Melville Douglas Focused Quarterly Commentary

/ Q3 2025

Resilient Growth Drives Financial Markets Higher

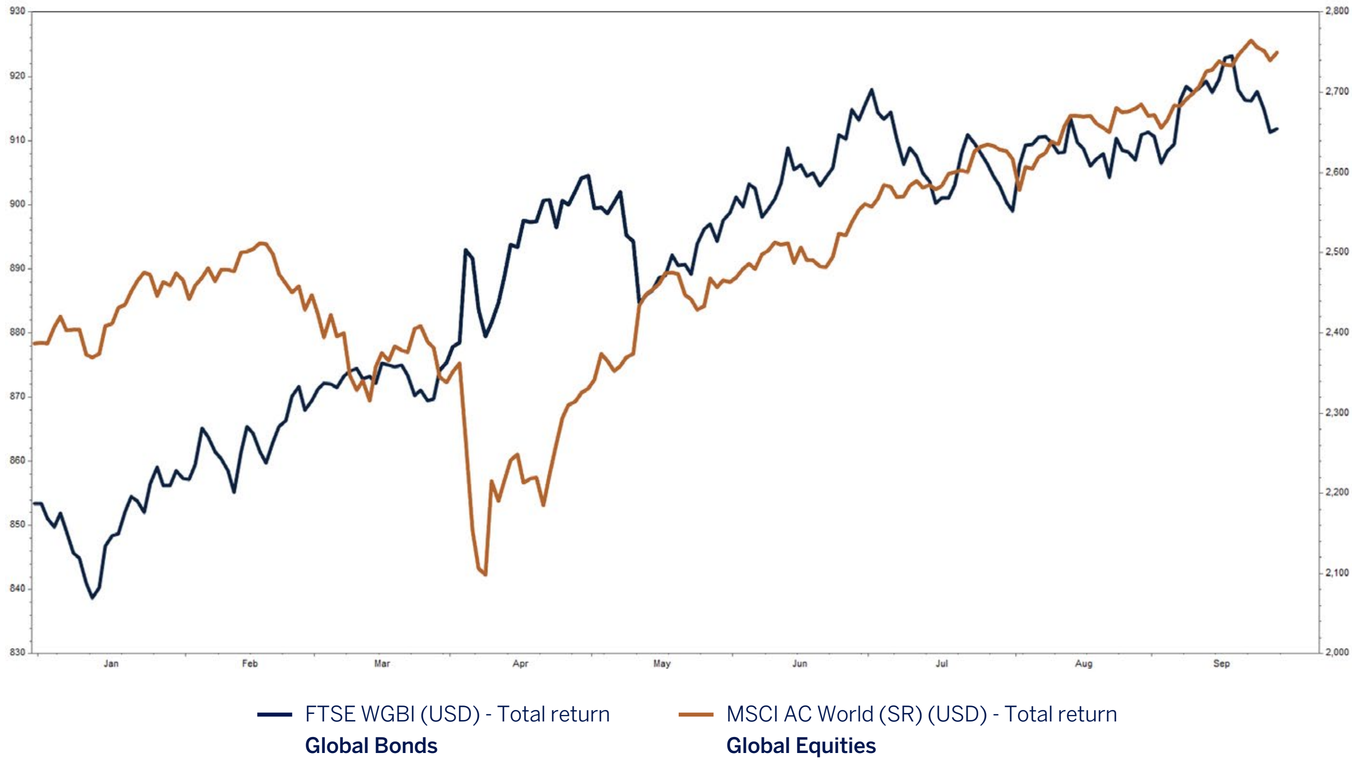
Bernard Drotschie
/ Chief Investment Officer

Global financial markets continued their upward trajectory in the third quarter of 2025, buoyed by resilient economic growth despite a backdrop of geopolitical tensions, policy uncertainty, and lingering trade disputes. This resilience has surprised many market participants and analysts, particularly given the complex interplay of macroeconomic headwinds and structural shifts in global trade and technology.

The strength of the global economy is increasingly underpinned by coordinated monetary and fiscal support across major economies. The United States, Germany, and China have all adopted more accommodative stances, with central banks easing financial conditions and governments deploying targeted fiscal measures to stimulate demand and investment. These actions have helped mitigate the impact of elevated tariffs and geopolitical friction, while also supporting consumer and business confidence.

> A weaker US dollar, coupled with upward earnings revisions and attractive valuations, has driven strong performance across emerging markets this year, outpacing returns in developed markets

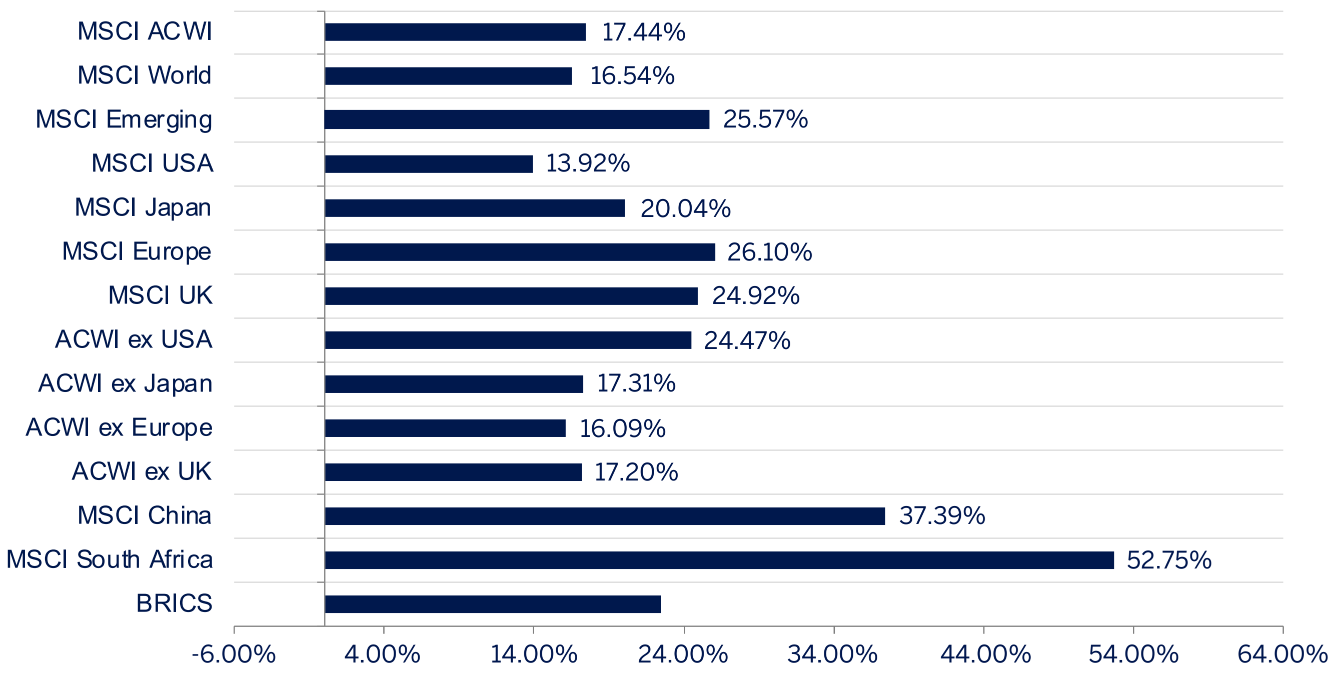
GLOBAL EQUITIES VS GLOBAL BONDS



Source: Factset

Equity markets have responded positively, with major indices reaching new highs. A weaker US dollar, coupled with upward earnings revisions and attractive valuations, has driven strong performance across emerging markets this year, outpacing returns in developed markets. Credit markets have also rallied, with spreads narrowing to levels not seen since the pre-pandemic era. This tightening reflects both improved investor sentiment and stronger corporate fundamentals. Household and corporate balance sheets remain robust, supported by rising asset prices, falling debt servicing costs, and improved liquidity conditions. These buffers have helped insulate the real economy from elevated levels of policy volatility.

MSCI REGIONS - YEAR TO DATE (USD)



Source: FactSet

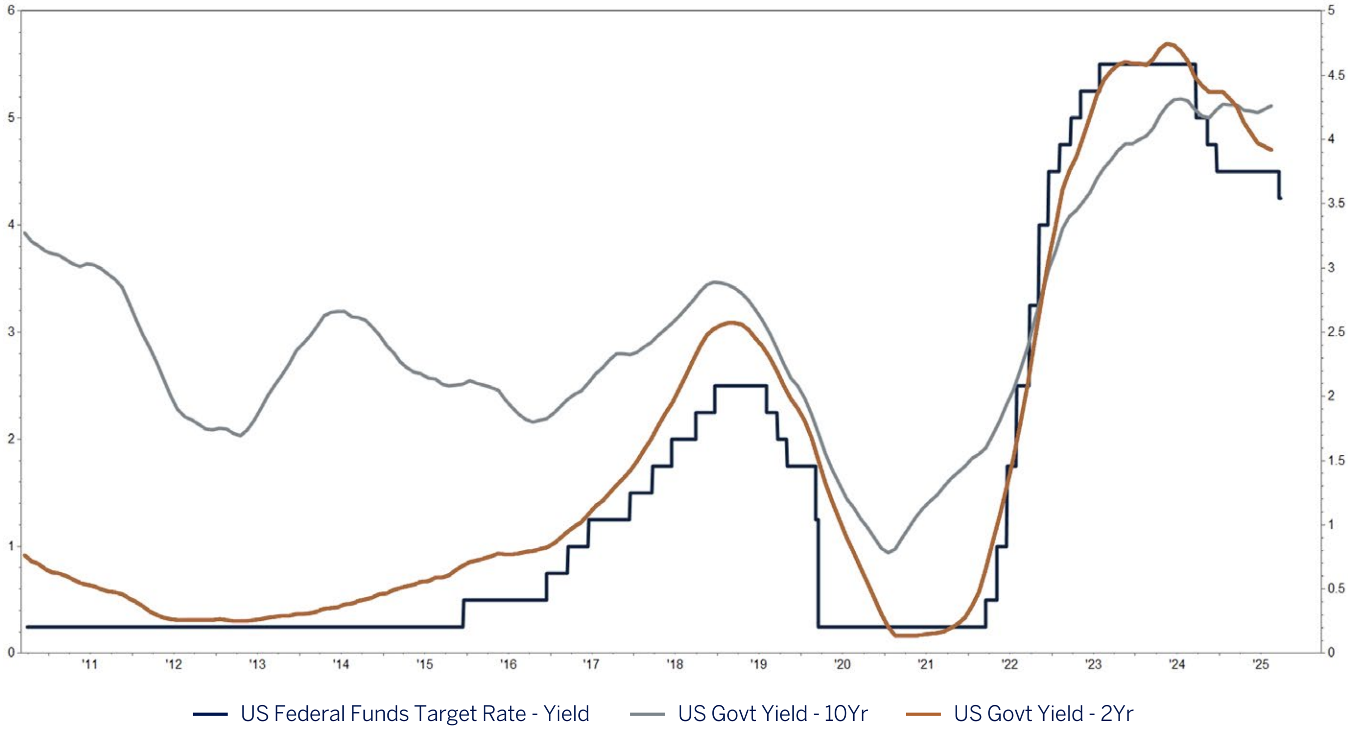
While the full impact of elevated tariffs is still unfolding, recent developments have helped reduce downside risks. The US administration's willingness to re-engage in trade negotiations with China has opened the door to a potential reduction in effective import costs. This would be a welcome relief for US consumers and importers, who have faced rising prices and supply chain disruptions. For now, corporates are absorbing much of the cost pressure, which is compressing margins and dampening near-term inflation. However, a weaker dollar and lower corporate tax rates are providing partial offsets, helping to preserve profitability and competitiveness.

Looking ahead, we expect several key drivers to support a continued rebound in 2026. These include the broadening investment cycle in artificial intelligence (AI) and automation, solid capital expenditure activity across sectors, easier monetary policy, and strong household and corporate balance sheets. Together, these factors create a constructive environment for risk assets. **As a result, we are adjusting our portfolio positioning: global equities moving to a neutral allocation, while fixed income in Sterling denominated portfolios is increasing to overweight. This reflects the attractive inflation-adjusted yields available.**

The Fed's First Rate Cut in 2025: Implications for US Bond Yields

In a notable shift, the US Federal Reserve (Fed) implemented its first interest rate cut of the year in September, citing signs of labour market weakness and broader economic uncertainty. While some observers have speculated that political considerations may have influenced the timing of the cut, the Fed's official rationale remains focused on its dual mandate: price stability and maximum employment.

FED FUND RATE VS US 10YR AND 2YR T/B (moving average)
Cash and Fixed Income have become viable alternnatives



Source: FactSet

The Fed's Dot Plot now suggests two additional rate cuts before year-end, implying a short-term easing cycle. However, expectations for further cuts taper off significantly beyond this point, with the terminal rate projected to settle around 3%. This suggests that the Fed is attempting to balance near-term support with longer-term prudence, particularly given the risks posed by elevated, albeit temporary, inflationary pressures from higher import tariffs. However, we believe the Fed are cutting interest rates because they can, rather than because they have to.

Importantly, the current environment is not one in which medium-to-long-term US Treasury yields should be falling sharply. Inflation remains above target and could rise further due to tariff-related pressures and supply chain disruptions. Meanwhile, the economy shows no signs of recession, and fiscal deficits and debt levels continue to pose structural risks. In this context, the traditional relationship between interest rate cuts and falling bond yields may not hold.

Historically, interest rate movements have had a meaningful impact on bond yields primarily during periods of either excessive economic weakness or strength, accompanied by stable inflation. Today's environment is markedly different: inflation is elevated and potentially rising, growth remains solid, and fiscal imbalances are significant. Moreover, the Fed's credibility and independence are being tested, which could affect market expectations and risk premia.

Therefore, we maintain a neutral stance on US Treasuries. While short-term yields may respond to Fed policy, we believe that medium to long-term yields will remain elevated due to inflationary pressures and fiscal concerns. We would reconsider this position only if inflation and hard economic data begin to show signs of material deterioration, such as a sharp decline in consumer spending, business investment, or employment.

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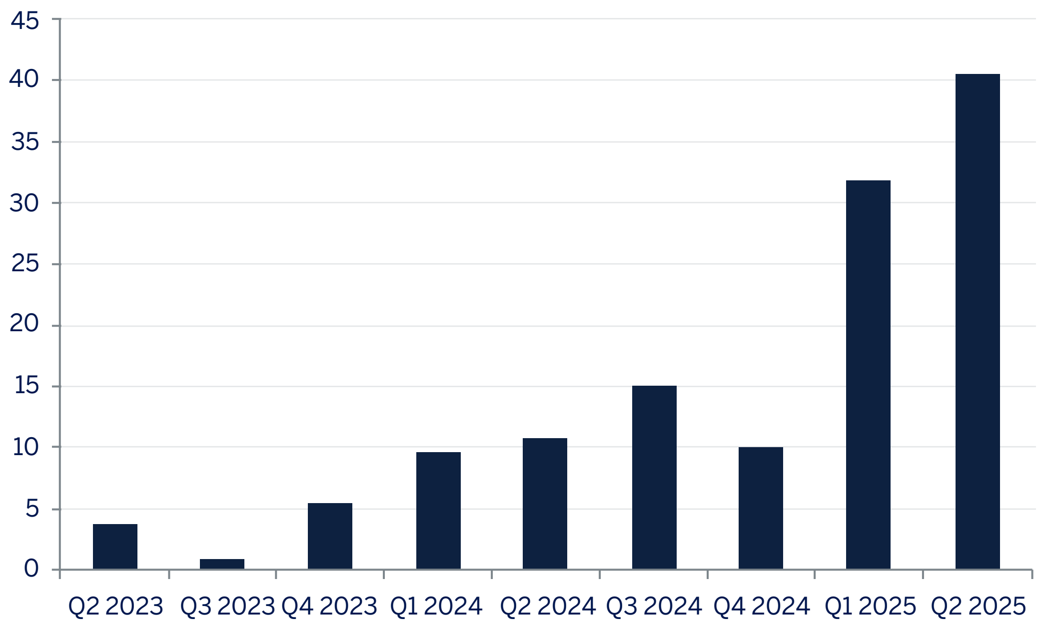
Labour Market Weakness Amid Strong Investment

One of the more interesting developments in 2025 has been the divergence between strong capital investment and weak labour market performance. While businesses have ramped up spending on technology, infrastructure, and automation, job growth in developed markets has slowed to a crawl. This disconnect raises important questions about the sustainability of the current recovery and the evolving nature of economic growth.

AI INVESTMENT CONTRIBUTION TO ANNUAL US GDP GROWTH, %

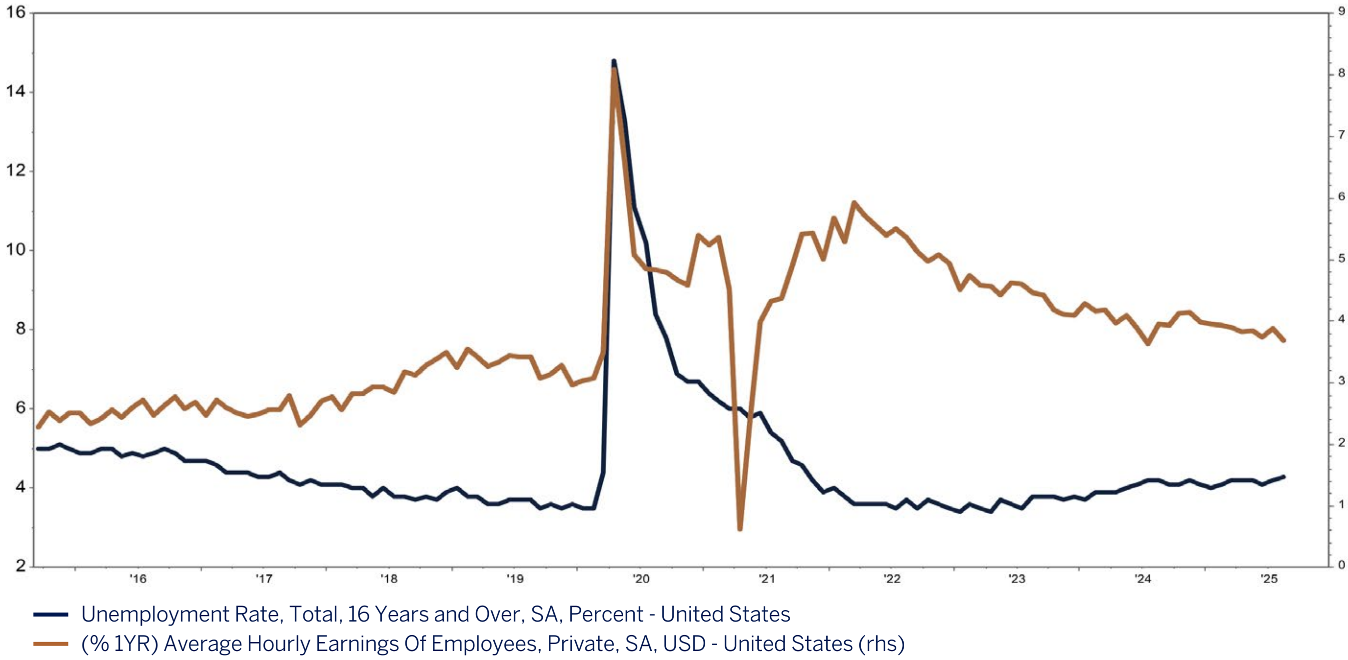


Source: DataStream, Rothschild and Co Redburn

We believe there are two plausible interpretations of recent business behaviour. The optimistic view suggests that strong investment and weak hiring reflect successful technological integration and a response to declining labour supply. In this scenario, businesses are leveraging automation and AI to boost productivity, reduce reliance on labour, and adapt to demographic shifts. Tight labour markets and rising wages are encouraging firms to invest in capital rather than expand headcount. If productivity gains are sustained, this could support a jobless recovery, with stable wage growth and healthy corporate margins.

Alternatively, the trend may reflect growing business conservatism amid policy uncertainty, particularly from the US administration, and experimentation with AI-driven productivity enhancements. This cautious stance, combined with stagnating real wage growth, could lead to further weakening in labour income. In such a scenario, reduced household earnings may trigger job shedding and a broader pullback in demand. A negative feedback loop could emerge, where business caution and declining consumer confidence reinforce each other, ultimately undermining economic momentum.

US UNEMPLOYMENT RATE & HOURLY EARNINGS (%)



Source: FactSet

While it remains too early to determine which path will prevail, the slowdown in job creation is a critical development that warrants close monitoring — both by market participants and policymakers, including the Federal Reserve. Although households have benefited from substantial wealth gains in recent years, driven by rising home and equity prices, these gains may not be sufficient to sustain current consumption levels in the absence of continued job growth. With savings rates already declining to support spending, future consumption will hinge on confidence in income prospects. Without renewed job creation, that confidence may erode, potentially triggering a broader slowdown in consumer demand and broader economic activity.

Conclusion

The global economic narrative has evolved meaningfully over the past quarter. While trade-related headwinds persist, they are no longer expected to generate sustained weakness. Economic growth has proven to be more resilient than anticipated, and policy support from central banks and governments is expected to provide the necessary impetus to sustain this momentum over the medium term.

We acknowledge that global equity valuations are elevated relative to historical norms. However, we do not view this as irrational. The structural premium associated with high-return technology stocks and the evolving composition of major indices justify a reassessment of traditional valuation metrics.

OUTPERFORMANCE OF MAGNIFICENT 7 UNDERPINNED BY STRONG EPS GROWTH

Source: Baird Securities

As of Q3 2025, the ten largest stocks globally account for 24% of the MSCI World Index—up from less than 10% in early 2018. Seven of these ten are technology firms, with the remainder comprising Tesla, JPMorgan Chase, and Berkshire Hathaway. These companies have delivered exceptional performance, contributing over 47 percentage points to the MSCI World Index's 125-point gain over the past 7.5 years.

This growing concentration reflects both the dominance of technology in the modern economy and the increasing importance of scale, data, and network effects. While elevated valuations may signal fragility, we believe that mean reversion is more likely to be triggered by macroeconomic weakness than by valuations alone. As such, our investment strategy remains focused on identifying resilient sectors and companies with strong fundamentals, while maintaining flexibility to adjust positioning should economic conditions deteriorate.

In summary, we remain cautiously optimistic. The global economy is navigating a complex transition, marked by technological disruption, policy shifts, and geopolitical realignment. While risks remain, the underlying fundamentals are supportive of continued growth and asset price appreciation. Our portfolios are positioned to capture these opportunities while remaining vigilant to emerging risks.

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Investment performance

As mentioned in the mid-year review, our Focused equity and multi-asset portfolios have underperformed both benchmark and peers this year, and over the last 12 months. This underperformance is almost entirely down to our Global Equity allocation, where our distinct quality/large cap growth style has faced some tough headwinds – US underperforming, and more cyclical, value stocks being more in favour – and our stock selection has suffered, particularly within our healthcare allocation. Conversely, fixed income weightings have continued to perform well.

Periods of underperformance are not unusual as active portfolio management requires a portfolio to be different to the benchmark in order to outperform, and when there are style shifts (e.g. growth to value) or when stock calls do not pan out as expected (i.e. the unexpected will happen), a bout of underperformance will prevail. The key to achieving long-term results is to stay true to the underlying investment philosophy whilst taking action where facts have changed. There have been more changes than usual to our global equity positions; we have increased exposure to AI-related stocks by increasing portfolio weightings to AI-chip designer Nvidia and by introducing Broadcom and Apple to client portfolios where appropriate. Recent corporate results have confirmed that businesses remain committed to AI-related capital expenditure to drive efficiencies. We have also increased exposure to Europe. The region has long had a valuation discount relative to the US, but previously there was no catalyst. What has changed is the increased scope and willingness for fiscal stimulus, particularly in Germany, alongside the European Central Bank cutting rates. We have lowered weightings to healthcare, as the sectors long held safe-haven status has eroded as a result of heightened policy and regulatory intervention from the Trump Administration.

Asset classes

Equities	Neutral
Fixed Income	USD Mandates – Neutral GBP Mandates – Overweight
Cash Plus	USD Mandates – Neutral GBP Mandates – Underweight

Bernard Drotschie
/ Chief Investment Officer

Global Asset Allocation

Global Equity - Neutral

- Earnings revisions have turned positive after the downward revisions earlier this year. Earnings growth is projected to regain momentum and broaden across sectors in 2026 and 2027.
- Earnings recovery is expected to be driven by favourable base effects, lower interest rates, and continued fiscal support.
- Monetary policy is set to become supportive, with interest rates likely to ease further during the rest of the year.
- Trade negotiations between the US and other global partners have taken a more constructive turn. While the full impact of tariffs has yet to materialise, we believe any disruptions will likely be temporary and partially offset by a weaker dollar.
- While valuations remain elevated, they may not fully reflect the structural premium justified by high-return technology stocks.
- Historically, valuations tend to contract during recessions rather than expansions.

Sector views

Consumer Discretionary	Underweight
Consumer Staples	Underweight
Energy	Underweight
Financials	Overweight
Healthcare	Underweight
Industrials	Underweight
Information Technology	Overweight
Materials	Underweight
Communications Services	Overweight
Utilities	Underweight
Real Estate	Underweight

Justin Maloney
/ Head: Global Equities

Derinia Mathura
/ Fund Manager

Global Fixed Income

G7 Government	Underweight
Investment Grade - Supranational	Overweight
Investment Grade - Corporate	Neutral
High Yield - Corporate	Overweight

Karl Holden
/ Head: International Fixed Interest and Currency Strategy

USD Mandates - Neutral

- The Fed implemented a 25-basis point cut in September for the first time this year, with more to follow.
- With inflation still above target and no signs of recession, we believe US Treasury yields will remain elevated.
- Fiscal deficits and rising debt levels add further pressure.
- We maintain a neutral stance on US fixed income and would only reconsider if inflation or economic data deteriorate materially.

GBP Mandates - Overweight

- The Bank of England (BoE) sanctioned its third rate cut this year with a 25-basis point easing in August, a continuation of its “gradual and careful” approach to monetary easing given stubbornly high inflation.
- In the UK we are more confident that yields at current levels are over-extended and represent attractive medium to long term value.
- Long term borrowing costs in the UK are close to 30-year highs and hampering the government’s ability to balance the books. In an effort to lower yields (and hence government costs) the BoE are slowing the pace at which it is reducing its bond holdings (QT) whilst looking to also reduce sales of longer-dated debt.
- The countdown to the government’s autumn budget is underway and action must be taken to fill the fiscal hole/shortfall which in some form has to encompass spending cuts or higher taxes, either or both should be positive for the sterling bond market.

Cash Plus

USD Mandates - Neutral
GBP Mandates - Underweight

- Lower interest rates favour longer duration Fixed Income assets.
- A prudent split between Enhanced Income, Liquidity and Absolute Return funds is being deployed.
- Weightings are dependent on base currency of portfolio.

Market performance / as at 30 September 2025

EQUITIES	Q3	YTD	12
Global			
Bloomberg World Large & Mid Cap NR (Sterling)	9.64%	10.06%	16.70%
Bloomberg World Large & Mid Cap NR (US dollar)	7.73%	18.30%	17.15%
UK			
Bloomberg UK Large,Mid & Small Cap NR	6.83%	16.81%	16.66%
US			
Bloomberg US Large Cap NR	8.04%	14.88%	17.99%
Europe			
Bloomberg Europe DM ex UK Large & Mid Cap NR	3.18%	1.71%	8.57%

FIXED INCOME	Q3	YTD	12
Bloomberg Barclays Series-E UK Govt 1-10 Yr Bond Index	0.16%	3.71%	2.53%
Bloomberg Barclays Series-E US Govt 1-10 Yr Bond Index	1.26%	5.29%	3.50%
Bloomberg Global Agg Treasuries TR Unhedged (GBP)	1.56%	-0.19%	0.50%
Bloomberg Global Agg Treasuries TR Unhedged (USD)	-0.23%	7.29%	0.86%
Bloomberg Sterling Corporate TR Unhedged (GBP)	0.75%	4.25%	3.92%
Bloomberg US Corporate TR Unhedged (USD)	2.60%	6.88%	3.63%

CURRENCY vs. STERLING	Q3	YTD	12
US Dollar	2.13%	-6.92%	-0.53%
Euro	1.68%	5.47%	4.83%
Yen	-0.55%	-1.10%	-3.42%

CURRENCY vs. US DOLLAR	Q3	YTD	12
Euro	-0.45%	13.33%	5.38%
Yen	-2.62%	6.29%	-2.89%

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