

Window on the World

SEPTEMBER 2025



With the sun setting on August and the summer, investors can return from their holidays with smiles on their faces. Over the past three months, equities (except for Europe) have produced high single-digit returns, building on the gains made since the market lows in April. U.S. equities are up a remarkable 30% over this period in local currency terms (USD)! In this edition of Window on the World, we look at the month of August in more detail, before digging deeper into the transformation in Japan and finishing on portfolio positioning as we head into the autumn.

Capital Market Returns July 2025

	Total Returns (%)			
	1 Month	3 Months	12 Months	YTD
UK Equities	1.2	5.6	13.6	15.6
US Equities	2.0	9.6	15.9	10.8
European Equities	0.6	0.0	11.4	12.3
Japanese Equities	4.5	9.9	16.2	12.0
Emerging Market Equities	1.5	9.8	17.6	19.6
UK Gilts	-1.1	0.1	-2.5	1.1
UK Corporate Bonds	-0.5	1.7	3.1	3.2
UK High Yield Bonds	0.8	3.6	10.6	7.1
US Corporate Bonds	1.1	3.0	4.2	5.5
US High Yield Bonds	1.2	3.5	8.2	6.2

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

Japanese equities were the standout performer over the month, rising by over 4%. Key drivers included a boost to investor optimism after a tariff agreement was reached with the U.S., which cut tariffs on Japanese exports to the U.S. from 25% to 15%. Coupled with this, a weaker currency boosted exporters, moderated inflation, and broadly resilient economic data provided a further tailwind to the market.

Emerging market equities also had a solid month, rising by 1.5%, driven by a strong performance from China. The decision by the U.S. and China to extend their trade truce until November helped propel Chinese equities higher, with the technology sector remaining a key contributor. This, in turn, helped to offset a weaker performance from Indian equities, where the U.S. placed a 50% tariff on Indian exports following its ongoing import of Russian oil.

The U.S. corporate earnings season is coming to a close, and on aggregate, it proved to be better than expected. This acted as a catalyst to drive U.S. equities higher, while

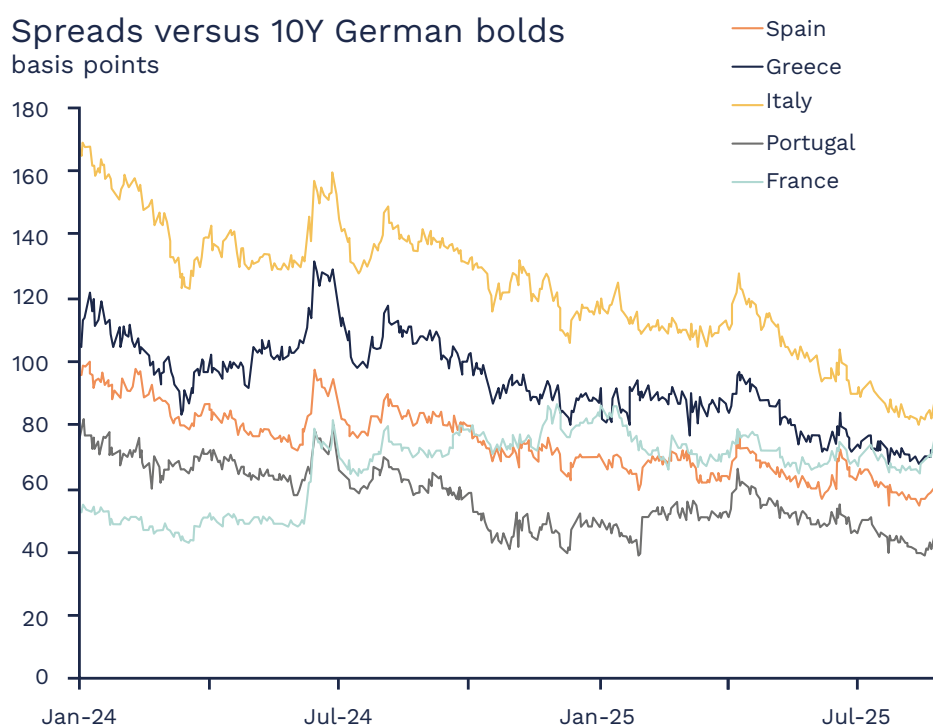
there was also some evidence of a broadening out over the month, with mid- and small-cap stocks outperforming their large-cap peers. The Federal Reserve has been under a lot of pressure to cut interest rates, which is widely anticipated for its 17 September meeting, so this has been another factor which has helped push U.S. equities up. Back at home, U.K. equities finished the month ahead too, but higher-than-expected inflation has tempered expectations for rate cuts this year despite signs of weakness in the U.K. labour market.

European equities lagged the broader global rally but delivered a small positive return. Economic data continues to indicate resilience in the economy, but this was partly offset by weakness in French stocks after the Prime Minister announced a no-confidence vote for 8 September. The vote is in response to the government's failure to pass budget cuts and, not surprisingly, raises political risk in the country.

French bonds sold off on the news, with spreads versus German bonds rising to levels last seen in December 2024.

YIELDS ON FRENCH 10-YEAR GOVERNMENT BONDS ARE NOW HIGHER THAN THOSE OF GREECE

Spreads versus 10Y German bolds
basis points



Source: Oxford Economics / Haver Analytics

Within U.K. fixed income, gilts declined over the month despite the Bank of England cutting rates as concerns remain over inflation proving stickier than expected, which puts upward pressure on yields. In addition, the market has doubts about the U.K.'s fiscal sustainability, which the forthcoming November budget may ease, but for now, the uncertainty remains. This put downward pressure on U.K. corporate bond prices, while continued tightening in U.S. credit spreads generated positive returns from this segment of the fixed income market.

Japan's equity comeback

With equity markets reaching all-time highs, it is unlikely to come as a surprise that equities in Japan have also reached this milestone.

What may be more surprising is that it took Japanese equities over 36 years to return to previous highs, arrived in 1989. The peak was followed by the bursting of an epic asset bubble, a prolonged bear market (equities finally bottomed in 2003 but only started to meaningfully recover from 2012), and an economy that suffered years of deflation. Perhaps even more surprising is that Japan peaked at 45% of total global equity market capitalisation; today, Japanese equities account for around 5%.



IT'S BEEN A LONG JOURNEY FOR JAPANESE EQUITIES TO RETURN TO PREVIOUS HIGHS...



Source: Bloomberg

Does this signal a new dawn for the Japanese equity market? To evaluate this, we need to look at what changed in 2012 to galvanise both the equity market and the economy. The catalyst here can be traced back to the appointment of Shinzo Abe (Prime Minister) for a second term in 2012, and the reforms he subsequently introduced. This took the form of a three-pronged approach to government policy designed to revitalise the economy, now commonly known as “Abenomics”.

To summarise, this approach combined fiscal stimulus, loose monetary policy, and structural reform to encourage growth and private investment. The country adopted a 2% inflation target, set negative interest rates, introduced yield curve control via quantitative easing (to manage the cost of debt) and increased government spending. These measures ultimately worked, spending increased, and the economy benefited. The policy also drove a significant weakening in the Yen, which helped the competitiveness of exporters and ended years of deflation.

More recently, structural reform has been in the spotlight, with the government implementing corporate governance and capital efficiency reforms, which have turned Japan into a more shareholder-friendly market. Companies have responded to these reforms by hiking dividends, making more efficient use of cash on their balance sheets and taking measures to boost profitability. In turn, this has driven a re-rating of the market, with global investors returning to the region.

13 years on from the start of Abenomics, investors looking at Japan see a much-improved situation. Corporate profitability has returned, and deflation is in the past. The Central Bank finds itself on a path to normalising monetary policy, and nominal GDP growth has improved. Corporate Japan is much more efficient and stronger than it was, and valuations are undemanding. For these reasons, we continue to retain exposure to the country in our portfolios.

Nevertheless, the bursting of the bubble has left a notable scar, which continues to overhang the market – a government debt-to-GDP ratio that the IMF calculates stands at 231%, the highest amongst developed markets. For context, the U.K.'s stands at 106% on IMF estimates. With global investors increasingly focused on the long-term sustainability of governments, the higher move in longer-dated Japanese government bond yields is a concern and a risk we continue to monitor. Japan is also well known for its ageing population (30% of the population is over 65, and this ratio is increasing), which adds to longer-term risks, leading to a shrinking workforce and putting more pressure on the fiscal budget from higher social security and healthcare costs.

CORPORATE GOVERNANCE REFORM IN JAPAN HAS DRIVEN A RAPID AND SIZEABLE IMPROVEMENT IN CAPITAL EFFICIENCY AND PROFITS

Japanese profit margins and RoE



Source: ESRI, Bloomberg Finance L.P.

Positioning and outlook

Looking into the remainder of this year, we will likely continue to see a slowdown in U.S. economic activity as businesses and consumers adapt to the country's tariff policy. Softer U.S. labour data will likely lead to the Federal Reserve cutting interest rates, which may mean putting inflation concerns to one side on the assumption they will be transitory. In the U.K., we look to the budget in the Autumn for more concrete plans on how the government can start the process of restoring public finances. In Europe, economic activity should continue to improve, although French political risk may weigh on sentiment in the near term.

Portfolio positioning is broadly unchanged over the past month. Within fixed income, we are marginally reducing our exposure to U.K. gilts and adding to emerging market debt, where yields on offer are attractive relative to the broader fixed income space, and allow us to further diversify our global exposure. We remain focused on shorter-duration fixed-income assets and aim to avoid the aforementioned volatility in longer-dated bonds. Our preference for equities in the rest of the world over U.S. stocks remains intact, and we continue to think valuations are undemanding in Europe, the U.K., Japan and Emerging markets.



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