The CIO view: What has changed, really?

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Introduction

The end of 2025 does not feel as different from the end of 2024 as we might have expected or hoped. Trade policies – and many other policies – from the US administration continue to appear with little warning, making it difficult to judge the state of global trade and of geopolitics. The war in Ukraine is still going on and despite lots of hope it is still not obvious how it will stop or be stopped. Governments, particularly in the West, continue to rack up large deficits and are stuck in a vicious cycle with their electorates. So, what has changed? Everything has gone up. Equities are hitting all-time highs, some credit spreads are at multi-decade tights and gold has continued to drive ever higher.

Worries, what worries?

It is worth noting that almost every concern an investor could have had at the start of 2025, came true. The worries were well-founded, and geopolitical volatility did not let up throughout the year. Despite this, however, most major economies have held up sufficiently well for this not to get in the way of a strong corporate story. The volatility we have seen has almost been ignored by the financial markets.

Indeed, given that the risks in 2025 were meant to be geopolitical, it is interesting that by the end of the year much of the volatility in asset pricing was aligned with a single set of results from Nvidia.

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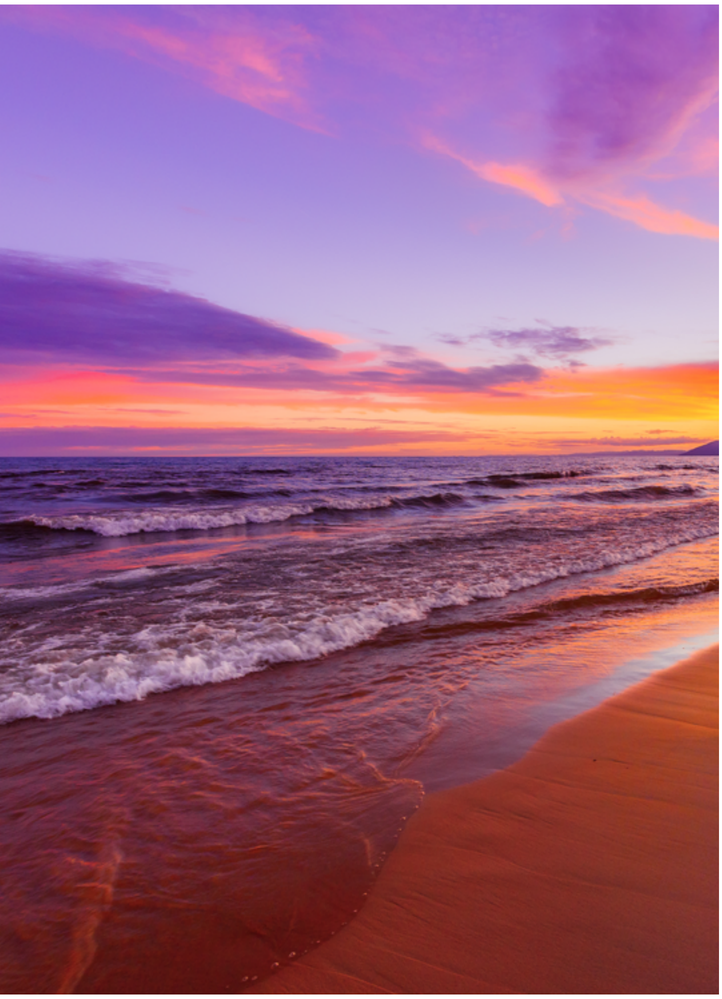
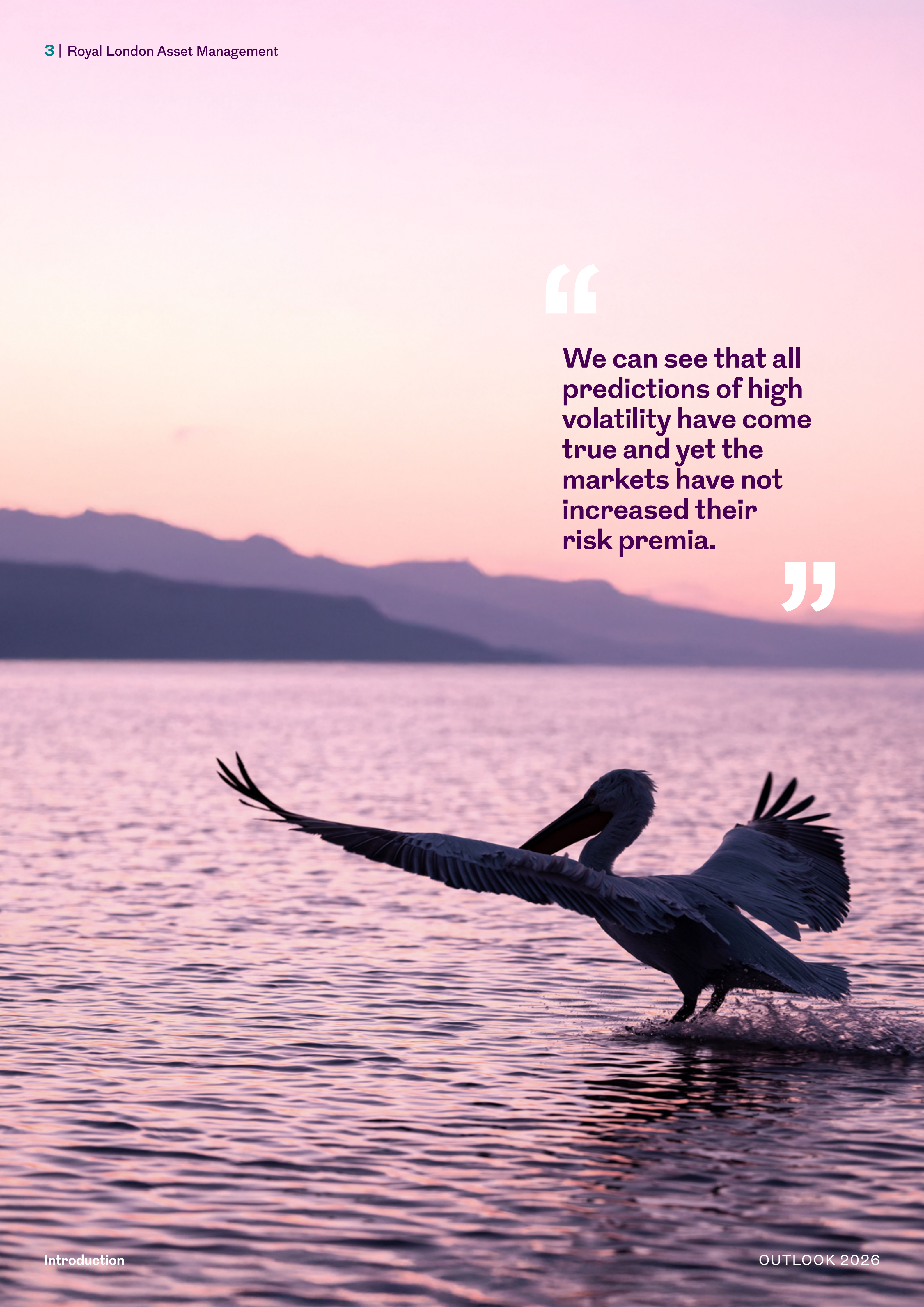


Where does this leave us?

A simplistic view is that we find ourselves in the same position as the start of the year, except that markets are all more expensive. If we were nervous 12 months ago then in theory we should be more so now. However, it is clear that markets are not thinking the same way as they were at the end of 2024. Then, we were fearful of the impending volatility and nervous of geopolitical actions around the world. Now we can see that all predictions of high volatility have come true and yet the markets have not increased their risk premia – indeed, in many cases these are now lower. This shows that markets are in a very different frame of mind. Still nervous, but now around valuation rather than volatility or fears of US policy.

So, everyone 'knows' that the US equity market is highly concentrated on an AI theme and is heroically valued. Credit spreads are also tight historically and not offering as much value as previously. However, even ignoring the fact that there is no obvious catalyst for values in those assets to fall, there are reasons to be cheerful. Government bonds offer value in a world where rates have been falling and may continue to fall. Inflation-linked debt can give investors protection against an unexpected inflation spike at a much cheaper rate then we have seen for many years. Property remains on a completely different cycle and it looks like the promised increased spend in infrastructure will come through in the next few years offering opportunities.



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Where will 2026's volatility come from?

The US President will not change his nature. An economy being captained by someone who is entirely focused on deal-making will continue to see bouts of volatility and an element of chaos. We cannot rely on lower volatility to drive returns.

There is also the factor of debt-to-GDP ratios sitting at numbers that would have given an economist in the '90s a panic attack. Some of the largest democracies do appear to be living beyond their means, making it important to ask: how long can this type of government spending continue?

We can expect more volatility – this time more concentrated in markets – as sentiment flicks from exuberance and excitement around AI to geopolitical gloom. Which is the correct side to be on? The answer, as always, is the side of diversification.

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Active management is vital

What these market conditions tell me is clear: diversification is king. Any portfolio has to be positioned carefully and not focused solely on overvalued parts of the market. Diversification and active management should always be best friends to a long-term investor.

It has been a difficult environment for active management in equities. Although volatility should favour active management, if that volatility is driven by relatively random factors then it is less useful for rational long-term investors. Similarly, we believe that diversification is without doubt the best way to invest in the long term but if returns are heavily concentrated in a small group of US equities then investors can be tempted to narrow their investment horizons. The kind of concentration in the equity markets that we have seen recently has not usually ended very well. Similarly, the amount of leverage being offered to funds – whether public or private – is at a high level and that has also often not ended particularly well.

In my view, uncertain markets create opportunities for active managers, where investment decisions can respect a difficult backdrop but not be dominated by it.

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