MONTHLY UPDATE

Latest views from the investment team

Transatlantic Tussles

Policy changes, economic data and corporate earnings all contributed to swings in asset prices in February. Confirmation that the Trump Administration seems willing to pull back from historic alliances has spurred concerns in Europe about the future of transatlantic security and triggered greater government spending commitments, particularly on defence. US consumer confidence has declined as the new administration has rolled out its agenda on tariffs, immigration and government job cuts, while there continues to be lingering concerns about the dominance of the US technology sector in the aftermath of January's DeepSeek panic. The upshot is that European and UK stocks outperformed their US equivalents again in February (as shown in the following chart), while US bonds performed well, and gold made further gains.

Increased government spending is now expected in Europe with more investment in defence a hot topic. European Commission president Ursula von der Leyen has proposed a relaxation in fiscal rules without constraining remaining budgets. On the same theme, incoming German Chancellor Merz signalled that he would attempt to reform constitutional debt rules to enable greater government spending. Meanwhile, the UK has also announced an increase in defence spending and the UK and Europe are engaged in talks about setting up shared defence funding structures going forward. This encouraging change in tone has been well received by stock markets with both the European and UK markets gaining over the month, with many defence linked stocks enjoying double digit gains.

Contrastingly, in the US, measures of US consumer and business sentiment have declined sharply in recent weeks with many respondents referencing tariffs as a worry. US President Trump has ordered the development of a comprehensive plan of "reciprocal" tariffs, including 25% on those imports from the EU, Canada, and Mexico, all major US trade partners, and so has triggered fears that the cost of imported goods will rise. This comes at a time when measures of consumer inflation have already started to increase, from close to 2.0% in September to 3.0% last month with broad-based pressures from food, energy, insurance, airfares, and others. Although still healthy, economic growth forecasts have also decreased which question the US exceptionalism theme that has dominated asset markets in recent years. Alongside nervousness around growing competition for US technology companies and expensive valuations, this has all weighed on US stocks in February and, so far, year to date. This contrasts with the rally experienced following the election. Bond prices, which rise as interest rate expectations fall, have benefitted from the economic softening narrative as well as from communications that the US administration is focused on containing US Government borrowing costs. Keeping bond yields down is critical for limiting the future cost of interest expense, a larger component of government spending than defence.

Rising inflation, supported by wage pressures, has also been a theme in the UK, Europe and Japan. In the UK and Europe, economists have upgraded their expectations for inflation but downgraded growth forecasts. Indeed, the Bank of England expect inflation to jump to 3.7% over the first half of this year as energy prices rise and the cost for employers from the National Insurance hike and minimum wages feeds through. Despite a higher inflation forecast, the Bank of England cut interest rates in February, helping to alleviate pressure for borrowers and suggesting policymakers are increasingly focused on supporting economic activity, rather than tackling above-target inflation. This has pushed short-dated Gilt yields down to the middle of the range observed over the last two years.

Bottom Line

The backdrop for asset prices remains supportive. However, there are risks of both a higher inflation environment - due to government spending, wage pressures and tariffs - and a weaker growth environment, as policy changes hurt confidence. These uncertainties highlight the importance of maintaining diversification and actively managing allocations within multi-asset portfolios.

NORTH CAPITAL

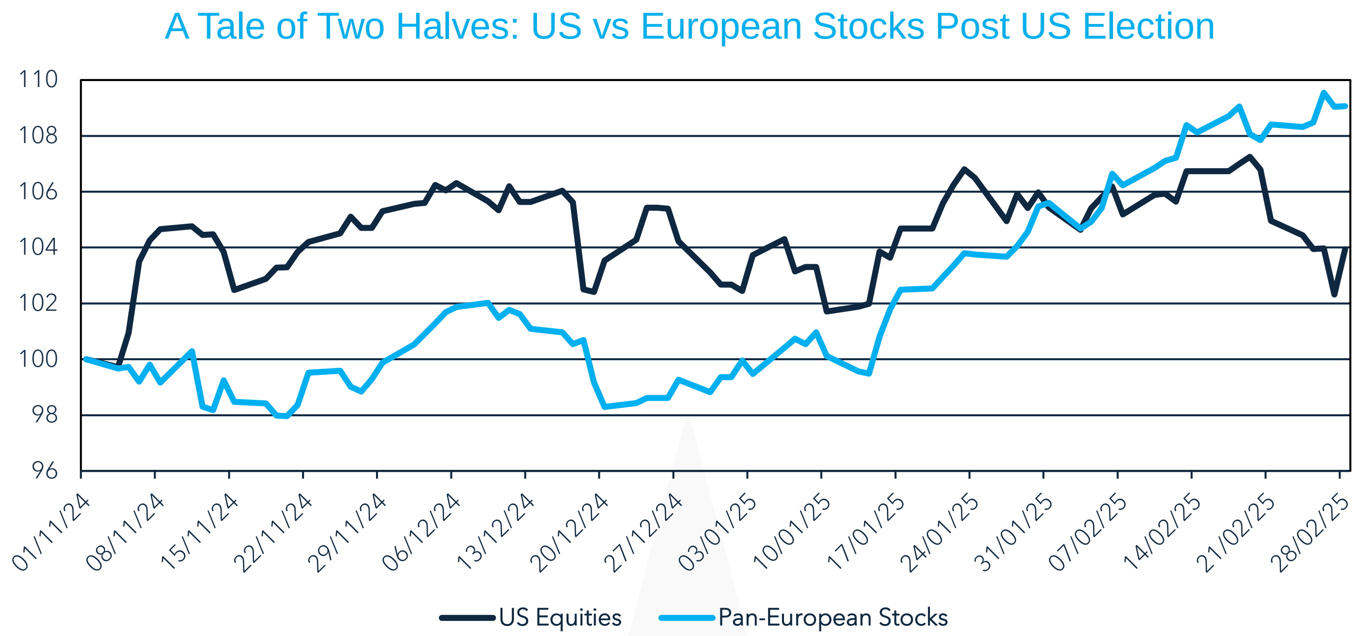
Month in Numbers

Change in various markets over the month:

ASSET NAME		CHANGE / VALUE
EQUITIES Local Currency		
United Kingdom	▲	1.57%
Eurozone	▲	3.34%
United States	▼	-1.42%
Emerging Markets	▲	0.61%
Japan	▼	-6.11%
BONDS/RATES Absolute change (%)		
Bank of England Base Rate	▼	-0.25%
		4.50%
Federal Reserve Funds Rate	-	0.00%
		4.50%
UK 10-Year Gilt Yield	▼	-0.06%
		4.48%
US 10-Year Treasury Yield	▼	-0.35%
		4.20%
CURRENCIES		
GBP/USD	▲	1.50%
		$1.26
GBP/EUR	▲	1.37%
		€1.21
DXY (USD Index)	▼	-0.70%
		107.61
COMMODITIES		
Gold (USD/ Troy Oz)	▲	1.48%
		$2,851.34
Brent Crude Oil (USD/Barrel)	▼	-4.23%
		$73.56
NOTEWORTHY		
Rheinmetall AG	▲	33.24%

March 2025

As of 28 February 2025



Q&A

Is it a good time for hedge funds?

"Hedge fund" is a blanket term for a diverse group of strategies seeking to deliver positive returns in all environments, and with a low correlation to traditional assets such as stocks and bonds. As discussed above, there are growing uncertainties over the prevailing environment, due to policy changes such as tariffs, geopolitical tensions and possibly fewer interest rate cuts as the decline in inflation has stalled. Therefore, it seems likely that stock and bond prices may be more volatile than has been observed over the last couple of years – a fertile ground for hedge funds. While an individual hedge fund can be quite risky, building a portfolio incorporating different managers and styles typically results in a much smoother return profile. The universe of funds is vast so, at North Capital, we use an expert third party to assist us in rigorously researching the universe and building our portfolio to suit the prevailing environment.