RATHBONES | Incorporating Investec Wealth & Investment (UK)

WEEKLY DIGEST | 11 March 2025

A balanced diet

John Wyn-Evans
Head of Investment Strategy

I am always in search of (sometimes tortuous) metaphors for elements of the investment process. One turned up over dinner at the weekend when I found myself in a conversation about how individuals serve up and then consume their meals. The extreme example is someone who keeps all the different parts of the dish separate and refuses to eat two items that have touched each other – which is a real condition called brumotactillophobia. Maybe we could think of that as an allocator who keeps all of the building blocks of a portfolio very separate with very distinct “flavours”.

At the other end of the scale is someone who puts everything in a liquidiser and sucks it through a straw. You get all of the nutritional elements, but no appreciation of, say, sweet versus sour. There might sometimes by an overpowering ingredient (such as a hot chili), but in the end it's just a functional "mush" that offers little in the way of enjoyment. Sort of like a global index fund or a constantly rebalancing 60/40 equity/bond tracker portfolio.

Somewhere in the middle lies the typical balanced meal/portfolio. It has several distinct elements, but they are allowed to overlap. There is an attempt to find flavours that complement each other. It can definitely require more labour and the top-notch tasting menu does not come cheap, but it keeps us engaged and interested. One could even add a condiment or interesting sauce to enhance the experience, but not so much as to ruin it. There are constant efforts made to enhance the recipe in pursuit of perfection.

All of which brings us to today's markets, which have taken on a very different tone compared to what we have experienced in the last couple of years. Those were characterised by leadership from US equities, with a big chunk of that coming from a relatively small group of mega-cap technology companies, with Artificial Intelligence being the driver of a lot of the gains. This year, the best performing equity markets have been those in Europe and China. What has changed?

There are negative and positive factors at work here. In the US, as we have had to comment on increasingly in recent weeks, the key source of trouble is the White House, thanks to the confusion being sown by the relentless torrent of policy announcements. Most people will have seen at least some footage of the meeting between Ukraine's President Zelenskyy and the US President and Vice President. Even though we have always assumed that difficult conversations take place behind closed doors, world leaders tend not wash their dirty laundry in public. This event was extremely unsettling for investors. (For light relief, the Saturday Night Live sketch lampooning the behaviour is worth watching: https://youtu.be/CUpOMSJ1MdU?feature=shared)

We have also had to contend with more tariff news, with Canada and Mexico now subject to 25% tariffs on exports to the US and China 20% (with some specific exemptions, which, funnily enough, suit the Americans). Some elements of these tariffs have been reciprocated. This outcome was not really expected. The general view was that tariffs were a big stick with which to make threats, but that they would most probably not be implemented because some sort of "deal" would be hatched to present Trump with a "win". There is now a greater threat that a combination of supply disruptions and higher prices will weigh on US activity, depressing GDP growth levels. This could be exacerbated by Elon Musk's mission to cut federal costs by dismissing staff and even shutting down whole departments. This is increasingly being reflected in more cautious outlook statements from US companies, with Delta Airlines being the latest.

Both the President and the Treasury Secretary, Scott Bessent, have alluded to the possibility that things will have to get worse before they get better. In some ways, perhaps, we should be impressed that any government is willing to tackle some of the thornier issues associated with relentlessly expanding fiscal deficits, because most governments in the rest of the developed world have either failed to attempt it or been thwarted in their efforts by voters. But after living so high on the hog for so long, the experience in the US comes as a shock.

Somewhat inconveniently, this depressant comes just as investors are, not for the first time, questioning the growth of everything associated with Artificial Intelligence and the returns achievable from the huge amounts of capital expenditure associated with it. Doubly inconveniently, it also comes after a burst of post-election stock market euphoria, with US equity indices now having given back all the gains made in the few weeks following Trump's victory. I'd be reasonably happy to characterise this as "froth being blown off the top" for now, especially as positioning had become quite extreme. Our subjective probability of a full-blown recession developing in the US this year remains at 25%, but greater risks cannot be ignored.

From a portfolio perspective we have a healthy exposure to the AI trade but were never by any means "all in" on it. Our general bias towards higher quality companies should also provide insulation against a worse economic outcome. And there is always a danger in going "all in" on the recession trade, not least because President Trump could turn on a sixpence should he become concerned that financial markets are too weak. There is also the potential for tax cuts to be announced. In his first Presidency, Trump cut taxes before he applied tariffs – this time he has delivered the bad news first. Admittedly, the latest utterings from Trump and Bessent over the weekend suggest that the stock market is not their focus, and so any thought of a "Trump put" should be set aside for now, but I suspect he will be pragmatic should the unemployment rate start to tick up more aggressively.

There again, if there is anyone on earth who can persuade his supporters that short term pain is worth it for the long-term gain, it might well be Donald Trump. After all, his role model, Vladimir Putin, seems to be able to pull that trick off in Russia, although, of course, he is not term-constrained in the duration of his Presidency (and we shall assume, for now, that Trump is). Having said that, a classic tactic to divert voters' attention from domestic troubles is to embark on some sort of overseas "adventure". Let us hope that Trump is not goaded into that course of action.

The rest of the world is by no means oblivious to this, but, so far at least, has been relatively well insulated, both in terms of the fiscal and trade threat and by virtue of having more lowly valued equity markets. Taking a snapshot as of the close of business on Monday evening (10/3/25), the S&P 500 index is -4.5% year-to-date, while the tech-heavy NASDAQ is -9.5%. The more concentrated Magnificent 7 stocks are -15.5%. From their recent all-time highs the falls are 8.6%, 13.4% and 20.3% respectively. But even within the US there are safer havens. The equal-weighted S&P 500 is -0.8% YTD, and the S&P 493 stocks (ex Mag 7) are -0.1%.

On a global basis, the MSCI All-Countries Index is -1%, but the ex-US version is +7.8%. Year-to-date, in local currency terms, a broad European Index (MSCI Europe ex-UK) is +8.9% and the FTSE 100 is +5.2%, while there is something of stealth bull market unfolding in China (MSCI China +17.3%). These figures become even more impressive when translated into dollars to make the returns more comparable. Europe ex-UK is +14% and the FTSE 100 +8.2%. The weak dollar has caught a lot of traders off guard, because a strong dollar was a key element of the post-election "Trump Trade".

A globally diversified portfolio is paying off finally. It could be that, inadvertently, Trump's policies have only succeeded in making Europe great again. There has certainly been a seismic shift in policymakers' tone, faced as they are faced with footing the bill for increased military and defence capabilities in the absence of support from the US. The European Commission has already announced its ReArm Europe programme, which would exempt defence spending from the bloc's fiscal rules, allowing states to increase it from below 2% of GDP currently to more than 3%. That could catalyse €650bn of extra spending (4% of EU GDP) over four years. The plan also includes €150bn of loans (1% of GDP) to member states funded by joint borrowing. At the same time, Germany's CDU and SPD coalition partners have agreed in principle to exempt defence spending above 1% of GDP from the country's own 'debt brake' rule. Furthermore, they have agreed to establish a debt-financed infrastructure fund of €500bn (12% of German GDP) to be spent over a decade, also exempt from Germany's fiscal rules. Now they just have to get them approved in the

Bundestag. Together, these changes will allow EU fiscal policies to be much looser than they have been. Suddenly, Europe has become a realistic alternative for many investors who had been ignoring it for years (which, to be fair, has not done them any great harm).

Returning to the dinner table, finally, it also turned out that we had different ways of consuming our meals. One piled a bit of everything onto their fork to gain the holistic experience. Another moved methodically through fibre first, protein second and carbohydrates last (which, I believe, is the best way to subdue blood sugar spikes). On examination, it appears that I like to try all of the elements separately first to see what they taste like on their own and then try different combinations. I'm sure there is a psychology Ph.D. waiting to be awarded for someone to study this, especially if it could be correlated to one's investment returns!

Economic Commentary

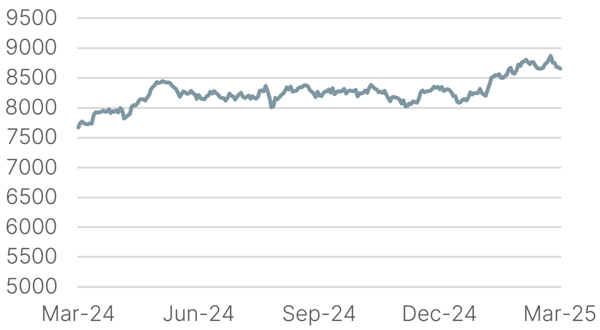
FTSE 100 weekly winners

Fresnillo PLC	14.3%
BAE Systems plc	11.4%
ITV PLC	10.8%
Schroders PLC	10.4%
Abrdn plc	10.4%
Rolls-Royce Holdings plc	7.7%
Antofagasta plc	6.4%

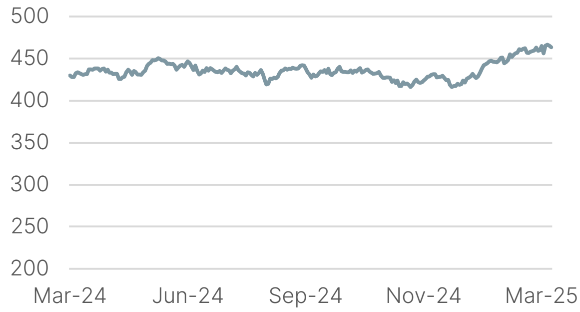
FTSE 100 weekly losers

Melrose Industries PLC	-23.7%
Rentokil Initial plc	-14.3%
Flutter Entertainment Plc	-13.4%
Smurfit Westrock	-10.6%
Informa Plc	-9.7%
International Consolidated Airlines Group SA	-9.6%
Ferguson Enterprises Inc.	-9.3%

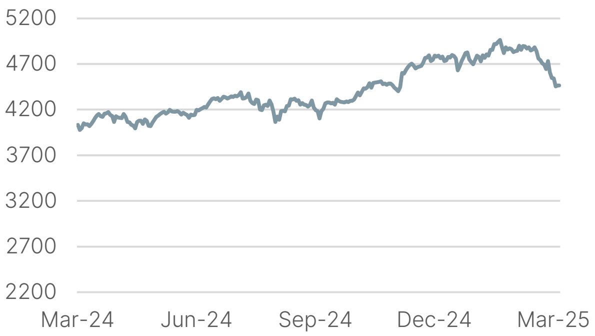
FTSE 100 index, past 12 months



EuroStoxx 600 index, past 12 months



S&P 500 index, past 12 months



All data shown in GBP.

investecwin.co.uk

Investec Wealth & Investment (UK) is a trading name of Investec Wealth & Investment Limited which is a subsidiary of Rathbones Group Plc.
Investec Wealth & Investment Limited is authorised and regulated by the Financial Conduct Authority and is registered in England.
Registered No. 2122340. Registered Office: 30 Gresham Street. London. EC2V 7QN. Member firm of the London Stock Exchange.