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Quarterly Equities and Multi Asset Outlook

Crisis fatigue

The art of adaptation

Q3 2025

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Crisis fatigue

- The conventional wisdom on market response in the face of increasing geopolitical risk is being challenged. The formulaic application of perceived market 'rules', such as the belief in the US dollar and US treasuries as safe havens, is not working as it has done in the past.
- A case of 'crisis fatigue' appears to be setting in among investors, possibly due to the incessant newsflow of risk events that we have faced, and eventually overcome, over the past few years – from COVID, to war, to US policy gyrations.
- In part, this resilience is rational, as geopolitical conflict only impacts risk markets in line with its impact on the underlying economic and corporate fundamentals. However, the market is getting too used to crying wolf – as the accumulation of political shocks, policy swings and conflict headlines has trained investors to look past threats that don't immediately materialise in a meaningful way for markets. That desensitisation is in itself a risk.
- Over the next pages, our equities and multi asset investment teams will discuss how they have navigated the last quarter, adapting to the new market dynamics while staying true to their investment philosophy and process.

Pass me the ham, please

The conventional wisdom on market response in the face of increasing geopolitical risk is being challenged. The second quarter of 2025 has seen an escalation of the conflict in the Middle East, a broader and harsher-than-expected tariff war staged by the Trump administration, and – despite some false hopes – no end in sight to the war in Ukraine. Following a well-rehearsed formula, the 'usual' asset allocation playbook should have proven effective: sell equities, buy bonds, and whatever you buy, make sure it is in US dollars.

Far from it. Over the second quarter, the US 30-year treasury yield has risen by 20 basis points (bps), ending the first half of the year up 8 bps. To add insult to injury, bond markets that in the past would have been shunned in favour of a flight to US yield, such as Italy and Brazil, saw the long end of their yield curves decline (and hence bond prices rise) over the second quarter.

The US dollar saw a 7% decline over the same period, adding to earlier weakness for a total 10.7% decline in the first half. Even more eye-catching has been the rise in global equity markets, with the MSCI All Country (AC) World up 11.7% in US dollar terms over the second quarter, beating the S&P 500 and trailing the Nasdaq's 18% rise. In all of this, emerging market (EM) equities managed to outperform the S&P 500 in US dollar terms, in good part thanks to a helping hand from appreciating currencies[1]. Investment grade and high yield spreads followed a similar script, after initially widening in the aftermath of Liberation Day, eventually rebounding to historically tight levels. Clearly not the direction of travel we had seen in past instances of increased geopolitical risk.

Just as interestingly, even from a liquidity perspective, both equity and credit markets have continued to function well even through the most volatile of times. The second quarter saw an increase in capital raising activity, both on the credit and on the equities side, and markets appeared to have no issues digesting the additional paper.

The seemingly off-script behaviour of markets appears to be the result of a certain level of 'crisis fatigue' among investors, possibly due to the incessant newsflow of risk events that we have faced, and eventually overcome, over the past few years – from COVID, to war, to US policy gyrations.

But this is not entirely a case of investors putting their heads in the sand, or – as my Italian grandmother (who was just as wise as she was expressive) would say – covering their eyes with slices of prosciutto (the Italian cured ham). In part, this resilience is rational, as geopolitical conflict only impacts risk markets in line with its impact on the underlying economic and corporate fundamentals. For example, in the case of the Middle East conflict, barring more extreme scenarios, oil supply and price would appear to be the most direct risk to the global economy. Such impact, however, would be limited, unless we had a protracted closure of the Strait of Hormuz, given the large percentage of global oil and liquid natural gas (LNG) that travel through it. The market has simply decided that the chances of such closure are unlikely, for now.

Similarly, the sell-off in US treasuries from private foreign investors and foreign central banks – reassessing their sizeable positions and derisking away from the US – is not unreasonable, amid concerns around the ballooning US budget deficit.

We have experienced such a shift in allocation first hand among our clients. European risk assets are among the most sought after, given the emergence of a new catalyst, ie, Europe benefiting from increased domestic defence and infrastructure spending.

We have also experienced increased interest in Asian assets and, more recently, we have seen a pick-up in interest in emerging market assets. Our European clients were the first to move, and we are now seeing a similar trend among our Asian clients.

And let's not forget the meaningful rebound in the Nasdaq, which was also explainable. Arguably, the post-DeepSeek fall had gone too far, and the 1Q25 earnings season confirmed that there was no sign of slowdown in Artificial Intelligence (AI)-related capex.

[1]Bloomberg, July 2025, total returns in US dollars. US Dollar Index (DXY), MSCI Emerging Markets Index.

So perhaps investors are not ignoring risks and forgetting their tried and tested scripts. They are simply adapting to a new world order. One where the US is still a market rich of investment opportunities, but it is not the only attractive market in the world, and also has its weak spots. Investors have not gone mad; rather, they are thinking differently, and perhaps a little more carefully and selectively.

As investors, we have to adapt to the new status quo, one in which the formulaic application of perceived market 'rules', such as the belief in the US dollar and US treasuries as safe havens, is not working as it has done in the past. This is a market where nuanced, independent and differentiated thinking counts.

It is also a market where our speed of reaction has to change from the past. We have spoken before about the increased velocity of market movements, and we have seen it in action in the speed of risk markets reversals in early April. Such speed does not allow time to 'explore' opportunities once they arise, do our homework, and then take advantage of volatility. By the time the homework is completed, the opportunity is gone.

At M&G Investments, we have learnt to do our homework ahead, deep dive into asset classes and securities independently from their current valuations, maintain wish lists, and be ready to take action, whether buy or sell, at whatever point the price comes in our direction.

> "...perhaps investors are not ignoring risks and forgetting their tried and tested scripts. They are simply adapting to a new world order"

Always look at the ~~bright side~~ downside

While we applaud what would appear to be a more nuanced way of thinking by our fellow investors, we also need to consider the risks ahead, at a time when risk assets have staged such a strong performance. There is a distinct possibility that the crisis fatigue we are witnessing across risk markets, while feeling like a rational response at this point, could end up on a slippery slope as markets start to ignore risk altogether.

Our Head of UK Equities observed that the market is getting used to crying wolf – as the accumulation of political shocks, policy swings and conflict headlines has trained investors to look past threats that don't immediately materialise in a meaningful way for markets. However, that desensitisation is in itself a risk.

With many tariff negotiations still to be settled, the risk to company earnings, and to a new bout of weakening consumer and corporate sentiment that could impact real demand, is still there.

Therefore, as investors, we continue to monitor market events, particularly the new developments on tariffs, as higher tariffs can have a direct negative impact on corporate earnings around the world. Tariffs could also trigger a demand slowdown as prices rise. At a macroeconomic level, we monitor any changes in consumer and corporate confidence that could be precursors to changes in demand and, of course, any worsening in unemployment data.

But timing is everything. We have all learnt that panicking and exiting markets too soon or too abruptly has never been the best recipe for investment returns.

For now, as visibility is limited by the challenges of policy forecasting, we believe that diversification, both across and within asset classes, is the best recipe for portfolio resiliency in the face of an uncertain macroeconomic environment.

Within our dedicated equities strategies, we focus on idiosyncratic, company-specific risks to drive outcomes.

And – where possible – we mitigate unintended risks through portfolio construction, avoiding concentrated bets.

Portfolio positioning

In our multi asset strategies, we have a small overweight position in equities, which we have recently brought down. We balance our small long in equities with a long duration position in government bonds, spread across maturities.

We still see long bonds as an insurance should the macroeconomic backdrop take a turn for the worse. However, over the recent months, we have diversified our bond positions further into German bunds, UK gilts and EM local currency bonds.

With regard to US government bonds, we are more comfortable on the 10-year versus the 30-year part of the curve, given volatility. We have also built positions in inflation-linked bonds, and are underweight credit given the high valuations – preferring investment grade to high yield.

Our multi asset equities allocation is underweight the US market and overweight Europe and Asia. We are diversified across countries and sectors in Europe, and some of our preferred markets in Asia are Korea, Hong Kong and Indonesia.

Recent portfolio changes across equities

Our investment teams have taken advantage of opportunities created by market gyrations, particularly in the first part of the quarter. One common theme across the US, European and Asian portfolios, has been an increase in technology exposure, particularly AI-related semiconductors and service providers, taking advantage of valuations that, in some cases, fell to levels close to the 2022 troughs.

Our longer-term outlook for innovation has remained unchanged. Semiconductors continue to become more powerful, AI capabilities are increasing with computing power, new markets for computing and AI are emerging, and we are seeing agentic AI and robotic AI as new emerging use cases for AI that can further drive demand for accelerated computing.

In Europe, we trimmed our defence positioning. We still recognise the potential in this space, but careful selection is needed; market excitement has led to pockets of over-exuberance in some sub-segments, with timeframes to deliver new capabilities longer than many realise.

Elsewhere, and across all portfolios, our investment teams have focused on idiosyncratic stock opportunities, spanning from industrials to specialty financials and even the much-battered auto sector. We have also been selectively adding to healthcare stocks, which have been caught in the political crosshairs.

In our Global Listed Infrastructure strategy, we have also used the renewed strength in European and US utilities to fund new exposures in Asia, India in particular, and emerging markets.

In our Asia portfolios, we also added to our India holdings, which are relatively more insulated from non-domestic revenue sources and hence tariff risks. We have lightened some of our exposure to regional financials, Greater China and, later in the period, some telecom holdings.

In Japan, we entered the quarter with a fairly conservative risk exposure and selectively added to a handful of single-company opportunities. The set of opportunities stemming from Japanese corporate improvement remains ample. Earnings remain healthy, as they grew by 9.8% in the fiscal year that ended in March 2025, and companies announced a record ¥3.8 trillion in share buybacks this April – nearly triple the ¥1.3 trillion of a year ago[2]. Japanese firms are set to repurchase 5% of their own shares, positioning themselves as the largest net buyers in the market.

Over the next pages, our equities and multi asset investment teams will discuss how they have navigated the last quarter, adapting to the new market dynamics while staying true to their investment philosophy and process.

We live in a rapidly evolving world, where the choice to embrace innovation, with AI at the forefront, is not optional but existential. The market landscape is also transforming, as wider access and ever-advancing technologies are redefining the breadth and speed of price changes. This is not necessarily negative for the investment community. Easier and wider market access also means more sentiment-induced market movements, which create opportunities that we, as active managers, can take advantage of.

[2]M&G, Morgan Stanley MUFG Research – Japan Equity Strategy, 4 June 2025.

As investors and stewards of our clients' capital, our aim is to build resilient portfolios that can stand the test of time. Following the panic and exuberance driven by market movements is no option for us. Independent thinking, strong investment processes and the ability to adapt to different market circumstances are key to us generating strong risk-adjusted, long-term returns for our clients.

We wish you an enjoyable and – hopefully – interesting read.

Fabiana Fedeli
Chief Investment Officer, Equities, Multi Asset and Sustainability

Global

Daniel White
Head of Global Equities

The art of adaptation in action

The second quarter of 2025 will be one for the history books. It commenced with a stomach-churning explosion in market volatility with the Liberation Day tariff bombshell. The CBOE Volatility Index (VIX) endured a record spike to levels that surpassed the COVID shock. Yet, within a matter of weeks calm was restored with various tariff extensions, climbdowns and rollbacks. That did not, however, last long and by mid-June, market uncertainty was again rising as geopolitical escalations in the Middle East threatened restored, yet highly fragile, investor sentiment. Yet, in all of this, and despite the volatile newsflow, equity markets have remained resilient.

How are our global investment teams dealing with these conditions? Is this a case of crisis fatigue? Essentially, it involves the 'art of adaptation'. Global markets fell 16% peak to trough from mid-February to early April. They subsequently rose nearly 20% with significant under-the-bonnet sector and style rotation within that retracement.

Our investment teams are learning to revel in the discomfort of the whipsawing. They remain long-term focused, and committed to their entrenched processes and philosophies, but have been reactive to volatility-induced opportunities to take advantage of dislocations and valuation anomalies driven by wild gyrations.

An example would be our Global Themes strategy, which was able to rapidly reduce its significant technology underweight as the valuations of many of the key thematic innovation winners that we had been waiting patiently to own quickly fell to levels that met our disciplined value-orientated approach. As shown below, the so-called 'Magnificent 7' (Mag7) P/E multiple declined to close to the trough levels seen in 2022.

The opposite has been the case for our European Value strategies. With Europe's renaissance catalysed by a seismic fiscal stimulus package from Germany, many traditional value stocks and sectors are being re-rated to 'growth' stock multiples.

An example would be a German defence manufacturing holding which, given our valuation anchoring and position sizing discipline, has been trimmed no fewer than 15 times this year as the shares have risen over 200%.

> "Active management can thrive in this environment of forced selling and complacent crowding"

Our Global Value team has been combing through the tariff wreckage and adding exposure in the much-maligned auto sector. Our North American Value team has been active with several new positions in various sectors. The purchase of an industrial process software company is symptomatic of the velocity of change; the shares have rallied 45% from the Liberation Day aftermath lows, very quickly validating much of the upside potential we recognised on purchase.

Meanwhile, our North American Dividend team has added to their weightings in financials whilst our Global Dividend team has been managing position sizing in technology names and selectively adding to healthcare stocks, which have been caught in the political crosshairs. The team has also built a new position in a leading semi-conductor equipment manufacturer.

In our Global Listed Infrastructure strategy, we have also used the renewed strength in European and US utilities to add new exposures in Asia, in particular India, and emerging markets.

Overall, the market looks set to remain more 'episodic'. Whilst it often proves short-sighted to over-react to headlines and short-term newsflow, it is also increasingly wasteful not to make bold decisions when the time is right.

Active management can thrive in this environment of forced selling and complacent crowding. We are optimistic that our experienced teams and resilient investment processes are well set up to take advantage of the alpha opportunities that will inevitably come our way.

Magnificent 7: valuation declined to 2022 levels

Source: Bloomberg. Bloomberg Magnificent 7 (BM7T), BEst p/e ratio, through to 30 June 2025.

Impact

John William Olsen
Head of Impact Equities

Thinking fast and slow

The dizzying number of sensational headlines, bombastic statements, political U-turns and the breakdown of longstanding conventions during the last couple of quarters seem to have brought about an interesting sense of crisis fatigue amongst investors. To some degree, this could just be contrarian stock market investors buying on negative news, expecting a quick reversal, but there also seems to be a general (and self-reinforcing) numbness to news.

Adaptation to uncertainty and a rapidly changing playbook isn't actually an artistic skill in our view, but a choice of investment approach, process and behavioural discipline.

Going into the news maelstrom with a balanced portfolio allows us to watch market movements without an urgent need to act – and that is a good option to have.

With relative calm, we can look for opportunities to pick up stocks, that fall out of favour due to overly simplistic first-level thinking. Some companies, with solid 10-year prospects, and great adaptability of their own, will get caught up in indiscriminate selling activity. They might experience shorter-term headwinds or volatility, but if we believe the effect on the franchise value is limited, then it could present a good buying opportunity for us. We are typically close to fully invested in equities, but in a balanced portfolio there will often be less attractively-valued stocks that we can trim or sell to fund these new opportunities.

Having thoroughly researched a company's moving parts, long-term outlook and competitive strengths, well in advance of these situations, adds to the probability of us making informed decisions when we face the choice.

> "[It] makes sense to apply second-level rational thinking, when markets are more cheerful, yet risks still prevail"

For example, we added a competitively-advantaged Dutch maker of lithography machines to our Paris Aligned strategies during the downturn, based on this line of thinking. We have also made several changes to our Impact strategy where we have seen opportunities to upgrade on quality, increase diversification and build new positions in stocks that we believe have a good chance to outperform over the next decade – partly because of their sound fundamentals and sustainability characteristics, and partly because we were able to find good entry points. These changes were made to either maintain or improve the balance of the strategies.

Markets have snapped back, and increasingly thick-skinned investors might decrease the short-term volatility, but it also makes sense to apply second-level rational thinking, when markets are more cheerful, yet risks still prevail.

Thematic technology

Jeffrey Lin
Head of Thematic Technology Equities

Uncertainty creates opportunity

Tariff threats caused uncertainty in the global financial markets. The main concerns were global growth slowdown and a potential inflationary impact. This led to the market pricing lower growth assumptions and implicitly higher cost of capital to account for a less certain outlook, resulting in a contraction in equity values.

As quickly as tariffs were becoming a possibility, we also believed that tariff decisions could be reversed. The near universal disapproval of tariffs by the American public and corporations was becoming a more influential force that had the potential to reverse President Trump's proposed tariffs.

Our longer-term outlook for innovation, however, has remained unchanged. Semiconductors continue to become more powerful, Artificial Intelligence (AI) capabilities are increasing with computing power, new markets for computing and AI are emerging, and we are seeing agentic AI and robotic AI as new emerging use cases for AI that can further drive growth for accelerated computing.

> "...agentic AI and robotic AI [are] new emerging use cases for AI that can further drive growth for accelerated computing."

During the uncertain period of tariffs, we were presented with opportunities to add to, or initiate, positions where long-term outlooks were relatively unchanged, but which were trading with higher implied discount rates.

We took advantage of the market volatility to trim some of our more resilient AI 'beneficiaries' and use the proceeds to increase our exposures to what we believe to be long-term structural winners among both AI enablers and AI providers, which saw their share prices sell off sharply.

The performance gains of AI were recently highlighted in the 2025 Artificial Intelligence Index Report published by Stanford University[1]. We believe further advancements in AI will continue to increase the addressable market opportunity and drive future investment performance.

[3]Nestor Maslej, Loredana Fattorini, Raymond Perrault, Yolanda Gil, Vanessa Parli, Njenga Kariuki, Emily Capstick, Anka Reuel, Erik Brynjolfsson, John Etchemendy, Katrina Ligett, Terah Lyons, James Manyika, Juan Carlos Niebles, Yoav Shoham, Russell Wald, Tobi Walsh, Armin Hamrah, Lapo Santarlasci, Julia Betts Lotufo, Alexandra Rome, Andrew Shi, Sukrut Oak. 'The AI Index 2025 Annual Report,' AI Index Steering Committee, Institute for Human-Centered AI, Stanford University, Stanford, CA, April 2025.

The key takeaways from the report include:

AI price and performance.

Machine learning performance has grown 43% annually, doubling every 1.9 years. Price performance has improved with costs dropping 30% per year, while energy efficiency has increased by 40% annually.

AI models are becoming cheaper to use.

The cost of querying an AI model in 2022 was $20.00 per million tokens; this dropped to $0.07 in October 2024.

AI continues to drive rapid advances in scientific discovery.

AI's role in scientific progress continues to expand. While 2022 and 2023 marked the early stages of AI-driven breakthroughs, 2024 brought even greater advancements, including Aviary, which trains LLM (large language model) agents for biological tasks, and FireSat, which significantly enhances wildfire prediction.

The clinical knowledge of leading LLMs continues to improve.

OpenAI's recently released o1 set a new state-of-the-art 96.0% on the MedQA[4] benchmark – a 5.8 percentage point gain over the best score posted in 2023. Since late 2022, performance has improved 28.4 percentage points.

Demonstrating agentic AI and robotic AI

Enterprise software vendors are in a strong position to add agentic AI enhancements to their products. At ServiceNow's Knowledge User Conference in May 2025, the company demonstrated agentic AI features that bring data from multiple systems to make key decisions much faster than manual processes.

Autonomous vehicles are an example of robotic AI. Alphabet's Waymo driverless service is currently offered in the US cities of Phoenix, San Francisco, Austin and Los Angeles, and the company has announced the service will be offered in Atlanta and Miami in the near future. The service is now providing 250,000 paid trips per week.

Separately, Tesla began testing of its Robotaxi technology with paying passengers in Austin in June 2025. The service fleet uses the Tesla Model Y with a safety driver, with the goal of becoming driverless at some point in the future. While Waymo is ahead of Tesla from a commercialisation standpoint, Tesla believes it can bring the service to market using a standard production vehicle whereas Waymo's vehicle is a modified production vehicle.

While global financial markets have rebounded quickly, we remain excited about further growth from innovation creating opportunities for companies enabling, providing and benefiting from AI.

[4]MedQA is a comprehensive dataset derived from professional medical board exams, featuring over 60,000 clinical questions designed to challenge doctors.

UK

Michael Stiasny
Head of UK Equities

Ignored risks are often the most dangerous

The second quarter of 2025 has been shaped by another bout of global disruption, but this time, the market response has been strikingly short-lived. When Donald Trump announced on 2 April 2025 that the US would impose tariffs on all imports, an event now branded Liberation Day, equity markets globally sold off sharply. In the UK, the FTSE 250 dropped more than 5% in a matter of days, and sterling weakened meaningfully against the dollar. But just as quickly as the sell-off came, it reversed (and in the case of sterling currency, moved to new highs). The tariffs were watered down, key exemptions emerged, and investors – not unreasonably – concluded that the policy would be 'more bark than bite'.

That rebound was rational. But what comes next is more troubling. The danger now is that crisis fatigue sets in, not in the sense of panic or paralysis, but in markets starting to ignore risk altogether. The accumulation of political shocks, policy swings and war headlines over recent years has trained investors to look past threats that don't immediately materialise. The market is getting used to crying wolf, and that desensitisation is itself a risk.

> "The market is getting used to crying wolf, and that desensitisation is itself a risk"

That makes selectivity more important than ever. One of the most notable themes this year has been the strong performance of UK financials, particularly the life insurers. Rising bond yields have been a clear tailwind for firms like Legal & General, Phoenix Group, and Aviva, where improved investment returns and robust capital positions have driven strong share price performance. Banks, too, have been resilient. Despite pressure on mortgage approvals and flatlining consumer sentiment, Lloyds, Barclays, and NatWest have all benefited from the persistence of high net interest margins and surprisingly benign credit conditions.

Conversely, the pharmaceutical sector, typically a core defensive, has underperformed. Trump's tariff rhetoric specifically referenced pharmaceuticals and, with the US being the largest export market for both AstraZeneca and GSK, the threat of sector-specific duties has been taken seriously. Both stocks lagged the broader index in the second quarter, not because of operational weakness but because of the repricing of political risk, a reminder that even 'safe' sectors are not immune in a fracturing trade environment.

UK equities remain attractively valued, in our view, trading at around 12x forward earnings[5] – a steep discount to global peers. In markets that aren't discounting risk effectively, there will always be opportunities to be active, and we believe the UK market looks very interesting for active managers.

The challenge for investors in the second half of 2025 is not avoiding risk, it's recognising that ignored risks are often the most dangerous. The market's ability to rebound from April's tariff shock was a sign of resilience. But it's important that resilience does not breed complacency amongst investors.

Crisis fatigue is real, but it has a counterpoint: clarity. We believe the winners in 2025 will be those who stick to fundamentals, avoid the noise, and lean into quality when others hesitate.

Adaptation isn't just an art, it's a discipline.

[5]Bloomberg, FTSE All Share Index, June 2025.

Japan

Carl Vine
Co-Head of Asia Pacific Equities

Relief, not confidence

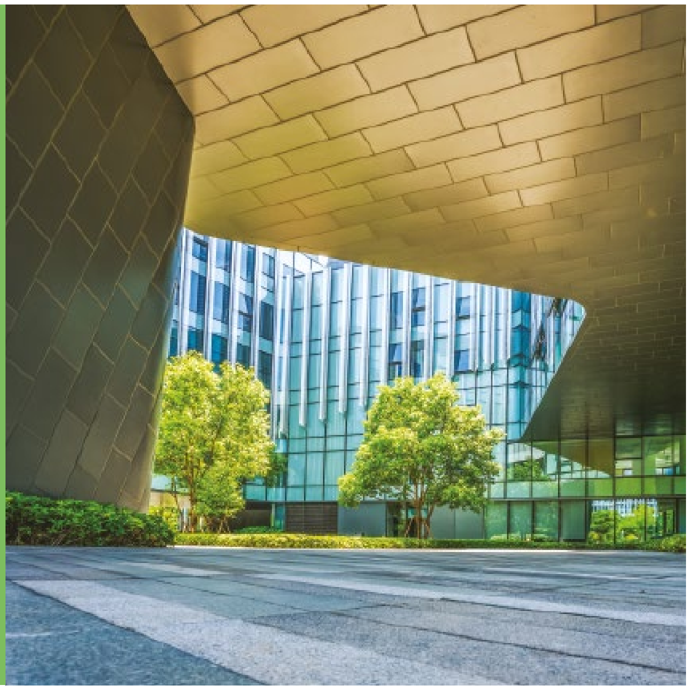
Liberation Day volatility came and went, but market fragility remains, shaped by shifting geopolitics, tariff brinkmanship, and a persistent failure of the macroeconomic consensus. Looking back, market conditions during the second quarter of 2025 were defined more by reflex and relief than by conviction or confidence. The rally from April's lows reflects a collective exhale following extreme policy-driven dislocation, instead of a constructive view of the prospective investment landscape.

Markets have been in a 'high volatility of volatility' environment for a while now, and it appears that crisis fatigue is setting in. This is a double-edged sword. On the one hand, it may blunt prospective volatility in the face of new policy curve-balls. On the other, it may lead to complacency. The economy suffers when the policy arena is seen to be more dominated by noise than information.

We entered the second quarter with risk exposures deliberately buttoned up. Our philosophy remains unchanged: allow a diversified set of idiosyncratic, company-specific risks to drive outcomes, while avoiding concentrated bets on style or sector. This discipline served us well during the early-quarter turbulence. Unusually for us, taking advantage of the volatility was not something we attempted in the recent episode. The tariff debate – the dominant narrative – offered little scope for differentiated insight and as such we did relatively little to the portfolios. We chose not to overreach.

As the quarter matured, however, we selectively added to a handful of single-company opportunities where price dislocation outpaced fundamentals. Still, we resist the temptation to become amateur forecasters of geopolitics or macroeconomic turns. Sometimes, restraint is a strategy in itself.

"The economy suffers when the policy arena is seen to be more dominated by noise than information"



Evolving environment

As ever, the remainder of 2025 offers multiple paths:

Stability with scepticism

Markets drift upwards on a lack of new policy landmines – but on thin conviction.

Policy overreach

A misstep – from central banks or trade officials – reigniting volatility.

Selective acceleration

Pockets of the market begin to re-rate as fundamentals outstrip fading macroeconomic noise.

Rather than betting on a specific outcome, we remain alert to the evolving environment and await asymmetric opportunities associated with company-specific debates, where we have earned the right to a differentiated perspective.

Another notable development during the quarter was the meaningful move in Japanese government bond yields, particularly at the long end. While this may seem ominous for a country with debt exceeding 200% of GDP, a more nuanced view suggests stability. Japan's debt is largely domestically held, inflation remains subdued and net debt levels are lower once the government's financial assets are accounted for. Add to this the immense savings of Japan's private sector, and it becomes clear why the economy remains resilient – despite decades of doomsday narratives.

Corporate Japan, meanwhile, continues to impress. Earnings grew by 9.8% this fiscal year, and companies announced a record ¥3.8 trillion in share buybacks this April –nearly triple the ¥1.3 trillion of a year ago[6]. Japanese firms are set to repurchase 5% of their own shares, positioning themselves as the largest net buyers in the market.

With margins of safety restored and valuations turning attractive, Japanese equities are regaining global attention. Even before factoring in idiosyncratic upside, the backdrop is compelling, in our view. Fortunately, company-specific dynamics remain strong – M&A, capital allocation and structural self-help are all accelerating. That plays directly to our strengths: selective stock picking in fertile ground.

[6]M&G, Morgan Stanley MUFG Research – Japan Equity Strategy, 4 June 2025.

Asia Pacific ex Japan

David Perrett
Co-Head of Asia Pacific Equities

Asia's diverse opportunities offer a path through the uncertainty

The second quarter was one that contained the greatest assault on the global trading regime since the Second World War and a hot conflict between Iran and Israel. Carnage for markets, right? Actually no!

In US dollar terms, the MSCI Asia ex-Japan Index rose more than 12%, with Korea and Taiwan leading the way rising a staggering 35% and 26% respectively[7]. The worst performing market was Thailand, which was broadly flat during the period. Throughout the period there was tremendous volatility, with markets plunging and then recovering their losses or, in many cases, then pushing on to new year-to-date highs. During this period of volatility, we added to our AI exposure and India holdings, while lightening some of our exposure to regional financials, Greater China and, later in the period, some telecom holdings.

Tech-heavy Korea and Taiwan benefited from ongoing evidence that AI demand remained strong, prompting index heavyweights like SK Hynix and TSMC to rally hard. The Korean market received a further boost from the election of a new president who appears committed to reforming the corporate code, encouraging companies to boost shareholder returns and simplify ownership structures.

Southeast Asian markets lagged for the most part. This relative weakness was partly tied to an absence of technology stocks within their respective benchmarks, but also concerns about the strength of global activity in a heavily trade-dependent part of the world.

Diverse stock opportunities

In many ways the events of the second quarter highlight the challenges of forecasting future events from a clean sheet of paper. Even if one had forecast events correctly, the likelihood is that one would have got the resultant market movements wrong.

Recognising the challenges of macroeconomic and geopolitical event forecasting, our approach is to focus on bottom-up stock opportunities and carefully mitigate unintended risks through portfolio construction.

[7]Bloomberg, MSCI Asia ex Japan Index, KOSPI – Korean Stock Exchange Index, MSCI Taiwan Index, total returns in US dollars. Period: 31 March 2025 through 30 June 2025.

> “In many ways the events of the second quarter highlight the challenges of forecasting future events from a clean sheet of paper”

Fortunately, there are a number of potentially interesting single stock opportunities dotted across the region at present: a Southeast Asian telecom company yielding nearly 8%, which is currently at the tail end of market consolidation; a global packaging company, trading at a 5%+ yield, that is going through an acquisition which should drive material synergies over the coming two years; and Chinese hotel businesses that are growing rapidly, as they consolidate the market with their nimble, client-focused franchise models. These examples offer a flavour of the diversified and uncorrelated stock opportunities that currently exist across the Asia Pacific region.

Importantly, they are opportunities that are in no way predicated on an investor having the ability to make an accurate judgement call on macroeconomic or geopolitical events.

Emerging markets

Michael Bourke
Head of Emerging Market Equities

Adapting to structural shifts and dislocations

Following the spike in volatility triggered by April's Liberation Day tariff storm, emerging markets (EMs) found a new sense of calm and have now rallied beyond the pre-Liberation Day level. Year-to-date, EMs have outperformed US equities by approximately 10 percentage points[8].

Even as President Trump's administration has delayed or revised their policies in the face of market turmoil, we see investors increasingly considering downside risks to the US economy, consumer sentiment, and private capital investment in a volatile policymaking environment.

Alongside low valuations and a weaker US dollar, this backdrop reignited investor interest in EMs and Asia. While there is dispersion within EMs performance, with a great deal of variation between top and bottom performers, only two markets have posted negative returns year to date[9]: Thailand (-13.1%) and Indonesia (-3.2%). Both markets are struggling under the weight of tepid growth, as investors await credible indications of an upturn.

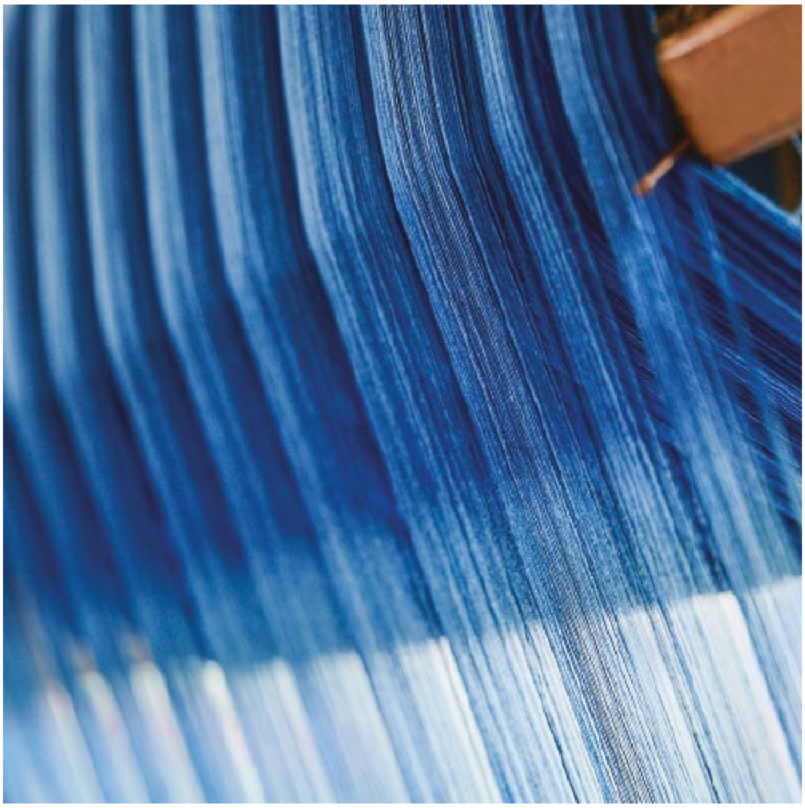
> "The efforts by many Chinese brands to 'go global' are emblematic of new networks solidifying"

Korea (+39.7%) is leading the way, buoyed by high exposure to compelling themes (such as defence, nuclear energy and artificial intelligence via memory chips) and momentum behind corporate governance improvements that might finally shake off the so-called 'Korea discount'.

We are also seeing return dispersion in Chinese equities (+17.5%). Backed by an estimated RMB 89 billion in southbound flows, H-shares have outpaced the onshore market by double digits. Much of this capital has been invested in high-growth, and increasingly global, companies – a bias that suggests low investor confidence that the drag from a tumbling property market will subside and give way to stronger domestic consumption.

[8]Refinitiv DataStream, MSCI Emerging Markets Index, S&P 500 Index, total returns in US dollars. Period: YTD through to 30 June 2025.
[9]Refinitiv DataStream, MSCI indices, total returns in US dollars. Period: YTD through to 30 June 2025.

The efforts by many Chinese brands to 'go global' are emblematic of new networks solidifying, with trade relationships in the Global South strengthening as the US cements a protectionist stance. These structural shifts require a nimble and adaptative mindset that eschews formulaic 'mean reversion' investment theses in favour of identifying genuine dislocations.



In Latin America, investor focus has shifted from tariff impacts to domestic policy cycles. Central banks across the region have either reached, or are close to reaching, monetary policy stability. High real rates and a more supportive external environment for EM currencies contributed to strong performance in Mexico (+31.2%) and Brazil (+29.4%). Mexican President Claudia Sheinbaum's pragmatic engagement with the US administration helped to mitigate concerns around trade between the two countries, while Brazil recovered from very weak performance in the fourth quarter as fiscal concerns softened for the time being.

In the meantime, the Middle East has become embroiled in another military conflict, this time between Israel and Iran. A US strike on Iranian nuclear facilities intensified concerns of escalation, with global implications for energy and commodities markets. The swift move from tariff-induced global volatility to fears of an oil shock underscore a state of 'multi-crisis' in global markets.

While EMs will be subject to rolling crises, we believe the blow to confidence in US risk assets will not fade quickly. Companies across EMs have reduced leverage in recent years, and now operate diverse supply chains and increasingly robust networks within the Global South. Most importantly, returns on equity within EM equities have been improving – this is the ultimate harbinger of positive long-term shareholder returns, in our view.

In the face of volatility, we are laser-focused on identifying dislocations and perfecting the art of adaptation. Over the past few months, we have reduced our exposure to outperforming EV and e-commerce names in China, while adding to our Brazilian telecom and bank exposures (following a sharp sell-off in December). After the Liberation Day sell-off, we added to our position in a Hong Kong based textile manufacturer where we felt the risk/reward skewed even more favourably to the upside. We also rotated our bank exposures in Colombia on valuation grounds.

Global research

Tim Alexander
Global Research Analyst

Global challenges driving growth in defence

Over the past five years, global tensions have surged, prompting nations to reassess the priority of national security within government budgets, with major ramifications for the defence sector.

Defence spending is rising rapidly, reflecting a geopolitical environment where risk and tension continues to grind higher. Our core thesis in the space is that it is this level, and anticipated future levels, of geopolitical instability that drives defence budgets, rather than individual governments' positioning on domestic political spectrums.

Given this thesis, and the weakening geopolitical picture on a multi-year view, we have been overweighting the defence sector in many of our portfolios: its growth, tied to persistent global challenges, can offer idiosyncratic returns and diversification against market pressures, often stemming from these same challenges.

We see three major hotspots driving this today, against a broader backdrop of weakening Pax Americana and a return to the Clausewitzian world where military force is a de-facto accepted option in the spectrum of political options:

- Russia's 2022 invasion of Ukraine destabilised Eastern Europe, pushing NATO members towards first meeting the alliance's 2% GDP defence spending target, then moving to raise the target itself as the conflict drags on without resolution. We see a decreasing number of likely end-state scenarios that improve global stability. Both conventional land forces like Infantry Fighting Vehicles (IFVs) and Artillery, as well as capabilities across the missile-drone spectrum, have been major budget beneficiaries as a result.
- In the Middle East, the 7 October 2023 attacks intensified regional insecurity. The Israel-Iran rivalry, compounded by complex and interlinked US-Saudi Arabia-Russia tensions, has fuelled proxy conflicts and arms races. This mix, which has recently erupted into open war between Israel and Iran, has driven nations in the area to boost defence budgets, spurring demand for advanced weaponry and missile defence systems.
- Sino-American tensions further heighten uncertainty, centred on the South China Sea, Taiwan, and China's growing influence – with parallels to the Melian Dialogue clear[10]. This is exacerbated by the perception of an upcoming 2027-2030 window for a potential Chinese invasion of Taiwan, driven by China's military modernisation and political timelines, and balanced by US efforts to bolster Taiwan's defences. This has spurred the US, Japan and Australia to increase investments in naval and cyber capabilities to counter Beijing's ambitions, as well as longer range military aircraft.

For investors, these dynamics present challenges and opportunities, requiring a mix of conviction and agility.

[10]The Melian Dialogue is a famous passage from Thucydides' 'History of the Peloponnesian War,' which is a classical text detailing the conflict between Athens and Sparta in the 5th century BCE. The dialogue is a dramatic account of the negotiations between Athens and the small island of Melos, which was attempting to stay neutral during the Peloponnesian War.

Adapting to geopolitical shifts

Our approach in the defence sector is to first build (and regularly challenge) our conviction on the direction and rate of change of geopolitical tension. We then map that to how governments can change defence spending, and priorities within it – balancing budgetary constraints against the need to defend their countries.

Finally, we compare our expectations from this framework with what the market is pricing in for individual companies – remaining agile as this moves over time – and layering in a company's ability and willingness to execute well and deliver good outcomes for all stakeholders.

For instance, early in the Russia-Ukraine war, we benefited from exposure to European defence contractors, anticipating order surges – a move validated by record backlogs and significant outperformance over five years by these companies.

In contrast, at the moment, we are somewhat more cautious with our defence holdings, particularly since NATO's move to a 3.5% + 1.5% stance on defence spending, as market excitement has led to what we believe are pockets of over-exuberance in some sub-segments, with timeframes to deliver new capabilities longer than many realise. As such, we currently prefer companies with more long-cycle and less short-cycle exposure within the space.

In an era of unrelenting crises, adaptability means anticipating broad geopolitical shifts, not just reacting to continual eruptions of military action. We remain vigilant, aiming to distinguish market noise from the enduring demands of national security, and positioning our portfolios to take advantage of how this translates into the fundamentals, of both defence stocks as well as broader markets.

> "Defence spending is rising rapidly, reflecting a geopolitical environment where risk and tension continues to grind higher"

Convertibles

Leonard Vinville
Head of Convertibles

Downside protection with a solid and strong bond floor

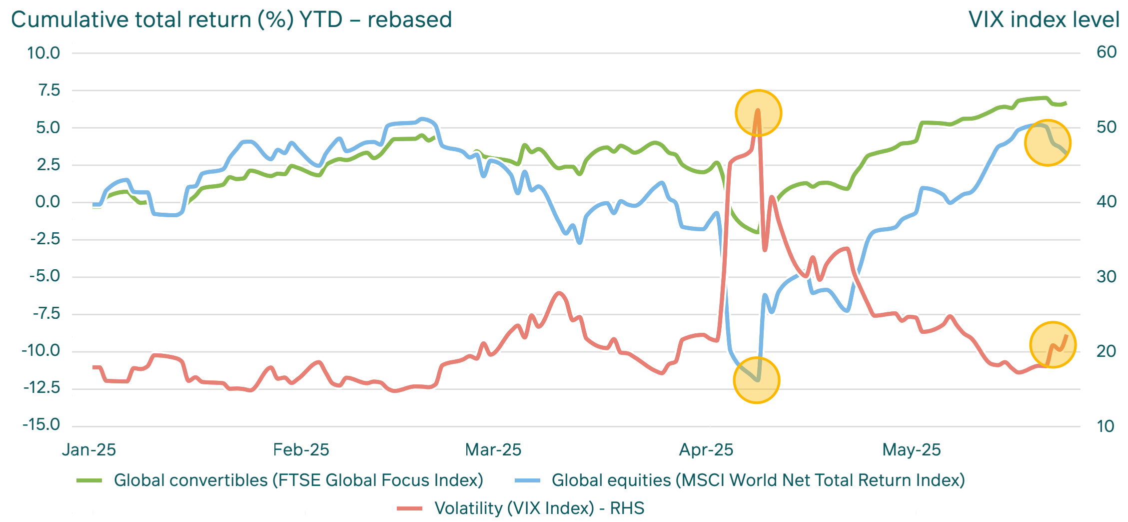
Trump's tariff announcements in April triggered a massive increase in volatility, with the CBOE Volatility Index (VIX) skyrocketing and global equities declining c.11% before staging a recovery. Convertibles were relatively cushioned, only falling c.2% on the back of the initial tariff plans, thanks to the protection offered by the bond floor.

From the trough of the crisis, global convertibles and equities recovered strongly, while the VIX dropped back down to January levels. However, over the past few weeks we've witnessed rising volatility again around the Israel-Iran conflict. At the time of writing, markets were relatively sanguine but the uncertainty and fragility remains. Should fresh geopolitical tensions precipitate a downturn in global markets, convertibles could play a role in navigating the next crisis.

Downside protection amid increased uncertainty

Convertibles can provide downside protection amid market downturns thanks to the bond component keeping its value when stocks go down. This is especially important in times of heightened uncertainty – when the risk is higher, the downside protection is even more valuable.

Global convertibles: downside protection in volatile markets



Source: M&G, Bloomberg, index returns in US dollars, 24 June 2025. Past performance is not a guide to future performance.

In addition, elevated equity valuations also carry greater risk of disappointing equity performance. In this regard, we believe US equity valuations (in aggregate) are stretched versus the rest of the world and carry greater downside potential. Hence, the bond floor protection would play a bigger role in the event of a US selloff. By contrast, Asian and European equities (in aggregate) offer greater upside versus downside potential, in our view.

> "when the risk is higher... downside protection is even more valuable"

Fundamentals, our guiding star through upheaval

Corporates can take advantage of high volatility to issue convertibles opportunistically and monetise this volatility, optimising their cost of debt by selling expensive long-dated options. This is what we have seen during May and June. Convertible arbitrage hedge funds have been attracted to the potential to buy convertibles implied volatility at a substantial discount to realised volatility in the market. However, this is a strategy that relies on swings and shifts, and is disconnected from the underlying fundamentals.

We believe fundamentals are slower moving than sentiment-driven prices, but can lead to permanent changes in value. We are unlikely to invest in convertibles with cheap options just because the option is cheap. We prefer to have a solid and strong bond floor to protect against downside moves, while we also seek the potential for equity upside.

In short, we believe a focus on long-term fundamentals is the best way to see through crises, rather than reacting to short-term twists and turns in the markets.

Multi asset

Stefano Amato
Fund Manager, Multi Asset

Strategic emphasis on diversification and vigilant risk management

In the wake of the tariffs announcement on 2 April 2025, after the initial drawdowns, global equities experienced a sharp rebound, ostensibly driven by President Trump's rapid shift towards negotiations, exceptions, and walk-backs.

Understandably, perhaps, investors have since been conditioned to remain laser-focused on any presidential utterance, often at the expense of quaint 'fundamentals', considerations such as slowing macroeconomic data, persistent inflation pressures, fiscal concerns, and elevated policy uncertainty.

This Pavlovian behavioural shift – remember President Trump's post just before the announcement of the 90-day pause in tariffs? "THIS IS A GREAT TIME TO BUY!!! DJT"[11]– implies a belief that policy announcements can overwhelm almost anything.

This might well remain true for a while…until it's not, of course – and most likely there will be no warnings.

Consequently, the investment environment has become increasingly challenging, as the deliberately engineered unpredictability of momentous policy announcements leaves investors with deep discomfort.

In response, we believe that prioritising a more flexible and adaptive approach that emphasises diversification and risk management is the best way to navigate this uncertain landscape effectively… but where to focus?

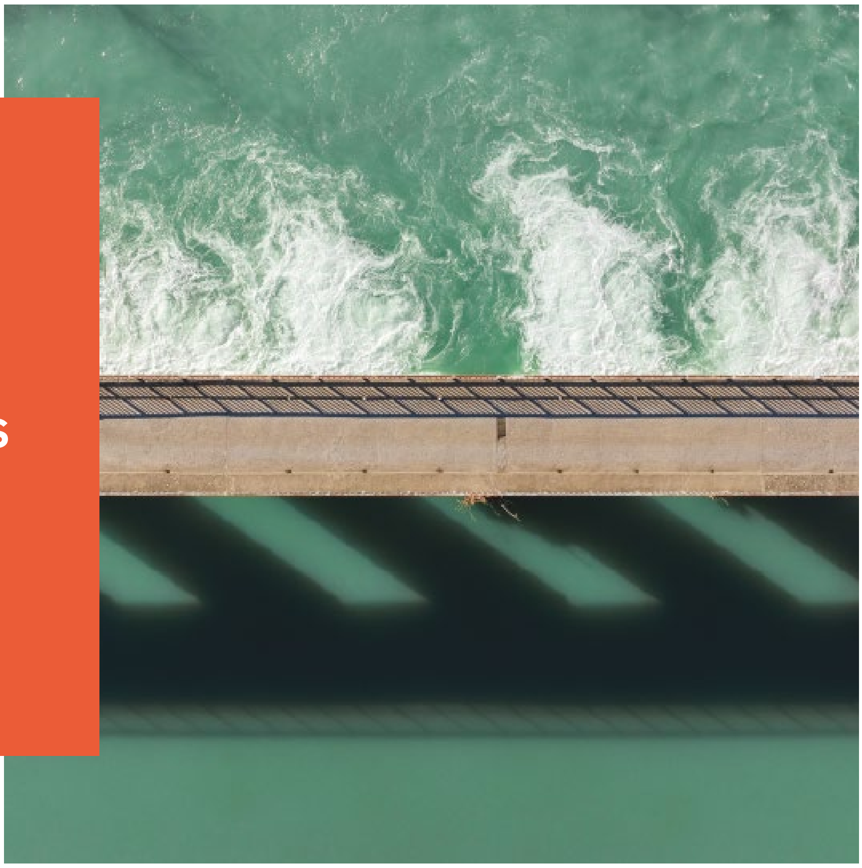
In the attempt to distil such high levels of structural complexity, we believe that the US employment situation emerges as a critical focus area going forwards.

US unemployment rate

(% Monthly, Seasonally Adjusted)

Source: U.S. Bureau of Labor Statistics, Unemployment Rate, retrieved from FRED, Federal Reserve Bank of St. Louis, 2 July 2025.

[11]Truthsocial, 9 April 2025.



> "...we believe that the US employment situation emerges as a critical focus area going forwards"

On one hand, US equities continue to thrive, bolstered by sustained demand from retail investors who benefit from automatic 401(k) allocations and a deeply ingrained 'buy the dip' mentality. In addition, US corporates keep reporting robust earnings, supported by tariff-induced front-loading activity, and abundant share buybacks are still in place.

Conversely, US treasuries are facing decreased demand due to fiscal concerns and abundant supply, and the onset of significant yield reductions may require a notable growth scare – which seems unlikely to pass without markedly higher US unemployment rates.

True diversification remains imperative

In such an uncertain and unusual environment – where the proverbial canary in the coalmine might well be the US workforce – and in which it is becoming more difficult to discern what's going on, we believe that true diversification remains imperative.

As we observe a notable shift in equity-bond correlations and that trust in the portfolio insurance properties of the latter is dented, the concurrent rise of economic nationalism also highlights the urgent need to spread exposure across various asset classes and regions.

With that in mind, across our long-only multi-asset portfolios we hold a diversified exposure, favouring Japanese equities along with selected segments of European and emerging market (EM) equities.

We also own a geographically diverse set of government bond positions, spread across countries (US, Germany, UK) and maturities, including both nominal and inflation-linked bonds – once again aiming to minimise idiosyncratic or policy-induced risk.

Finally, we retain a preference for EM local currency government bonds over credit instruments, given significantly more attractive valuations and less concentrated exposure.

The art of adaptation in the face of crisis fatigue necessitates a strategic emphasis on diversification, vigilant risk management, and an adaptable investment approach to navigate what we expect to remain a volatile investing environment.