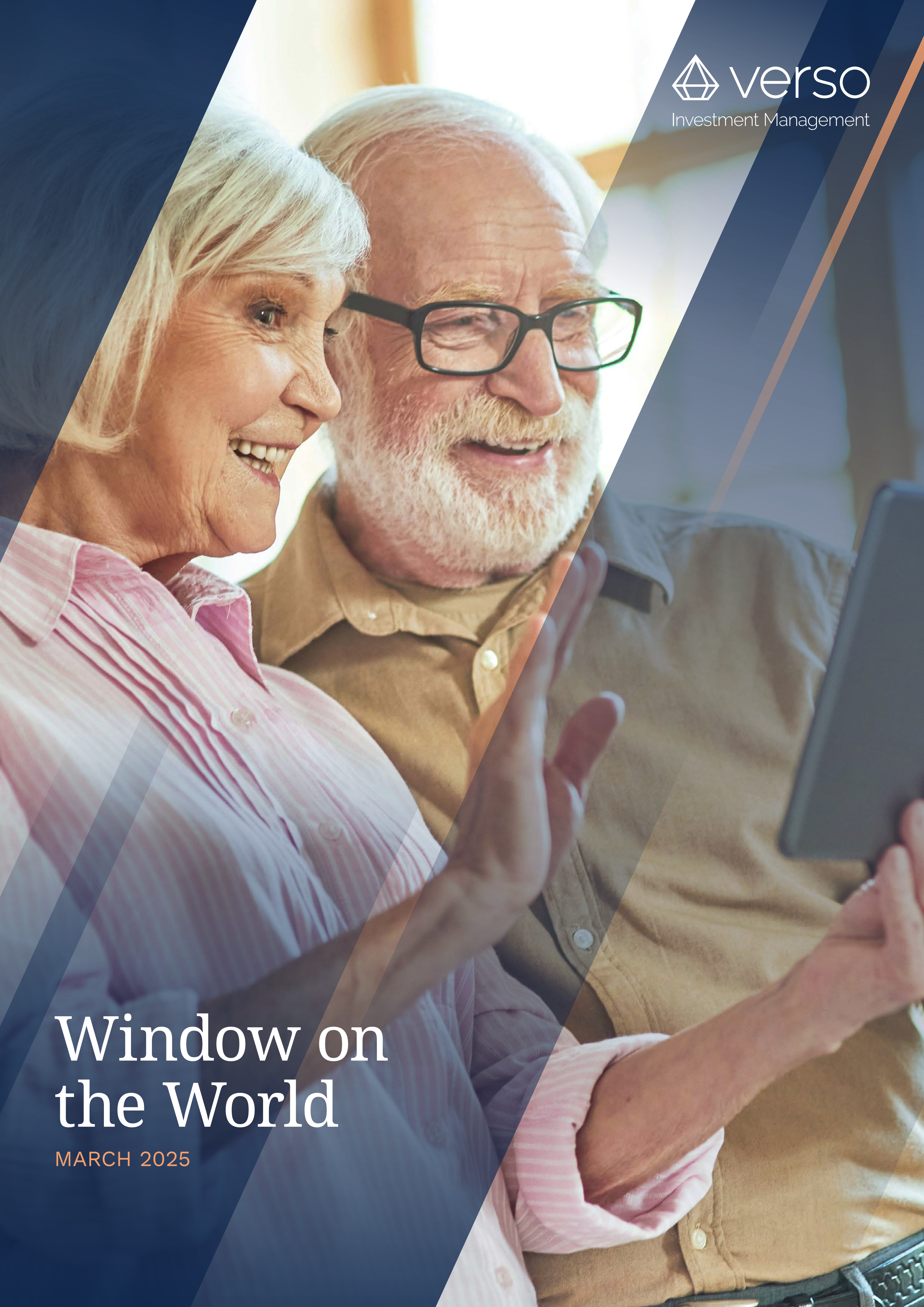


verso
Investment Management

Window on the World

MARCH 2025

Most years, February passes investors by without much notice, not because it is the shortest month of the year, but because since 1928, US stocks have, on average, declined by a mere 0.14% during the month; February is typically a very uneventful month. But not so in 2025, when it proved to be an exception to the rule. Investors had to digest a series of market-moving events, which have continued into March. The nub of it is a sharp increase in uncertainty that has introduced volatility into the mix across equities, fixed income, commodity, and currency markets.

While all eyes tend to be on the US, and for good reason, at the aggregate level, it was a positive month for UK, European, and emerging market equities, but challenging for Japan and the US. Bonds also had a good month, rallying as some US economic data was softer than expected, causing yields to fall.

	Total Returns (%)			
	1 Month	3 Months	12 Months	YTD
UK Equities	2.0	6.9	19.9	8.3
US Equities	-1.3	-1.0	19.0	1.4
European Equities	3.5	14.1	15.6	11.9
Japanese Equities	-3.8	0.2	2.6	-3.7
Emerging Market Equities	0.5	2.2	10.8	2.3
UK Gilts	0.8	-0.9	1.8	1.7
UK Corporate Bonds	0.4	0.9	5.7	1.6
UK High Yield Bolds	1.3	3.3	10.9	2.5
US Corporate Bonds	2.0	0.8	6.7	2.6
US High Yield Bonds	0.7	1.6	10.2	2.0

Source: Bloomberg, Verso Investment Management, as of the end of February 2025

Softer US economic data

By the end of February, Donald Trump had been in his second term as president for just 45 days. Although it might feel a lot longer, investors have had to absorb a wall of policy initiatives and changes, including tariffs, the prospect of a ceasefire in Ukraine, and the US stepping away from backstopping European defence going forward, plus efforts by the Department of Government Efficiency (DOGE) to cut government spending, which has already led to redundancies. With the speed of news flow, the market has been deluged, creating considerable noise as investors try to make sense of what's happening.

A key impact of all of this has been to create a significant amount of policy uncertainty, and this has likely contributed to some recent softer US economic data. Perhaps not surprisingly, this data indicates that both consumer and business confidence has begun to weaken, while trade data has indicated that firms may have been front-loading imports in January to be one step ahead of tariffs, which have come into effect for Canada, Mexico and China. It is also apparent in US manufacturing that businesses are set to hold back on hiring and that firms expect prices to rise. This, of course, supports the widely expressed view that tariffs are inflationary (despite Donald Trump's promise to lower inflation), so the market is expecting to see inflation numbers pick up.

Soft landing, hard landing, recession? That's a question that's never far away, and for now, we remain of the view that the US economy is weakening from a period of very resilient growth to one more in line with its potential. This would fall into the soft-landing camp, as opposed to something more concerning. With the prospect for fiscal support later in the year (tax cuts), plus lower energy prices (oil prices have recently hit a three-year low) and looser financial conditions (via lower bond yields and potential cuts to interest rates), there should be a fair amount of support for the economy.

Nevertheless, this heightened policy ambiguity and its impact on sentiment does introduce more uncertainty around the path the US economy will take in 2025. Indeed, it opens up the possibility for multiple paths, which means further downside in US equities – which declined in February – cannot be ruled out.

THE CITIGROUP ECONOMIC SURPRISE INDEX ROLLED OVER IN NOVEMBER, AND MOVED INTO NEGATIVE TERRITORY IN FEBRUARY, RAISING FEARS OF A GROWTH SCARE

Source: Bloomberg

A pivot point for Germany

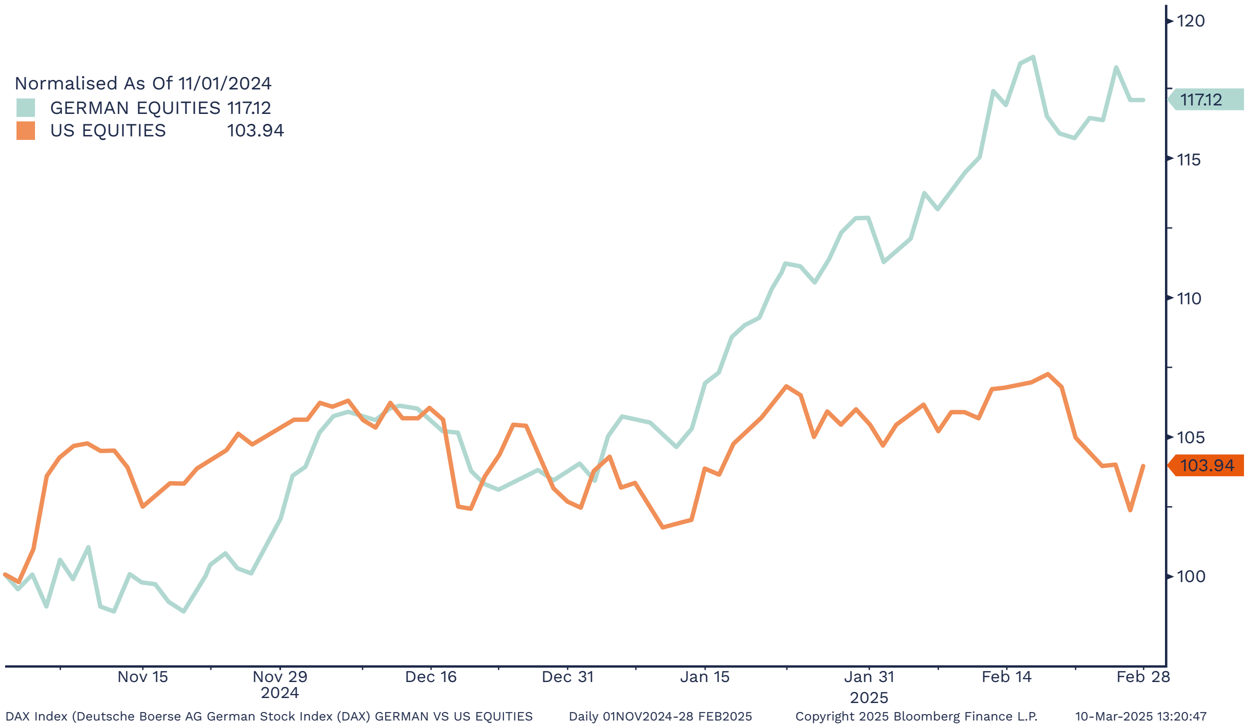
European elections often pass without much notice (like February), but this year, there was unprecedented attention on the German elections, with much focus on the rise of the far-right Alternative for Germany (AfD) party.

Turnout was the highest in 40 years at 82.5%, and the AfD ultimately secured just shy of 21% of the vote. Add into the mix Donald Trump's policy approach, comments on Ukraine, and his intended tariffs on the EU, and Friedrich Merz, the Chancellor-in-waiting, has been thrust into the limelight regarding his plans for infrastructure and defence spending. His party, the Christian Democratic Union (CDU), is expected to form a coalition with the Social Democrats (SDP), although it is likely that this process will take a few weeks.

Merz has already outlined plans to dramatically increase both defence and infrastructure investment and hopes to have this approved under the "old" government. This could total €1 trillion of spending and debt issuance over the next decade – more than a fifth of the country's total economic output. This is expected to potentially transform the longer-term outlook for Europe's largest economy, which has been in stagnation for two years, and is hoped will encourage other European partners to follow suit.

The market likes positive news, of course, and spending big is "good news". So, not surprisingly, it has galvanised better performance from European equities this year, particularly in Germany, where stocks are up 13% year-to-date as of the end of February 2025. For a long while now, valuations of European equities have been at a notable discount to their US peers, and this remains the case. So, we are retaining our current overweight positioning in the region.

GERMAN EQUITIES HAVE OUTPERFORMED US EQUITIES SINCE THE ELECTION, WITH THE POST-VICTORY GAIN IN US EQUITIES BEING GIVEN BACK



Source: Bloomberg

Chinese Tech catches a tailwind

February was also a positive period for Chinese equities, particularly the technology sector, where it is becoming clear that they are an important player in the Artificial Intelligence space. The ramifications of the DeepSeek development (covered in the last Window on the World) may have slipped from the headlines, but it continues to resonate across Chinese technology.

We think that Chinese technology stocks, which trade at significant discounts to their US peers on valuation, could continue the strong run they've enjoyed this year. And, coupled with the potential of additional support for the economy from the Chinese authorities, it provides a constructive backdrop for the country and emerging markets more generally. So, we are happy to retain our overweight exposure to the region.

Portfolio positioning and outlook

While there has been plenty of market noise over the course of 2025 – tariffs and talk of trade wars with Canada, Mexico, Europe and China, the Russia-Ukraine war, and the deluge of policies hitting the domestic US economy – there has, we feel, been little to warrant any significant changes to portfolio positioning. We remain weighted for a broadening out in equity market performance, elements of which have been in play year-to-date.

As part of this strategy, we retain our underweight allocation to the so-called Magnificent Seven, with concerns around their rich valuations and continually high expectations for earnings growth, which has served us well year-to-date. In the UK, Europe, and emerging markets, equity valuations remain undemanding, and we are overweight these regions across our portfolios.

We also acknowledge the uncertainty the change of US administration has brought and, within the bond market, have a preference for UK government bonds and short-dated credit. Gilts continue to appeal on valuation grounds, and work well as a hedge should economic conditions deteriorate further, while short-dated credit exposure reduces our risk against any deterioration in credit spreads.

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