Spring 2025

market outlook.

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contents.

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The UK Economy

The UK economy has shown resilience over the past quarter, notably avoiding many of the larger tariffs recently imposed by the U.S. on other countries. In contrast to the growing uncertainty in other markets, the UK has become increasingly attractive to investors. As a result, the FTSE 100 has posted relatively strong gains.

The ongoing threat of global tariffs and uncertainty surrounding international trade policy is likely to dampen business sentiment and planning in the near term. At home, domestic tax reforms — including rises in national insurance contributions and the minimum wage — further complicate the landscape, making it more difficult for firms to plan and grow. However, these measures may also bolster the government's balance sheet, offering a potential boost to the UK's financial outlook and long-term economic growth.

Recent UK economic data has been encouraging, underpinned by a strong labour market, rising wages, and more stable inflation. However, for the Bank of England to begin cutting interest rates, inflation must remain firmly under control. Risks such as persistent wage pressures, resilient consumer demand, supply-side constraints, and geopolitical tensions could continue to exert upward pressure on prices.

Many UK-listed companies, thanks to their globally diversified revenue streams, are less exposed to domestic risks. Despite this, they still trade at notable discounts compared to international peers — a dynamic that is drawing investor interest. For firms more reliant on the domestic economy, a potential interest rate cut would reduce borrowing costs, helping to support consumer spending, business investment, and overall financial conditions.

The European Economy

Political uncertainties in Germany and France could pose risks for the eurozone. In Germany, internal disagreements over energy, immigration, and defence policies are straining the ruling coalition. In France, public discontent over pension reforms and the rising cost of living is affecting President Macron's approval ratings. Instability in these two major economies may undermine investor confidence and slow responses to economic challenges.

The European Union is navigating rising trade tensions with both China and the U.S. While China remains a key economic partner—particularly for export-driven economies like Germany—growing concerns over China's rapid expansion into electric vehicles (EVs) pose a direct challenge to EU industrial competitiveness. At the same time, although the U.S. remains a longstanding ally, persistent tariff threats and unpredictable actions—such as disputes with Denmark over Greenland—highlight increasing volatility in transatlantic relations. This adds to the uncertainty facing European businesses, especially those reliant on global trade. For European equity markets over the short term, sentiment remains sensitive to shifts in trade policy.

The European Central Bank (ECB) has taken proactive measures to support the eurozone economy, cutting interest rates as inflation eases ahead of the U.S. and UK. While this provides short-term relief, the ECB's capacity to drive a lasting recovery or address deeper structural issues is limited, and its policy options are increasingly constrained, at least over the short term until trade and political uncertainties are resolved.

Trade tensions and tariff threats further complicate the economic landscape, restricting the ability to ease policy without risking a resurgence of inflation. Despite these challenges, European equity valuations appear attractive in the long term. With recent performance being driven by non-fundamentals, we still await a robust catalyst to sustain long-term growth in markets. As such, investors would be wise to remain cautious about their exposure to Europe in the short term.

The US Economy

President Trump’s second term has brought a more aggressive tariff strategy, leading to significant market volatility. This was anticipated given the historical pattern of tariff announcements. While it has created short-term uncertainty, we believe these tariffs are part of a broader negotiation strategy, rather than a permanent shift in economic policy. Despite the forceful rhetoric and sweeping reciprocal tariffs, markets have largely priced in worst-case scenarios. Historically, Trump has used tariffs as a tactical tool to bring counterparts to the negotiating table, and this instance follows that pattern. Signs of de-escalation, including pauses and partial rollbacks, have already prompted sharp market rebounds. Despite ongoing tariff disputes, both the U.S. and China are showing a growing willingness to reengage in dialogue. Negotiations are progressing with some stronger resistance - particularly from Canada’s new Prime Minister, Mark Carney, who has adopted a more assertive stance than some. While some negotiations may take longer, any signs of progress could serve as a positive catalyst for markets in the coming quarters.

However, ongoing tariffs may prompt a shift in focus—from solely controlling inflation to also supporting economic growth and employment. Such a pivot would signal a more flexible policy stance, reassuring financial markets by emphasising stability and long-term growth.

The U.S. economy experienced a mild contraction of 0.3% in Q1 2025, primarily due to the front-loading of activity in anticipation of tariff changes. This appears to be a temporary effect rather than a structural downturn. Underlying economic fundamentals remain robust, with the labour market showing resilience and inflation decelerating year-on-year. These factors should provide a stable backdrop for equity markets over the course of the year.

U.S. equity markets have responded positively to the easing of geopolitical tensions and a marked shift towards more constructive trade rhetoric from President Trump. His more measured approach—particularly in relation to trade with China, strengthening ties with India, and adopting a less confrontational stance on the Ukraine-Russia conflict—has helped ease investor concerns. With worst-case tariff scenarios largely priced in, markets have begun to stabilise and show signs of recovery. In addition, strong earnings from several of the "Magnificent Seven" tech companies have provided further momentum, reinforcing the thoughts for a positive outlook on U.S. equities.

The Japanese Economy

Japanese automakers remain vulnerable to tariff risks, particularly in the U.S., which could pressure margins and dampen growth. Broader supply chains, including electronics and pharmaceuticals, also face uncertainty amid ongoing trade talks. While Honda-Nissan merger discussions have stalled, there remains potential for other mergers and acquisitions in the sector. Despite short-term trade policy challenges, there is potential for constructive trade negotiations, which could open up new opportunities for Japanese stocks as conditions improve.

The yen has strengthened, partly due to the Bank of Japan’s gradual interest rate hikes. However, this appreciation, coupled with ongoing tariff negotiations, adds uncertainty for Japan's economic outlook. While a stronger yen can lower import costs, it may negatively impact exports. Governor Ueda’s decision to pause further rate hikes complicates the situation. The Bank of Japan’s substantial holdings of U.S. Treasuries could be leveraged strategically in trade negotiations and also offer short-term support for the yen.

Inflation in Japan remains notably subdued, despite the pressures of imported inflation. This poses a challenge given the current policy stance and labour market conditions, including persistently low wage growth. With domestic demand still weak, subdued real wages are restraining consumer spending on non-discretionary goods, limiting both economic momentum and growth prospects.

Japan’s small-cap sector remains undervalued, presenting attractive opportunities; however, the broader market has been buoyed by short-term sentiment driven by hopes of tariff relief and trade improvements. While progress on tariff relief could boost market sentiment and benefit all sectors, including small caps, we remain cautious about the sustainability of the rally. The momentum appears to be driven more by external factors and sentiment rather than structural improvements in Japan’s economy. With that in mind, it may be considered wise to wait for more favourable market conditions before considering it a strong investment case.

Emerging Markets & Asia Economy

China is once again at the centre of trade tensions with the U.S., a scenario reminiscent of the 2018 tariff disputes. Despite the steep tariffs currently in place, China is likely to experience a lesser impact than some may have previously anticipated. U.S. exports to China make up a small percentage of GDP, and as such, their effect on the overall economy will be limited. China's large domestic market provides a buffer, while its strategy of diversifying trade—strengthening ties with Southeast Asia, Latin America, and Africa—further reduces reliance on the U.S. market. Additionally, China's shift in agricultural imports, such as sourcing soybeans from Brazil instead of the U.S., reflects a broader push for economic independence, which helps mitigate trade friction and enhance resilience.

China's dominance in rare earths and electric vehicle (EV) development bolsters its global position. Controlling over 90% of refined rare earth minerals, China wields significant leverage in sectors like EVs, smartphones, wind turbines, and defence. This control allows China to influence global supply chains and maintain leadership in critical industries. While U.S. tariffs pose short-term challenges, they may prompt policymakers to announce further stimulus measures, including monetary easing, to support domestic growth. China remains a key global player, presenting strong potential for long-term investment opportunities despite near-term volatility.

India has strategically positioned itself to benefit from U.S. tariffs on other economies, with Prime Minister Modi pursuing a trade deal with the U.S. while also aiming to strengthen industrial leadership in the steel sector by boosting domestic production and encouraging supply chain resilience. As U.S. companies seek to diversify away from China, India is increasingly viewed as a preferred alternative, reinforcing its role in global supply chains. A recent trade agreement with the UK, targeting increased bilateral trade by 2040 through liberalised market access, along with a domestic budget focused on stimulating demand, further supports this momentum. These developments collectively enhance the outlook for Indian equities, particularly across manufacturing and export-oriented sectors, as foreign investment and earnings growth potential continue to rise.

Taiwanese semiconductor companies play a critical role in global supply chains, providing advanced chips that are vital for a broad range of consumer and industrial technologies used by both U.S. and Chinese firms. A potential easing of U.S.–China trade tensions could spur a rebound in chip demand and loosen cross-border restrictions, boosting orders for Taiwanese manufacturers. This would likely benefit Taiwan's export sector and support earnings growth in technology. In turn, it could lift investor sentiment and drive renewed upside in large tech stocks, particularly across the semiconductor and broader tech sectors.

Fixed Interest

Government bond yields have been volatile this quarter, although overall returns have remained relatively flat.

The majority of the volatility in fixed income markets has stemmed from government bonds. Spreads on corporate bonds remain tight and have shown little material volatility, despite a slight sell-off.

Despite ongoing uncertainty surrounding economic growth, inflation, and rising government deficits—which has contributed to heightened volatility in government bond yields—corporate issuers have generally maintained discipline. Their solid balance sheets and healthy liquidity positions leave them well-equipped to navigate short-term challenges. Notably, the recent widening in credit spreads has been more pronounced in the high-yield segment, which is typical during periods of market stress. Importantly, higher starting yields suggest that medium-term returns in the corporate bond market are likely to be reasonable.

If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on 0800 028 3200, Monday to Friday 9am-5pm or you can email us at mywealth@wealthatwork.co.uk

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