CEDARWOOD
WEALTH MANAGEMENT LTD

Quarterly Investment Bulletin

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Headlines

- In June the US Federal Reserve held interest rates at 4.5 - 4.75%.
- Global stocks fell sharply in April on tariff announcements.
- In May the Bank of England lowered interest rates to 4.25%.
- UK economic growth was positive over Q1 but contracted in April.
- Japan's inflation rate was 3.5% in May.
- UK inflation fell marginally to 3.4% in May.
- European inflation fell to 1.9% in May.
- US technology stocks recovered significantly during the quarter.
- The US/Israeli attacks on Iran caused sentiment to weaken in June.
- The US S&P 500 has risen by 23% since the lows post the Liberation Day tariff announcements.
- European equity markets have continued to perform well year to date.
- Asian markets have seen a strong recovery this quarter.
- The oil price was more volatile during the Iranian crisis, but this was short lived

General Economic Overview – Quarter 2 2025

The quarter erupted into a sea of uncertainty after Liberation Day in early April when the US administration announced huge increases in tariffs against most countries that traded with them, including punitive increases for China. Naturally this had ramifications on the equity and bond markets in the following weeks and continued to create volatility throughout the period. As the quarter progressed these threats were watered down, with reductions and suspensions of the increases as the President was seen to back down. The situation with China was the most worrying for global growth as both countries traded verbal blows and tariff rates increased, only to be deferred as talks began between the two superpowers. By June it appeared an agreement had been reached and global stock markets reflected this, having recovered all the falls caused by the initial tariff announcements.

Geopolitical issues have not gone away and continue to act as a brake on investor confidence. A shift by the US to increase tariffs will lead to further uncertainty in global equity and debt markets. The war in Ukraine continues and the recent escalation in tensions between Iran and Israel has created further uncertainty. The most obvious beneficiary of all this has been precious metals with gold being seen as a hedge against the risk of further uncertainty and a fall in value of the US dollar. Change can bring about opportunities, and the need for countries and regions to remove their reliance on the US has been given a push by the current US administration. Europe has already increased its defence spending and industry sectors are looking hard at how they reduce their reliance on the US market and form stronger bonds with other regions and sectors. There are some unintended risks with the US strategy as other alliances are strengthened, such as those between Russia and China, and a more immediate effect has been the fall in the value of the US dollar which, as part of the 'MAG' strategy, helps American exports and the manufacturing sector. Whether this can work in the long term is very debatable, but it does help other dollar-based economies, especially emerging markets, as long as tariffs don't remove the advantages.

As usual there are many factors in play, but geopolitical issues have risen to the top of investor concerns and are likely to persist for the rest of 2025. Markets in general have remained sanguine and quite resilient but have reverted to a large cap quality bias as uncertainty is always around the corner. Global growth outlooks have been revised downwards, as might be expected in such an environment – it seems that despite backing down in a number of areas, US tariffs will be imposed on most countries as the year progresses and trade negotiations are concluded.

Equity Markets

As has been the case all year, equity markets continue to be sensitive to any changes in the geopolitical landscape. The tariff negotiations dominated the headlines and sentiment in the second quarter but after a very poor start to the quarter, there has been a significant recovery. Investors have perhaps become a little more complacent as the White House has backtracked following the sell-off in both equity and bond markets after Liberation Day. There is now a feeling that President Trump's strategy won't lead to a trade war that will materially affect the global economy and lead to recession. Markets have recovered to pre-Liberation Day levels and to the all-time highs established in February, but with increased volatility as confidence has fluctuated. In sterling terms several markets are still negative this year, including the US, but in local currency terms all key markets are delivering positive returns.

Whether this momentum can continue will depend on how the trade negotiations develop and where they end up. Any escalation will undoubtably cause markets to wobble, as will the issues in the Middle East which escalated following the US involvement in Iran.

UK

After a strong performance in the first quarter, ONS data issued in June showed that Britain's economic output contracted sharply in April when shockwaves from President Trump's announcement of wide-ranging tariffs hit the global economy. According to the ONS, a fall in real estate and legal activity in April (after the end of a temporary tax break on house purchases) contributed 0.2 percentage points of the 0.3 percentage point fall in output in April. Car makers also reported lower output and lower exports to both the US and the EU. The ONS predicted that the tariff increases will have a negative effect on the economy in 2026, reducing output by 0.3%. The fall in April contrasts with the strong growth of 0.7% in the first quarter which outstripped growth in the other G7 countries and prompted the Bank of England to revise up its full-year growth forecast to 1% last month. Falls in retail sales in May seemed to confirm that the picture had changed as businesses were hit by government led changes including the increases in national insurance and the national wage. The Bank of England maintained rates in June as inflation was above the 3% for the second month in a row, and if an escalation of tensions in the Middle East causes oil prices to rise then inflation may creep up further.

Despite these challenges, the UK stock market has recovered well year to date, particularly relative to the US. Valuations of large-cap stocks have improved and have driven returns, benefiting from a shift in global capital flows and uncertainty over US economic policy, while more domestically focused small- and mid-cap stocks have continued to struggle. Investors have redirected assets toward undervalued markets while favouring the relative safety of larger companies.

US

The US continues to be the centre of geopolitical upheaval as White House announcements create uncertainty in markets. The backlash from the tariffs announced in early April affected bond markets and it didn't take long for the US administration to backtrack and offer various alternatives to the initial tariff levels. An amnesty was introduced, allowing for individual negotiation to take place and this has evolved over the quarter. The UK was one of the first to establish a deal and the US and China have seemingly come to an agreement, although the details need to be understood. These deals have not removed tariffs, and many are still significant, potentially affecting global growth and increasing inflation in the medium to longer term. The Federal Reserve has maintained interest rates since December, and this has caused some frustration for President Trump who would prefer rates to come down to support his tax reduction policies. The uncertainty of the effect of tariffs and the recent upheaval in the Middle East have meant that rate cuts are unlikely in the near term. Economic data in the US has deteriorated slightly but employment remains robust, and consumer spending continues to hold up meaning the US Fed are reluctant to bring down interest rates until the picture becomes clearer. The US stock market has recovered significantly in the second quarter and in local currency terms is now just shy of the gains in Europe year to date. The market has been underpinned by retail investors buying the dip and by companies that have backed themselves by buying back shares in record quantities.

For the first time in three years, US GDP growth fell by 0.5% annualised in the first quarter, which was greater than originally estimated. This was driven by a surge in imports ahead of tariffs, though core

GDP (excluding volatile items) still rose about 1.9%. Analysts in the major US banks expect the economy to rebound in Q2 as confidence has improved in US consumer data. The recent recovery in US equity markets demonstrates that increased pragmatism has returned to policy announcements and tariff negotiations, which in the short term at least should stabilise sentiment.

Europe

We noted in last quarter's review that sentiment toward Europe has shifted in 2025 as lower interest rates and the resolution of key elections improved the outlook for investors. In Q2 this has continued to develop as European policymakers have come together to rebuild confidence in the economy. The defence sector also had a recent boost from a broad commitment from NATO to increase spending to 5% of GDP which includes many European states.

The Eurozone economy is still projected to expand modestly, with real GDP growth forecasts rising from 0.9% in 2025 (source: ECB) to 1.1% in 2026. One of the issues for Europe has been the performance of the German economy, which was in technical recession during 2024. The economic predictions for GDP growth in Germany are weaker than for other major European economies ranging from 0.1 to 0.5% (source: JPMorgan). An older population and weaker productivity levels have aligned with significant competition from China in industrial areas and a lack of a strong digital infrastructure to deliver a very difficult economic backdrop for Germany. In response to these economic challenges, the German government has approved a significant fiscal stimulus package, including a €500 billion infrastructure investment fund, which aims to bolster economic growth and address structural issues within the economy. The relaxation of the debt break will allow more favourable budget spending to boost economic growth.

Across Europe inflation has now fallen below 2% which has led the ECB to follow a looser monetary policy than most developed nations with the central rate now down to 2% after a further cut in June. The ECB has flagged this response as data driven, as in the US, and is supportive of the weakness in European economies following the Russian invasion of Ukraine. Following a series of cuts, the likelihood is that there will be a pause in lowering rates at the next meeting.

The European stock market has been the best performing region for sterling investors year to date with a 12% return (source: FT 1st July 2025) compared to a negative return for the main US indices. This quarter however, there has been a significant recovery in the US and European markets have fallen behind.

Asia & Emerging Markets

This quarter Asia navigated a tricky global landscape by leaning into domestic strengths. China's macro-stabilisation and policy pivots, Japan's manufacturing re-emergence, South Korea's cautious normalisation, India's robust internal expansion, and calibrated support in Southeast Asia demonstrated a consistent theme of domestic demand as a growth anchor. Manufacturing and trade-sensitive sectors bore the brunt of the tariff anxieties and investment drift, but resilient internal consumption and targeted monetary easing helped prevent a deeper slowdown. Central banks across the region largely headed toward easing – beyond China, many Asian central banks (e.g. Philippines, Thailand) are expected to cut rates two or three times in 2025.

Asia continued to display a blend of resilience and vulnerability amid intensifying global headwinds, including US tariff risks, China's internal economic pressures, and uneven regional recoveries. Policymakers responded with varied strategies from targeted stimulus to accommodative monetary policy to shield domestic demand as exports remained tenuous.

In China, recent growth showed signs of moderating. Q1 GDP had grown at a respectable 5.4% year-on-year, but momentum slowed heading into Q2. Investment in infrastructure, ongoing rate cuts, and fiscal measures underpinning consumption helped stabilise activity, and Premier Li Qiang emphasised a shift toward a consumption-led model to insulate against weakening global trade. There were some encouraging signs as China's retail sales figures for May surprised to the upside (+6.40% year-on-year), growing at their fastest rate since late-2023 as government subsidies appeared to underpin consumption. Industrial profits marginally missed expectations, expanding at 5.8% year-on-year, while fixed-asset investment printed a 3.7% year-on-year gain which was below market expectations as property investment has fallen 10.7% in the first five months this year (source: FT June 2025). Last week China's State Council upped its real estate support calling for 'stronger efforts to stabilise and recover the real estate market', proposing to integrate high-quality housing development into urban renewal strategies with comprehensive policy measures. This shift aims to transform the sector by moving developer competition away from price wars toward quality-focused development, supported by coordinated urban planning, land supply, fiscal, and financial tools.

China's economic data has shown mixed signals of late – policymakers expressed growing optimism about recovery trends, but hard data revealed persistent challenges, particularly negative industrial profit growth and weak inflation pressures from ongoing price wars in key sectors like automobiles.

The broad emerging market index was the second-best performing region for UK investors this quarter as a weakening dollar helped a number of regions. South Korea was one of the best performing regional stock markets – its manufacturing PMI stayed below 50 at 48.7 for June, but it signalled a slower contraction and increasing confidence in future production, buoyed by political stability following the June election. India was among Asia's standout performers as its factory activity accelerated to a 14-month high, fuelled by surge in export orders which also drove record hiring. The picture was mixed across Southeast Asia – Malaysia experienced export softness in Q1 as GDP slowed to 4.4% from 5.1% (source: S&P.com), but was buoyed by electronics and tourism which prompted expectations of rate cuts. Singapore rebounded from a Q1 contraction, with strong electronics exports driving a continued uplift.

Looking ahead, Asia's path through the rest of 2025 depends on its success in cushioning against trade policy shocks, steering through China's medium-term slowdown, and sustaining consumer and investment momentum. With selective stimulus, rate cuts, and structural shifts toward services and tech, the region hopes to balance external vulnerability with internal vitality, aiming to remain the global growth engine even as clouds gather on the horizon.

Japan

Japan is managing a critical transition from ultra-loose monetary policy. Inflation above target is pushing the BOJ toward normalisation, but global and domestic headwinds are prompting caution. Industrial output rose modestly (0.5% in May), but this was weaker than expected amid export concerns, particularly due to looming US tariffs affecting autos and component. Headline CPI hit around 3.6% in April which was well above the BOJ's 2% target. Food costs are climbing fast, and Teikoku Databank project that July food inflation will be up 15%, significantly straining household budgets.

The Japanese government has to find a balance in dealing with the immediate issues of higher inflation and navigating the transition to tighter monetary policy, whilst at the same time seeing record highs in long-term borrowing costs and the prospect of a shrinking investor base for the country's debt. Yields on 30-year bonds have reached 3.7% recently, after weeks of anaemic auctions. Part of the problem lies in the structural issues surrounding changing demographics as the remaining life expectancy of the large and wealthy baby boomer generation is less than 20 years compared with 40 years in 2000. This situation makes it difficult to normalise monetary policy and restore positive interest rates, especially when the debt to GDP ratio remains around 250%, half of which is held by the BOJ. Tariff negotiations with the US are another destabilising variable which will continue to cause negative sentiment until there is more certainty. To reduce some of the concerns on yields the governor of the BOJ announced a slowing of its cutting back on bond purchases.

With strong price pressures but slowing growth, trade friction, and an aging economy, Japan's central bank is walking a tightrope in attempting to contain inflation without choking demand.

Fixed Interest

Bond markets have seen some significant volatility this year due to the same issues facing other asset classes as investor actions have been dominated by the sentiment created by geopolitical issues. There have been several buying opportunities in recent weeks as geopolitical tensions have caused spreads to widen but the markets have been quick to adjust. Fixed income strategists generally expect further rate cuts by central banks this year, which would provide a tailwind for sovereign bonds across most advanced economies. Deciding on where to position bond holdings on the curve remains a tricky balance with the threat of falling interest rates – shorter duration assets have performed well in recent years and still offer a good balance between yield and protection from large and rapid moves in rates. Currently interest rate movements have stalled (other than the ECB) which favours shorter duration, but investors are starting to move up the curve in anticipation of rate moves in quarters three and four.

Like last quarter, holding a broad range of fixed interest strategies still seems more attractive at the moment. The demand for government bonds still seems to be healthy although the increasing US debt pile and the weakening of the US dollar has threatened demand for US treasuries. This has caused yields to creep up at the long end of the curve as risk factors have increased, but in a falling interest rate environment, these yields should come down over the longer term. The recent issues in the Middle East have shown that investors have not abandoned the US as the ultimate safe haven, as the dollar recovered during the highest stress points over the last few weeks.

Government bonds now present a compelling mix of attractive yields and potential for price appreciation if central banks follow through with expected easing. In credit, investment-grade (IG) spreads remain tight, but yields are high in absolute terms relative to pre-Covid era. The market has moved to focus on higher quality assets, sacrificing yield for security in a period of heightened uncertainty. More emphasis is being placed on high-quality IG bonds and structured credit like securitised assets (MBS, CLO AA tranches) but high yield spreads are narrow, among the tightest since 2007, so further spread compression may be limited. Yield is important, and the fact that defaults remain low has encouraged investors to support this area of the market despite some of the current geopolitical concerns.

We expect the trends seen in the first half of the year to persist. Global yield curves are likely to continue steepening, reinforcing the view that short duration remains the most attractive area within fixed income. Market volatility is set to remain elevated, driven by an uncertain outlook for the Fed and the US economy, characterised by high interest rates, sticky inflation, mixed economic data, and ongoing concerns around trade and fiscal policy. In Europe, further rate cuts are anticipated from the ECB and the Bank of England, with policy rates reaching around 1.5% in the Eurozone and 3.75% in the UK which supports short-dated bond performance through declining front-end yields. The US outlook is more complex – we expect the Fed to begin easing in autumn, but this path could be disrupted if inflation reaccelerates due to higher tariffs.

Alternatives

The use of alternative investments in portfolios has increased in the last twelve months although the definition of what falls into this category varies depending on the investor's criteria. Overarching trends illustrate that infrastructure investments, particularly those tied to digital and greenfield technologies, delivered strong performance. Property markets, notably in the UK, rebounded thanks to yield strength and cautious borrowing conditions, though sentiment remains sensitive to trade and global growth signals. Precious metals maintained momentum as macro hedges, with rampant inflows into gold, silver, and platinum funds sustaining robust rallies.

In this investment environment, investors are increasingly leaning towards alternative assets for diversification, inflation protection, and reliable yields. Infrastructure offers a compelling mix of stable cash flows and structural thematic growth, property presents income-rich opportunities in select regions, and precious metals continue to provide a protective ballast amid uncertainty.

The infrastructure sector continued to demonstrate impressive resilience amid volatile markets. Commercial Real Estate Company's Q2 2025 report highlights a surge in capital inflows, particularly into greenfield projects such as data centres and renewables, with fundraising hitting the third-highest level seen in any first quarter (roughly $48 billion) propelled by a wave of retail participation and mega-fund initiatives.

In the property market, conditions differed by region – UK total returns reached a robust 8.1% over the twelve months to February 2025, bolstered by yield-driven income in retail and industrial segments. Capital values edged upward by about 2.1%, recovering from earlier losses, with prime assets seeing some yield compression, while offices remained range-bound (source: aberdeen Investments) With inflation easing and mortgage rates stabilising, Q2 has emerged as an opportune moment for property investors, with yields of 6 to 8% gross in regional cities, especially in new-build, rental-focused developments.

Precious metals recovered this quarter, driven by a softer US dollar, investor cautiousness around government debt, and sustained geopolitical tensions. Gold continued its upward path, up roughly 25% since the start of the year and nearing the record highs above $3,300–3,500 per ounce seen in Q2, as portfolios sought a hedge against uncertain macro conditions.

Summary

If judged on stock market performance, the global economic picture would be relatively positive given the recovery of the US equity market over the quarter. The US is seen as the engine of global economic growth and any uncertainty about this is reflected in asset markets around the world – the attack on global trade by the US administration has clearly caused waves of uncertainty across a wide range of sectors and regions. It has now entered a different phase after the US retreated on its initial threats and moved to negotiate with its trading partners. This has been a positive sign, but tariffs will still increase, creating more pressure on inflation.

The economic picture is therefore perhaps more fragile than it first appears. The tariff negotiations are still mostly unresolved and there is persistent inflation causing interest rates to stay elevated, whilst at the same time geopolitical tensions have escalated especially in the Middle East. Policymakers face a delicate balancing act to support growth without fuelling inflation, sustain trade connections amidst protectionism, and safeguard financial stability in an increasingly fragmented system.
The end of US exceptionalism was discussed at length in the months after Liberation Day, but this has somewhat abated in recent weeks as investors have switched back to a positive outlook on the US, ignoring the uncertainty of a frequently changing narrative. Resolution of the issues on trade and global supply chains would certainly settle markets and potentially allow them to broaden out beyond the drivers of the last few years which have been large cap quality growth stocks. Global economic growth looks to be stable but slowing, although there is no concern that a recession is likely to occur. Although the majority of multi asset managers are neutrally weighted and geopolitical uncertainty remains, we are positive on risk in the longer term, so advocate investors continue to be patient riding out any short-term volatility whilst ensuring portfolios are adequately diversified.

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