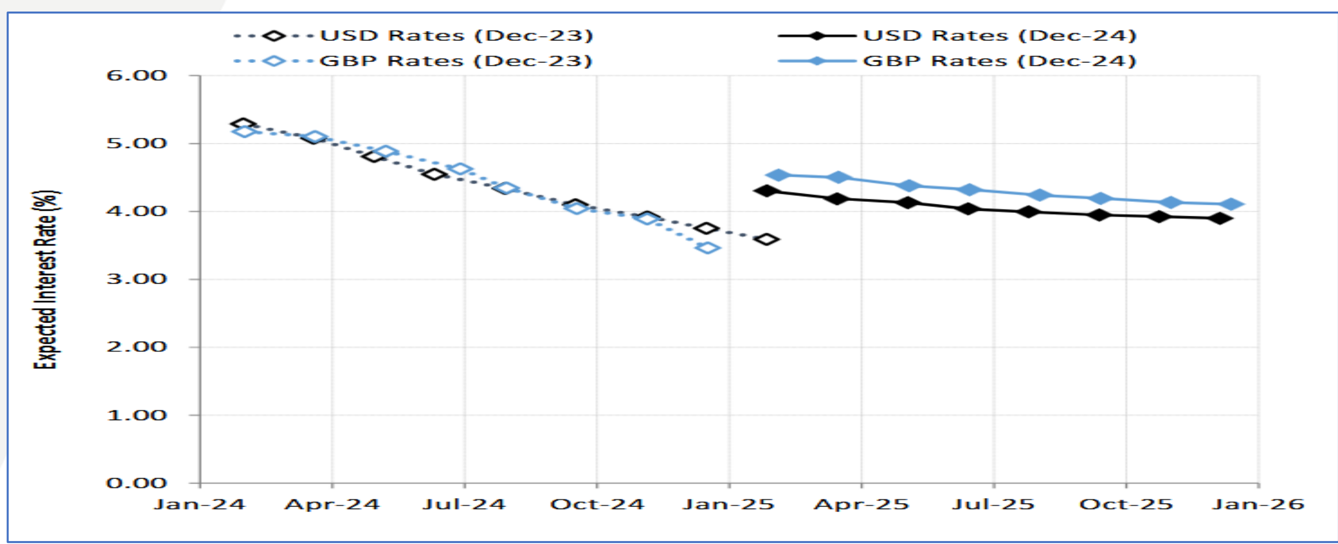
The surprise in 2024 was the strength of the US economy (again!). At the start of 2024 expectations for US GDP growth in 2024 were around 1.2% with many commentators seeing the risks to the downside and a potential recession as the US consumer finally felt the effects of higher interest rates. The outturn was US GDP growth of 2.8% over 2024, with annualised GDP growth in Q4 of over 3%, only marginally down from 2023's 3.2% and still robust enough to provide good earnings growth across much of the corporate sector. This lead to the strong US equity market performance and tightening credit spreads as the corporate sector continued in good health. In 2024 the main US equity index (S&P 500) was up 25% in US Dollar terms which followed a rise of 26% the previous year. This was supported by the very strong performance of US technology stocks, particularly those focused on AI. Elsewhere GDP growth came in close to expectations in 2024 with the EU and UK weak.

Chart 4 shows the predicted path of interest rates in the US and UK with the dotted line being forecasted in January 2024 and the solid line the forecast in January 2025. As can be seen, the strength of the US economy has led to a reappraisal of the timing and extent of the expected fall in interest rates but this has only been part of the story. President Trump's policies towards boosting growth, raising trade tariffs and clamping down on immigration are all inflationary and this is pushing bond yields higher (prices lower) at longer maturities. This has affected interest rate expectations across the developed world but,

particularly in the UK, where it is mixed with stubborn wage inflation and high government borrowing which has limited the scope for interest rate cuts.

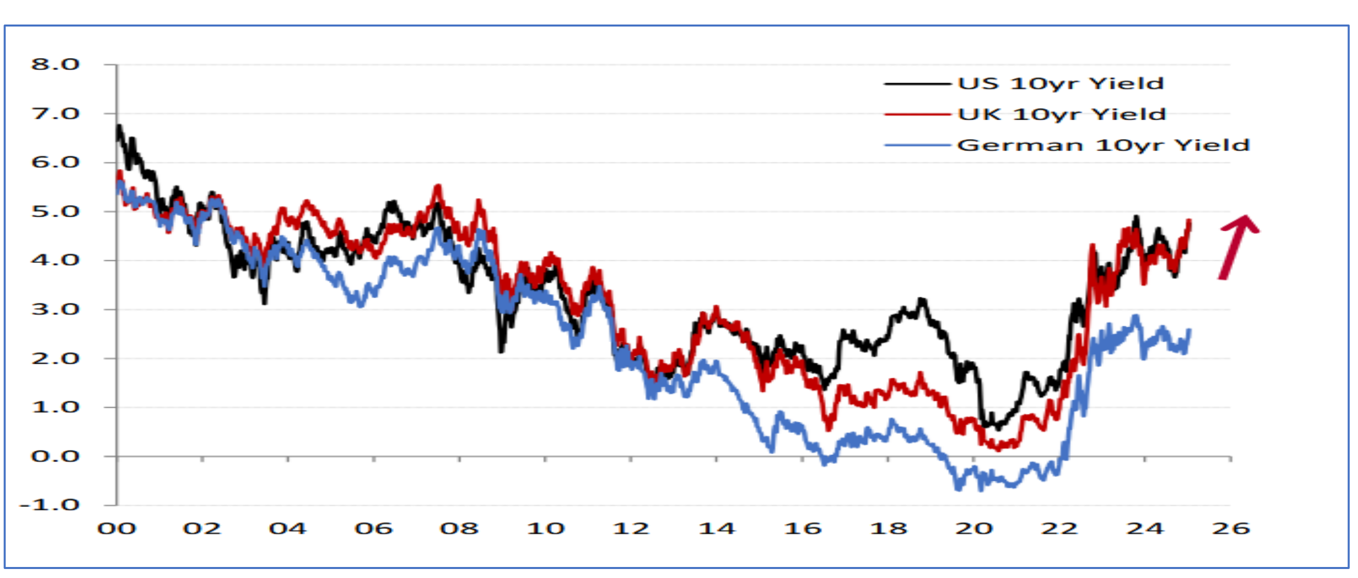
Going forward I expect central banks to continue gently cutting interest rates through 2025 despite inflation not hitting their 2% target, providing the Trump tariffs do not stoke immediate inflation.

Chart 4: US and UK interest rate expectations



If President Trump attempts to force short-term interest rates down to suit his political aims by replacing the current independent chair of the Federal Reserve (US Fed) Jerome Powell with someone more compliant, this could cause investors to lose confidence in the inflation outlook over the longer term and thereby push bond yields still higher (prices lower) in the belief that inflation will remain higher into the future. See Chart 5 below.

Chart 5: 10-year bond yields



Looking at valuations across equity markets, the strength of US equities has not been driven entirely by rising profits, valuations have been pushed higher and now stand at an historically high level and at a stretched premium to other equity markets.

This makes some sense given the make-up of the US indices with a higher percentage of faster growing technology stocks but, given the premium valuation attributed to US stocks at present, particularly the US Technology sector, and the concentration of the index into a small number of very large stocks in the US, I would now be looking to bias equity portfolios away from the US.

Given the heightened level of political uncertainty and the uncharted waters we are entering with trade tariffs rising rapidly and an immigration clampdown in the US, it would seem probable that the law of unintended consequences will play out and in those circumstances I would rather be in cheaper markets than expensive ones.

Chart 6: Equity market valuations

Total Returns in GBP (2020-2024)

Dividend Earnings Growth Valuation Change Currency Total Return

20% 16% 12% 8% 4% 0% -4% -8%

World USA Eurozone UK Japan EM China A

Source MSCI/Davy

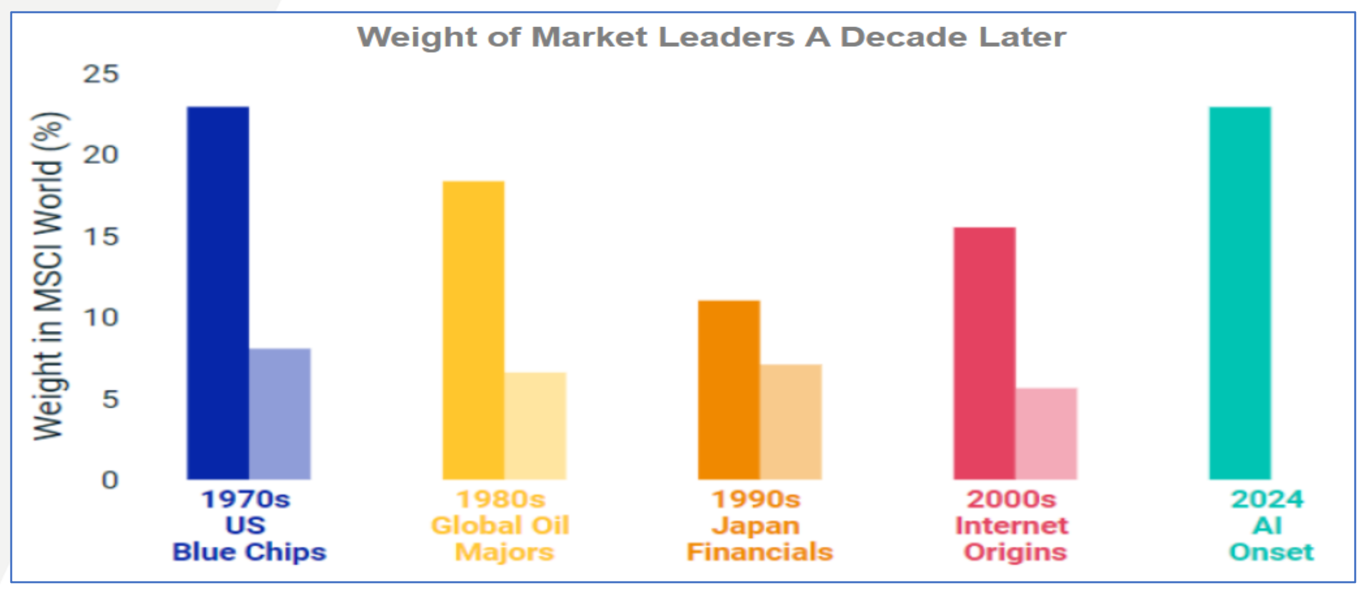
The chart above breaks down the total return achieved by different equity markets over the last 5 years (annualised). As can be seen, the level of earnings growth in the US, Japanese and European equity markets has not been too dissimilar over this post Covid period, but the return from the US equity market has been boosted by an increase in the valuation investors are prepared to pay.

This does not remove the probability that the US should see GDP growth above 2% in 2025 and the corporate sector continue to see good earnings growth. It seems likely that President Trump will support the US technology sector, particularly against judicial interference and any challenge from competition authorities, but by protecting them from outside forces he will dampen innovation in the longer term. History tells us that the stock market always over-values today's winners and never sees the threats approaching for them.

The chart on the following page (Chart 7) shows the maximum concentration of the largest 10 stocks in the MSCI World index at their peak and then again 10 years later. Each time the market has overestimated the peak and extrapolated a story beyond what is likely, or in some cases, even feasibly possible. The result is that the subsequent 10 years sees an unwinding of this over-valuation. The difficulty, of course, is telling when the peak is!

This index concentration has made life difficult for active managers. If the concentration begins to unwind, active managers should benefit from a broader, and perhaps, more rational market environment.

Chart 7: Market Concentration – weight of the largest 10 stocks in the MSCI world index



Source MSCI/Davy

It could be different this time and perhaps social media, data and the massive level of investment needed for AI to work naturally creates monopolies which reap excessive returns and last well into the future but that sounds too easy to fit with my experience.

The other market signal of stress is the gold price (See Chart 8). Gold has risen consistently through 2024 and accelerated again year-to-date. The obvious answer to why this is happening is more buyers than sellers! It appears that demand from central banks has increased, particularly from China who will be looking to diversify their Central Bank reserves which are largely in US Treasuries. However, the rise is also symbolic of greater political uncertainty and heightened inflation risk.

Chart 8: Gold price in US Dollars

Long Term Capital Market Assumptions

Table 1: J P Morgan LTCM assumptions for 2025

Return forecast in Sterling	2024 LTCM forecast	2025 LTCM forecast	Annualised Volatility
UK Cash	2.8%	2.9%	0.7%
UK Gilts	4.5%	4.2%	7.7%
UK Investment Grade Bonds	5.4%	5.2%	8.2%
UK Index Linked Bonds	5.3%	4.4%	11.2%
Multi-Asset Credit	6.3%	5.8%	8.8%
Global Equities	6.2%	6.3%	13.7%
Emerging Market Equities	7.2%	6.4%	17.9%
UK Core Real Estate	6.5%	7.6%	13.1%
Global Value-Added Real Estate	8.1%	9.0%	17.8%
Global Infrastructure	5.2%	5.5%	10.6%
Private Equity	8.1%	9.1%	17.2%
Private lending	6.9%	7.4%	15.4%
Gold	2.5%	3.3%	16.9%

As can be seen from the table above, investment return expectations for Bonds have fallen slightly as interest rates have fallen from recent highs but return assumptions for Equities and Alternative Assets have increased. J P Morgan have raised there expected Global Equity return on the back of greater investment and the benefits of AI but this only accrues to Developed Equity markets, expected returns on Emerging Market Equities fall. Alternatives see slightly raised return expectations across the board following a couple of more muted years with UK and International Property and Private Equity in particular looking attractive.

Table 2: Regional Equity Return Forecasts

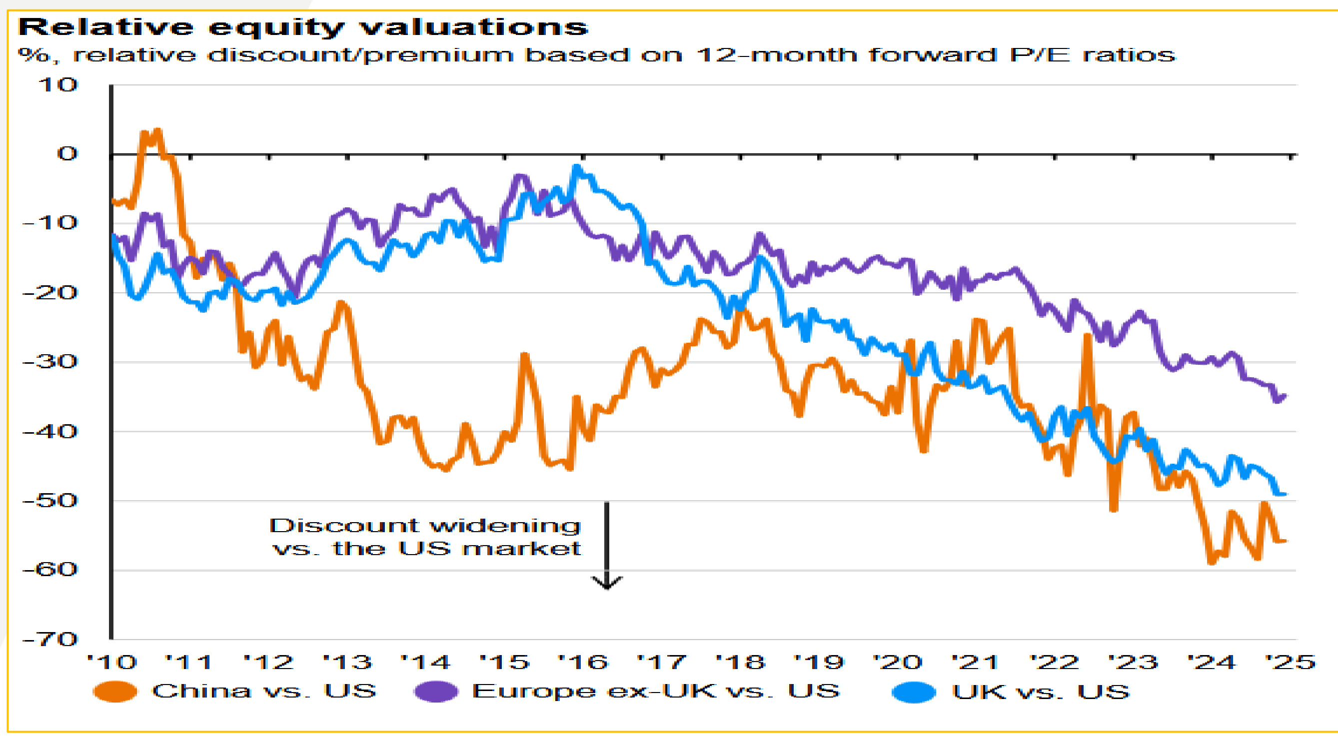
Return forecast in £	2024 LTCM Forecast	2025 LTCM Forecast
Global Equities	6.2%	6.3%
US Large Cap Equities	5.4%	5.9%
EU Large Cap Equities	8.1%	7.7%
UK Equities	7.2%	7.1%
Japanese Equities	7.7%	8.2%
EM Equities	7.2%	6.4%

As can be seen in the chart above, within Global Equities, the majority of the slight increase in return expectation is driven by a rise in the forecast return from US Equities although this still lags the returns forecasted elsewhere. In the short term, the US is looking likely to produce higher economic growth and hence corporate profit growth than elsewhere but the valuation of US Equities is looking increasingly stretched and my own preference is to believe that valuations matter and that exceptionalism is only ever a passing phase. The policies of President Trump are a destabilising factor and whilst the markets seem prepared to accept these at the current time, I do see the law of unintended consequences as more likely to be a factor during times of rapid and unpredictable change and, as such, would rather be invested where there is valuation support than not

The US market now makes up more the 70% of the Global Equity indices and is on a significant valuation premium to other markets. Whilst this might be justified for a while longer, I suspect investors are resorting to extrapolating current trends and then writing the justification for this rather than thinking about the longer term.

The chart on the following page shows the current valuation premium of US stocks against history.

Chart 9: US Valuation Premium



Active Versus Passive Equities

It should be an easy decision to invest passively within Global Equities given the better historical performance when compared with active management and cheaper investment management costs. Many commentators have tried to call a resurgence in the performance of active management only to be embarrassed again and again. However…

1) I do believe there is a subset of active managers who can outperform over the long-term. They have a strong investment philosophy, which drives a rigorous investment process, which requires significant resources to conduct their own primary research.
2) They invest for the long-term, otherwise the costs of researching investment ideas never gets paid off and they are more often owned as a partnership partnerships rather than part of a large investment firm which helps enable this longer term approach.
3) Their resulting portfolio tends to be concentrated with a relatively small number of high conviction holdings which means that its performance will be significantly different from the index. This can be mollified by employing a small number of such active managers, each with an individual investment approach, such that the combined portfolio has a lower investment risk and hence, lower volatility in relative performance.
4) Markets tend to go through phases when a particular style of investment works and then fades away. This partly explains why high conviction, active managers exhibit serial correlation of their relative performance against an index but, medium term, a reversion to the statistical mean. This means that if a manager has outperformed in the last quarter they are more likely to continue to outperform as market dynamics remain stable but their performance will ultimately return to the mean, or below for a period of time as the long-term market dynamics change. Nonetheless, if their primary research is well focused and thorough, they should add value over the long-term.

My understanding here actually fits with the approach that has been adopted by Brunel from the start when they first selected multiple managers for each of the Global High Alpha and the Sustainable portfolios. Unfortunately, their style biases have been a drag in performance over the last four years.

On top of this view, I do see markets today as unnaturally concentrated in a few large US tech stocks. Chart 7, earlier shows this concentration and how, previously, such concentrations have always unwound and I would assume this will again be the case at some stage. When this happens, the large tech stocks in the US will underperform for a prolonged period aiding active managers who are usually underweight these stocks due to internal risk constraints. When this happens, the US market itself will also underperform, particularly given its current raised valuation level. I cannot guess when this will happen and recognise that under President Trump monopolies in the tech space are likely to thrive as competition authorities are kept at bay and it may take longer for these monopolies to be undermined by competitive forces than in the past but the more they are protected, the less innovative they will become.

Lastly, from an ESG and Responsible Investment perspective, I see it as only really possible to enact a Responsible Investment policy through active ownership otherwise the ultimate lever, to disinvest if you do not believe a company is engaging properly with its broader societal or environmental responsibilities, no longer exists. Even engagement can be less effective when you have to hold the stock anyway.

Because of the above, I believe now is a time to stick with active equity manages rather than take the easier root and adopt a passive approach.

Asset Allocation

Table 3: The Fund's current asset allocation against the Strategic Benchmark

Asset class	Asset Allocation as at 31/12/24	Strategic Asset Allocation	Position against the SAA	Deviation in cash terms
UK Equities	10.3%	**10%**	+0.3%	-£11
Global Equities ex UK	45.1%	**41%**	+4.1%	-£152m
Fixed Interest	8.1%	**9%**	-0.9%	+£33m
Index-Linked Gilts	5.7%	**7%**	-1.3%	+£48m
Property	6.4%	**8%**	-1.6%	+£59m
Private Equity	12.4%	**10%**	2.4%	-£89m
Secure Income	4.2%	**5%**	-0.8%	+£29m
Private Debt	2.3%	**5%**	-2.7%	+£100m
Infrastructure	3.8%	**5%**	-1.2%	+£45m
Cash	1.8%	**0%**	+1.8%	-£67m

These figures are taken from the State Street report. Figures may not add up due to rounding.

The current deviation from the Fund's SAA is within acceptable bounds although I would recommend taking the equity weighting back to the benchmark and reinvesting UK Corporate Investment Grade Bonds particularly as this money has already been committed to invest into Alternative Asset Classes and is awaiting drawdown. This holding would be temporary as the money would be drawn down into the Alternative portfolios over time.

Points for Consideration

1) Performance of the two global equity portfolios was again poor in the fourth quarter and again there were plausible reasons for this in the concentration of stock aligned with President Trump benefitting from his election victory at the expense of any rational investment approach. Looking at share price movements so far in the current quarter, this appears to be unwinding and the two active global equity portfolios should outperform their benchmarks in this quarter but this has to now continue.

With so many of Brunel's portfolios underperforming, they will be under increasing pressure to take action and change managers. This always comes with a cost as the new manager wants to alter the portfolio they inherit but pressure should be kept on Brunel to explain manager changes. This should not purely be done on the basis of poor past performance. By the time you have suffered three years of past performance the investment style the market is rewarding may be about to change. This is where the vast majority of manager changes within LGPS funds have been shown to be badly timed historically. Brunel must give a clear rationale of any manager changes.

2) The move to a new, smaller cap focused UK Equity portfolio is ongoing. I would expect a review of this transition in due course.

Underlying Mandates

Rather than comment on each portfolio separately, duplicating the reporting from Brunel, the table below sets out each portfolio within the Fund with a note on my opinion of the management and performance using a traffic light system. Because of the transfer of assets to Brunel all the portfolios will have changed manager over the last four years. For this reason I have rated some of the portfolios amber purely because the performance history is too short to support an opinion.

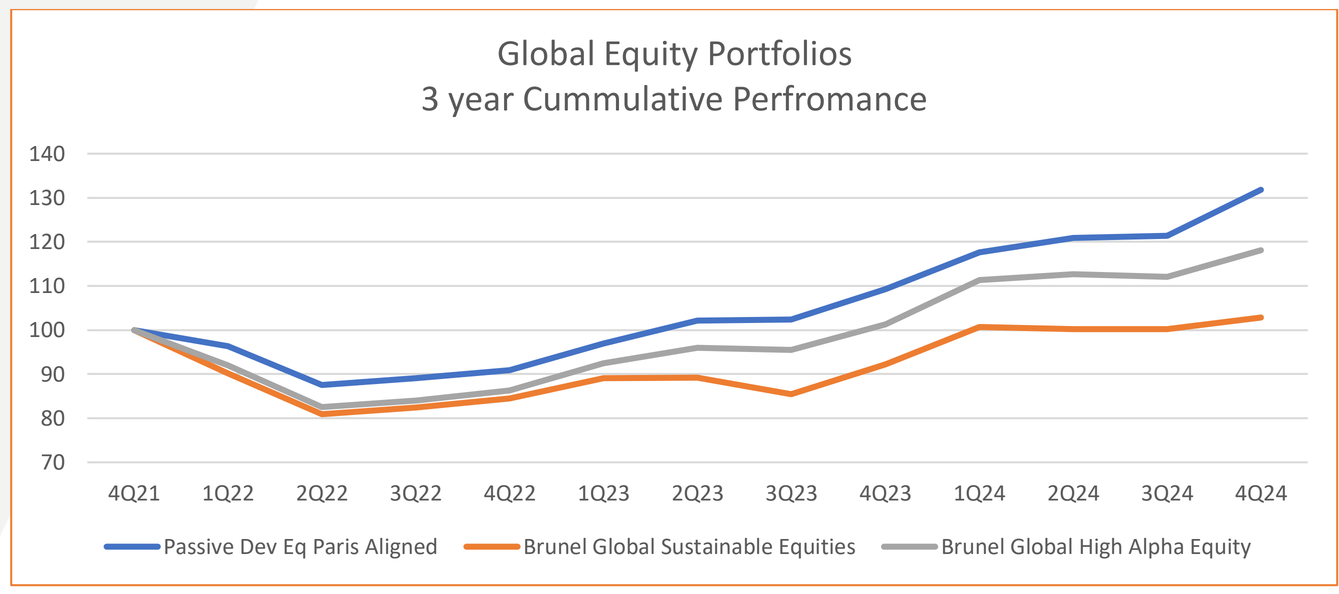
We now have 3-year performance figures for both Private equity and Infrastructure, and whilst the initial drawdowns to these portfolios were slow and Brunel's speed of commitment was initially poor this has now speeded up and performance figures do suggest that Brunel are achieving a reasonable level of return from these asset classes.

Portfolio	Benchmark	Inception	Performance	3 year relative p.a.	Comment
UK Equity	FT All-Share EX IT	09/18		-1.2%	Performance has been below benchmark across all longer term periods but appears to be recovering.
Global High Alpha	MSCI World Equity	09/19		-4.0%	Underperformance over three years of -4.0% but outperformance since inception in 6/19.
Global Sustainable	MSCI All World Equity	09/20		-7.8%	Performance a major concern with the portfolio underperforming by over 5% p.a. since inception in 10/20
Global Paris Aligned	MSCI Paris Aligned	07/18		n/a	Passive portfolio, yet to reach 3-year figures. I have some concerns over portfolio construction.
UK Fixed Interest	£ Non-Gilt Credit	11/21		1.1%	Acceptable performance in a strong credit environment.
Passive Index-Linked	FTSE >5 Year Index-Linked			0.1%	
Multi Asset Credit	Cash + 2%	11/21		-4.0%	Performance has lagged the benchmark since inception portfolio construction is heavily weighted to one, defensive manager.
Property	Property benchmark	04/20		n/a	UK Performance has been good but poor in International Property lagging by 5%.
Secure Income	Cash + 4%	07/20		n/a	Noticeable performance issues.
Infrastructure	CPI	01/19		n/a	Drawdown has been slow; performance looks OK.
Private Equity	MSCI All World Equity	01/19		n/a	Drawdown has been slow; performance looks good for cycle 1 but poor for cycle 2.
Private Debt	Cash + 5%	08/17		n/a	Drawdown has been slow; performance looks good.

Portfolio Performance

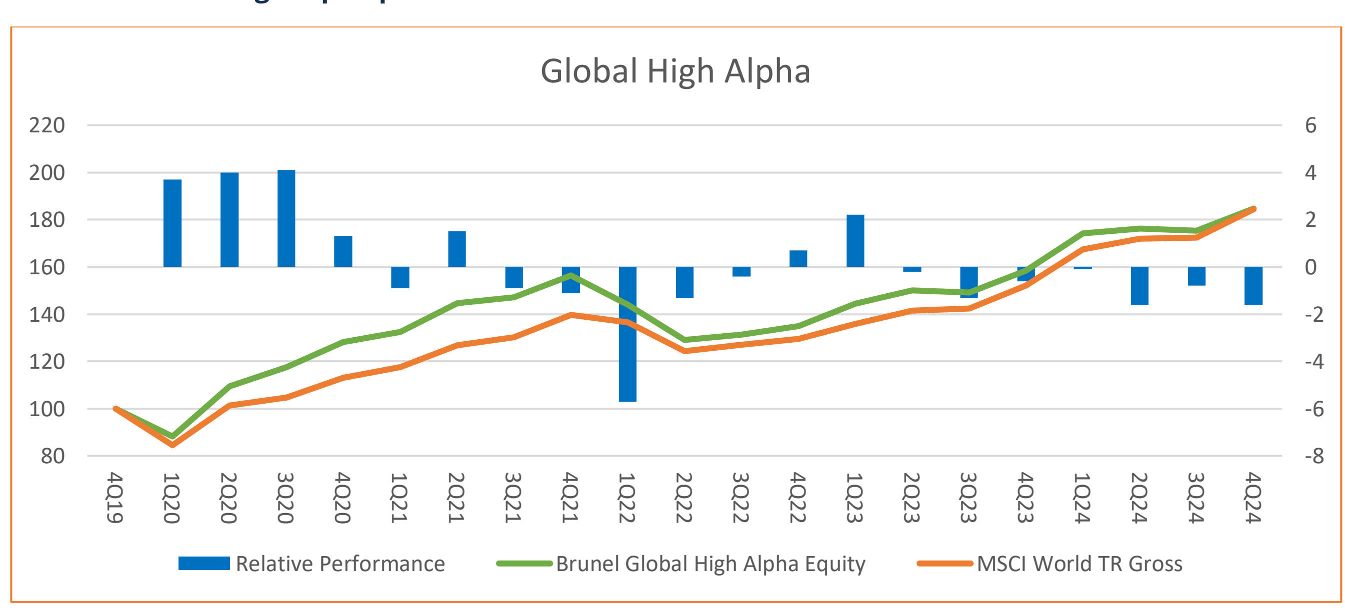
Global Equities

Chart 10: Global Equities



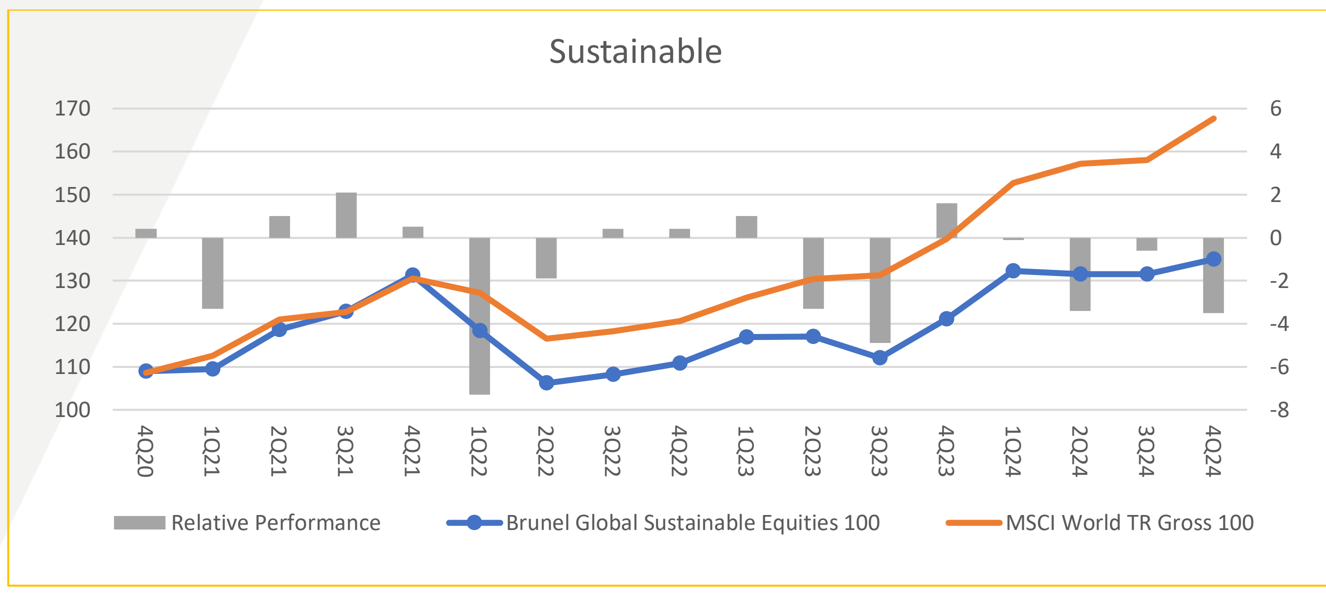
The chart above shows the cumulative performance of the Fund's three global equity portfolios over the last three years. Over that period, the effect of the underperformance of the two actively managed portfolios, Sustainable and Global High Alpha, against the performance of the Paris Aligned passive portfolio was over £150m. I.e. if the Fund had chosen to invest all its global equities into the Paris Aligned portfolio rather than across all three portfolios the Total Fund would now be approximately 5% larger. This underlines the scale of the underperformance by the managers appointed by Brunel to run the active Global Equity portfolios.

Chart 11: Global high Alpha portfolio



As can be seen from the above chart the initial performance of the Global High Alpha portfolio in 2020 was very strong but the Russian invasion of Ukraine, rising inflation and rising interest rates undermined the portfolio's performance against its benchmark and the portfolio is yet to show solid signs of recovery.

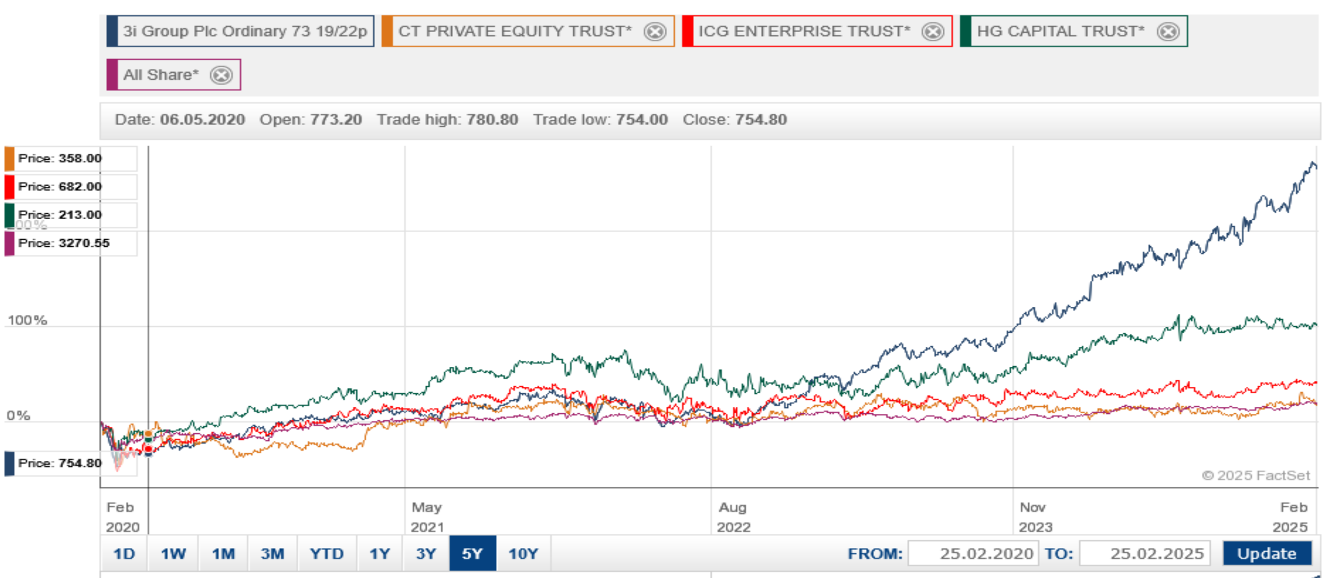
Chart 11: Sustainable Equity Portfolio



The Sustainable Equity portfolio was invested into a year after the Global High Alpha portfolio so missed out on the market conditions where a focus on innovative, smaller, fast growing companies, was rewarded by investors. Instead this portfolio has been held purely through a period when interest rates have been rising and companies with a strong environmental slant have been out of favour. Nonetheless, if you match the time periods between the two charts above and look at the bars (the quarterly relative performance) you will see a strong similarity. This is because Brunel's Responsible Investment and ESG mantra runs through all of their manager selection briefs thereby giving all of the portfolios they produce an overriding style bias which will have a dominant effect on each portfolio's performance against its benchmark.

Private Equity

Chart 12 quoted Private Equity performance



The chart on the previous page shows the 5 year cumulative return of four of the Funds quoted Private Equity Investment Trusts. Unfortunately I could not find the data for the fifth, Patria Private Equity Trust (ex Abrdn). The chart shows that, over the last 5-years, only the CT Private Equity Trust has struggled to outperform the UK FT All -Share. The outstanding performer has been 3i Group. However, I believe this to be driven partly by one very good investment and have some concern that this performance may not be repeatable. I am not able to advise on single stock selections under my FCA registration but I would suggest that your officers analyse this stock and ensure that they are happy with the current valuation and future prospects.

Market Summary

- Trump's clean sweep of the house and senate in the US Presidential Election triggered a US-based risk-on rally led by the 'Magnificent 7' (with small/mid-caps temporarily benefitting) due to higher expectations of growth, reduced taxation and cuts to regulation. All other developed regions, bar Japan, saw modest equity declines with emerging markets worse hit (-8%), reflective of increased tariffs / protectionism and geopolitical risk. YTD returns nonetheless remain up across all major regions. Despite further interest rate cuts by the US Fed, BoE and ECB, government bonds sold-off across the board, notably the UK, and with US Fed commentary hinting at a slower pace of cuts in 2025 (reflective of higher inflation expectations), this compares to concerns over EU growth but with more controlled inflation leading to some divergence on rate paths. The US Dollar index was up 8% (+7% on the Euro), with Sterling continuing modest gains on the Euro (as of quarter end). Leading economic indicators were mixed, with manufacturing Purchasing Managers Indices (PMI) below 50 across all major regions, with continued weakness in the Eurozone (Q4 average 45.43) and the UK also contracting (48.30) alongside the US (49.20). US Service PMIs expanded to 56.8 in December versus 55.2 in September. Inflation remains above 2% across all major developed economies. Q4 annual real GDP growth was led by the US (2.7%), versus more muted activity in the UK (0.9%), the Eurozone (0.9%) and Japan (0.5%). US growth remains supported by high fiscal spending.
- Global markets deteriorated versus performance in the first 9 months of the year, although the S&P500 was up 2.4% (led by the 'Magnificent 7' and cyclical sectors), with the Nikkei also up (+5.4%) supported by a weaker Yen. However, most asset classes finished 2024 up year-on-year, with a notable exception of Gilts. Equities were muted across other regions bar emerging markets which suffered declines over the quarter. All regions posted healthy full year returns, with the US a notable outperformer (+25%), driven by the 'Magnificent 7' (up on average by 67%, largely due to AI-related themes). We note concerns are rising over 'Magnificent 7' future capex requirements and concentration risk. Gilts declined c.3% in Q4 as concerns over stagnation rose alongside the longer duration of UK debt. US government bonds also fell by c.3% on inflation concerns accompanied by hawkish US Fed commentary. By contrast the EU inflation outlook is more muted and bonds were supported by clearer central bank guidance from the ECB. Growth concerns and political instability nonetheless remain at the fore, ultimately leaving Euro government bonds unchanged. Corporate debt was mixed and more muted, with the US underperforming Europe. Commodities generally rose during the quarter, with natural gas +24% and oil +4%, and agriculture, coffee and cocoa prices were significantly higher, while cotton and sugar prices were significantly lower. Copper fell by 12%, with gold unchanged. Bitcoin increased 47% in the quarter, reflecting excitement from the pro-crypto Trump administration and significant ETF inflows. Altcoins similarly benefitted.

We highlight the following themes impacting investment markets:

- **America first policy signals increased geopolitical uncertainty:** Trump 2.0 embodies America-first policies resulting in a strengthening of the US Dollar and supportive of US cyclical, risk-on assets. Domestically, expectations are of fiscal stimulus, higher growth and higher inflation accompanied by a deteriorating fiscal balance sheet and associated higher government bond yields. For the rest of the world, a second Trump presidency poses a spectrum of risks: threats of tariffs, threats of leaving NATO, and a greater degree of unpredictability. Biden's administration likely marks the last one wedded to the post-WW2 Washington Consensus.
- **A magnificent US rally but risks ahead:** The 'Magnificent 7' rose by 67% in 2024, driven by AI-excitement (Nvidia: +186%), strong earnings, inflows from passive investing and increased risk appetite. Collectively they drove more than half of the S&P 500's +25% performance in 2024 and these seven stocks now represent one third of the index. Given this concentration and concerns over future capex requirements, US equity indices may be exposed to a correction, with some expectations that the 'Magnificent 7' may possibly act as a future drag on overall index performance.
- **Government bond volatility / regional divergence:** Both US and UK government bond yields are at levels not seen since the financial crisis. In the US, alongside higher inflation expectations, while the US Dollar's reserve currency status provides greater fiscal headroom than peers, concerns are growing that prolonged large deficits are stretching this advantage to a point where the country's long-term fiscal stability is being questioned. Additionally, questions persist about the political ability of the US to achieve a balanced budget. Rising borrowing costs in the UK reflect high inflation and more acute budgetary concerns, with the growth outlook considerably weaker than the US, pointing towards stagnation. The situation is concerning, with rising yields squeezing fiscal headroom resulting in a further deterioration of the economic outlook and leading to higher yields. The Eurozone is also experiencing economic weakness but has a clearer outlook on inflation, tempering any material change in bond yields. As such there has been a notable divergence to US / UK yields (with the 10-yr yield on Euro government debt trading at 2.4% versus 4.6% in the US and UK at quarter-end, with that spread having increased by 0.4% since Q3).

Regional Commentary

- In the US, the total return of the S&P500 was up 2.4%, capping off a strong year (+25%) dominated by the 'Magnificent 7' (which accounted for half of this growth) and notably outperformed in Q4 (+15%). Otherwise, equity gainers in the quarter were communication services, information technology and consumer discretionary sectors, the weakest sector was materials. The US Fed made consecutive 25bps cuts in November and December, however hawkish 2025 commentary led to a stock market sell-off, particularly for small caps. Real annual CPI inflation increased from 2.4% in September to 2.7% in November. Government and investment grade bonds declined 3%, whereas high yield rose 0.2%, potentially on the improved growth outlook. Real GDP grew 2.7% YoY in Q4. US Dollar strength was notable, up 7% and against all major currencies, again driven by the implications of Trump's second presidency. US services PMI remains expansionary, rising to 56.8 from 55.2 in September, by contrast, manufacturing continues to contract (49.4).
- The EuroStoxx 50 total return was -1.8% (YTD: +11.0%), with recession fears alongside political instability in France and Germany compounded by concerns over trade wars sparked by Trump tariffs. The weakest sectors for the quarter included materials, real estate and consumer staples. Sectors posting gains included industrials. The ECB cut rates by 25bps in both October and December, with ECB President Christine Lagarde saying the 'direction of travel is very clear' regarding rate cuts and reflective of low growth and slowing inflation (averaging 2.2% in the quarter). Eurozone bonds held up well compared to other regions, led by high yield (+2.0%). Manufacturing PMIs remain a key concern (45.1, having been in contraction for

over two and a half years) with services showing modest expansion (51.6). GDP growth remains sluggish (Q4 yoy: +0.9%).

- The FTSE all-share index declined 0.4% (YTD: +9.5%) amid rising bond yields and concerns over the macroeconomic backdrop, with sentiment exacerbated by cost increases announced in the Budget alongside an increase in borrowing. The BoE cut interest rates by 25bps in November but held steady at 4.75% in December, citing persistent inflation concerns and economic uncertainties. Gilt yields rose significantly, with the 10 year increasing to 4.6% from 4.0% in Q3, increasing borrowing costs are raising concerns that spending cuts or tax rises may be necessary and would further weaken the economy. Services PMI remained positive (51.1) while manufacturing PMIs were below 50 in each month for the quarter (vs 52 on average in Q3). Real YoY GDP growth of 0.9% came against a backdrop of rising inflation (2.6% in November YoY vs 1.7% in September) raising concerns about stagnation.
- The Nikkei 225 total return was 5.4% (YTD: +21.3%), driven by a weakening Yen (which improved the outlook for large-cap exporters) and developments in the US. The implications of Trump's second presidency are less clear for the country than its international counterparts given its significance in US-China relations. During the quarter, most Japanese companies released their semi-annual earnings, with results mixed across sectors. Share buybacks continued to rise, and firms announcing additional buybacks generally received positive market responses. The BoJ maintained interest rates at its December meeting, taking a softer stance than in July, citing insufficient macroeconomic strength to boost domestic demand despite improving business sentiment. PMIs were tightly dispersed between 49-51, with services outperforming. GDP growth remains weak (+0.5% YoY).
- Emerging markets equities declined 8.0% during the quarter (YTD: +7.5%) and were particularly affected by tariff threats from the US. Brazilian shares led EM declines on fiscal concerns, while South Korea fell amid political instability following two presidential impeachments. South Africa, India, and China also posted losses, with China impacted by uncertainty over stimulus measures and potential US tariffs. Saudi Arabia declined but outperformed the index, while only four EMs (Czech Republic, Kuwait, Taiwan, and the UAE) saw positive returns, with Taiwan boosted by AI demand.
- In commodities, Brent crude increased 4% (YTD: -3.1%), natural gas increased 24.3% (YTD: +44.5%), gold increased 0.2% (YTD: +27.5%), copper decreased 11.6% (YTD: +3.5%). The Goldman Sachs Commodity Index increased 3.1% (YTD: +4.2%), within which energy and livestock were the strongest performers, while industrial and precious metals lagged.

Global listed property fell, with the FTSE EPRA Nareit Global Index declining by 3.2% (YTD: +2.6%). The Nationwide House Price Index in the UK posted solid gains throughout the quarter, culminating in 4.7% growth in December, the fastest pace since Oct-22. House prices remain just below the record high in the summer of 2022.