Royal London Asset Management Market Review and Outlook

Quarterly Overview

31 March 2025

Overview

Overview

After initial stability, following a turbulent fourth quarter of 2024, the global economy saw modest growth and central banks eased monetary policy as inflation remained well below the peak levels of recent years. As the quarter progressed, however, stability gave way to volatility, primarily due to elevated policy uncertainty in the US, with President Donald Trump pivoting away from Europe; the spectre of aggressive tit-for-tat tariffs; and Europe's fiscal regime change, led by Germany looking to alter decades of fiscal policy stability and ramp up spending, principally in relation to defence.

The increasingly uncertain US policy backdrop and related disruptions to global trade seem likely to weigh on growth in the US and beyond. Fiscal stimulus may provide something of a shield in economies like the euro area and China. Gradual and careful rate cuts are likely in major economies (except in Japan), but the US inflation outlook is uncertain enough that US rate hikes can't be ruled out either.

This result of this was weakness in global equity indices as US tech stocks saw a dramatic sell-off following news of Chinese competitor, DeepSeek. European and UK stocks fared much better, posting positive total returns for the three months.

Most major central banks are running with interest rates slightly above neutral. If growth remains positive and inflation remains moderate, then central banks can continue to cut towards neutral. But stickier than expected inflation, substantial policy uncertainty, and rates being closer to neutral suggests that at least some slowing of the pace makes sense beyond just the US.

After a quarter point cut in early February, in March, as expected, the Bank of England's Monetary Policy Committee voted to keep rates on hold at 4.50%, with an 8-1 vote in favour of keeping rates steady. The bank continues to see a "gradual and careful approach to the further withdrawal of monetary policy restraint" as appropriate. The BoE has noted that not much in the domestic picture has changed for them. On inflation, although inflation has been a touch stronger than expected, they see domestic and wage pressures as moderating (but remaining elevated) and they still expect inflation to fall back after an expected rise in CPI in coming months. But – as with other central banks – they are dealing with significant external sources of uncertainty. The minutes from March's meeting flagged increased trade uncertainty, tariff, geopolitical uncertainty, a global rise in financial market volatility and Germany's fiscal plans.

Chancellor Rachel Reeves delivered her Spring Statement towards the end of the quarter, with the main headline being the country will need to spend less to meet fiscal rules. The Office of Budget Responsibility revised down their growth forecasts for this year by 1.0% (to 1.0%). They revised up their forecasts for bond yields. Neither of those things were good news for their forecasts for public finances. The Debt Management Office announced that this coming fiscal year will see a net financing requirement of £304bn of which £299bn will be gilt sales. It would not be a surprise to see more fiscal tightening action from Reeves at the Budget in the Autumn. February CPI came in lower than expected at 2.8% year-on-year after 3.0% for January, with consensus for 3.0%, as did core at 3.5% year-on-year after 3.7% and consensus 3.6%. January GDP was weaker than expected, but that follows the stronger than expected December print. GDP fell 0.1% month-on-month after rising 0.4% in December. Consensus expectations had been for a 0.1% month-on-month rise in January. Taking the last couple of months together, the data fits the picture of a flattish UK economy – as has been painted by recent PMI business surveys.

Overview

In the US, at its final meeting of the quarter, the Federal Reserve, as expected, kept rates on hold with the Fed Funds target range at 4.25-4.50%. With the Fed seeing the US economy as “strong overall”, the central bank feels they are in a good place, and Chair Powell noted that they are in a position where the bank can and or they can hold (perhaps notably not mentioning a possible hike) interest rates. FOMC participant forecasts still have two rate cuts in them for 2025. Broader Fed commentary continued to indicate that they are not in a hurry to cut rates. In a very uncertain environment, it makes sense to wait until things are clearer and “we’ll be adapting as we go,” said Powell.

US activity growth indicators have been mixed of late, with sentiment and survey indicators typically soft but worries about tariffs featuring in much of the commentary. The February US Employment Report didn’t surprise by much but was a bit softer than expected overall. Non-farm payrolls rose 151K, so not far from consensus at 160K or the average increase of the past 12 months (168K). February’s US CPI came in lower than expected at 0.2% month-on-month from 0.5%. Core was also 0.2% month-on-month after 0.4%. Both figures were a tenth less than expected and a bit more inflation target friendly. The data was likely somewhat reassuring, but with tariffs being implemented and likely to impact with a bit of a lag – alongside plenty of other US policy uncertainty – the most recent inflation data is unlikely to alter the Fed’s thinking at this stage.

There are risks on all sides to the US outlook with President Trump bringing policy upheaval on multiple dimensions. To the extent that the surprisingly robust growth picture of the last couple of years was fiscal spending and immigration assisted, there are additional reasons to worry with the early targets for Trump’s team including cutting Federal spending and immigration, alongside raising/threatening tariffs.

At its final meeting in the quarter, the European Central Bank cut rates 25bps, to 2.50% on the deposit rate, which was very much as expected. The ECB continues to describe the disinflation process as well on track and continues to “follow a data-dependent and meeting-by-meeting approach” without pre-committing to a particular path. They still see the skew of risks to growth as to the downside. Uncertainty was a recurring theme for the March press conference. ECB staff revised down their forecasts for euro area growth, but President Christine Lagarde admitted that staff had not had chance to incorporate any effects of increased fiscal stimulus. She was clear that, should the additional defence spending/infrastructure spending in Germany come through, that would be a positive for aggregate demand. In comments in late March, however, President Lagarde flagged ECB analysis suggesting that a 25% US tariff on EU imports and lower euro area GDP growth by about 0.3% with more if retaliatory measures follow.

Euro area growth petered out at the end of last year, with the focus now on three drivers of growth: the consumer - where (ongoing) rate cuts and positive real income growth are supportive; fiscal policy, where again things are looking positive; and Trump and the external environment - where slower global trade, higher tariffs and greater trade policy uncertainty all have the potential to weigh on activity. CPI inflation surprised a little on the upside, but services inflation finally fell more significantly from the 3.9%-4.0 range it has been stuck in for a while.

Overview

Global and UK Government Bonds

The first quarter was a turbulent period for government bond markets with a series of macro and political factors keeping investors occupied. The gilt market found itself caught between the US Treasury market and bund market, whose performance were dominated by US trade policy and announcements around Germany's fiscal policy.

Government bond markets also saw heightened volatility over the quarter, amid ongoing political noise across Europe and the US. In the US, 10-year treasury yields fell to 4.21% from 4.57%, while German 10-year bunds yields rose to 2.70% from 2.36%. Benchmark 10-year gilt yields increased to 4.68% from 4.57%.

Against a backdrop of rising volatility, global index linked markets generally delivered a positive return for the quarter. Yield curves were generally steeper as short-dated real yields fell – most notably in the US. The UK was a notable outlier, seeing negative overall returns as further concerns over the UK's fiscal position and the collapse in demand from LDI buyers pushed yields higher, particularly at the long end of the curve.

Global Credit and High Yield

Global corporate bonds saw modest positive returns in local currency terms over the quarter. US dollar markets were the strongest performing, although this was largely due to the fall in US treasury yields, with spreads slightly wider over the period. Euro and sterling credit markets saw similar, much more modest gains, driven by different underlying factors: euro markets had the headwind of higher yields, but more than offset this with tighter spreads, while sterling market shrugged off wider spreads helped by the impact of the high carry in the asset class.

In the high yield market, the ICE BofAML (BB-B) Global Non-Financial High Yield Index (sterling hedged) benchmark returned 1.34% in the quarter with spreads at 312bps, widening from 269bps at the start of the quarter. At the end of the period, the index's yield-to-worst stood at 6.78% (6.64%), drifting higher since the fourth quarter on the back of rising yields and widening spreads. In the broader-based high yield index, which includes CCC rated bonds, spreads widened to 372bps from 324ps, with a yield-to-worst of 7.4%.

UK Credit

The sterling investment grade credit market (iBoxx non-gilt index) returned 0.70% over the quarter, with the average sterling investment grade credit spread (the average extra yield available from non-gilt bonds compared with government debt of equal maturity) widening over the period from 0.85% to 0.95% (iBoxx). Most sectors saw positive returns, with the exceptions of utilities, consumer services and social housing. These exceptions were driven more by the greater exposure to long-dated bonds than issues with the sectors themselves.

Amidst this wider volatility, sterling credit markets have held up well so far, with the main attraction being the all-in yield this asset class continues to offer. While sterling investment grade all-in yields are attractive, their make-up has changed; a larger component of the yield is from government bond yields. The volatility we are seeing in fixed income markets is coming from government bond yields. However, credit spreads also remain susceptible to further weak macroeconomic news.

Overview

Equities, Commodities

The result of all the uncertainty seen in the quarter was global equity indices succumbing to weakness, led by the US market, which posted a torrid quarter as technology stocks experienced a dramatic sell-off following news of a new competitor in the AI industry: China's DeepSeek.

From a sector perspective, most of the unwind has happened in AI-related growth names. These companies face slowing rates of growth, rising competition from China and were the most at risk from a downturn in sentiment given how well loved these stocks have been over the past two years. Consumer discretionary stocks also suffered from concerns that stubborn inflation and declining growth prospects would hit spending.

European and UK stocks fared much better, posting positive total returns for the three months. In Asia, markets were negatively affected by concerns about the effects of US tariffs and a potential trade war. During the fourth quarter, the MSCI World Growth Index posted a loss of 8.71% while the MSCI World Value Index posted a gain of 3.87%.

Most major central banks are running with interest rates above neutral, but increasingly not by much. If growth remains positive but unimpressive and if inflation reassures somewhat then central banks can continue to cut towards neutral. But stickier than expected inflation, substantial policy uncertainty, and rates being closer to neutral suggests that at least some slowing of the pace makes sense beyond just the US.

The price of WTI crude oil rose 0.87% over the quarter to $71.71 a barrel, while copper futures rose 22.23% in US dollar terms.

Cash Markets

The Bank of England rate cut in February was the focus for money market rates over the quarter. Having started the year at 4.70%, SONIA fell to 4.45% after the cut. Two-year gilts, often seen as a proxy for market expectations of BoE rates, started at 4.38%, fell through February ahead of and after the rate cut, and were then traded sideways for the rest of the quarter in a narrow range just under 4.25%, ending at 4.21%.

Money market rates fell in line with the Bank of England rate cut in February. Longer maturities have not moved substantially over the period – these were already pricing in modest rates in 2025 at the end of last year, and while the start of the Trump presidency has led to volatility for risk assets and policy expectations, it had little impact on UK economic data and therefore interest rate expectations over the quarter.

Disclaimers

Important information

For professional clients only, not suitable for retail clients.

This is a financial promotion and is not investment advice.

Telephone calls may be recorded. For further information please see the Privacy Policy at www.rlam.com.

Issued in April 2025 by Royal London Asset Management Limited, 80 Fenchurch Street, London EC3M 4BY. Authorised and regulated by the Financial Conduct Authority, firm reference number 141665. A subsidiary of The Royal London Mutual Insurance Society Limited.

FC RLAM ON 0406-RA