

ROCQ CAPITAL

Third Quarter 2025

Global financial markets delivered positive performance over the third quarter of 2025, with equities gaining ground and corporate bonds rallying modestly. The quarter was shaped by a combination of monetary policy shifts, evolving trade dynamics and strong corporate earnings, particularly from the largest US technology firms.

One of the most notable developments was the US Federal Reserve's (Fed) first interest rate cut of the year, lowering the policy rate by 0.25% to 4.25% in September. This move followed signs of weakness in the US labour market, including significant downward revisions to previous employment data. The Fed is likely to cut rates at its two remaining meetings this year and while inflation remains a concern, the easing stance has provided support for asset prices across financial markets. Fed Chair Jerome Powell introduced this dovish tone at the institution's annual Jackson Hole symposium in August, and it was welcome news for markets and the US administration, even if it falls short of the President's call for rates of 2%.

However, inflation has not been tamed, and US CPI is now around 3%, a little higher than in the spring and on a slightly rising trajectory, though the full impact of trade restrictions has yet to be fully reflected in the data. Meanwhile, the passage of a large new US fiscal package early in the quarter is expected to widen the government budget deficit. This has contributed to upward pressure on long-term bond yields, a trend that is global and may be linked to concerns around the dollar and government prudence generally.

Trade policy and tariffs continued to dominate headlines, though the summer months brought fewer surprises than earlier in the year. In July, both Japan and the EU reached agreements with the Trump administration, easing tensions and providing a modest boost to sentiment. Although the terms of these deals may not be particularly favourable for global trade or growth, the reduction in uncertainty has been welcomed by investors and businesses alike.

In the equity space, global indices rose steadily, buoyed by a strong Q2 earnings season. US equities were led by the so-called Magnificent 7 as the cloud computing divisions of Amazon, Microsoft and Alphabet continued their impressive growth trajectories, reinforcing investor confidence in the sector. Nvidia once again served as a bellwether for AI sentiment, reporting a 56% year-over-year revenue increase to \$46 billion. Despite these stellar results, the stock fell 3% on release—a clear indication of the market's elevated expectations and the high bar set for performance.

Internationally, Japan's Nikkei 225 was a standout performer, gaining around 10% in Sterling terms. This rally was driven by positive trade developments with the US and further supported by Berkshire Hathaway's continued endorsement of Japan's five major trading houses: Itochu, Marubeni, Mitsubishi, Mitsui and Sumitomo. The Japanese market appears reasonably valued and has tailwinds via corporate governance reforms, as we have highlighted for some time.

Closer to home, the Bank of England cut rates from 4.25% to 4%, while the European Central Bank held steady at 2.15%. Both central banks are expected to remain on hold for the remainder of the year, reflecting a cautious approach amid mixed economic signals.

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Finally, a notable portfolio change was made during the quarter. In accounts with equity content, we sold our position in Fundsmith Equity – a long-standing holding since the fund’s inception. While Fundsmith continues to invest in high-quality companies, we felt its strategy may lack the flexibility required in today’s rapidly evolving trade and policy environment. In its place, we introduced Columbia Threadneedle Global Focus, a fund we believe offers a more dynamic approach and is better positioned to navigate the current landscape.

Outlook & Portfolio Strategy

We are cautiously optimistic as markets navigate a mix of macroeconomic and geopolitical risks. One of the most prominent themes (and concerns) continues to be the dominance of large-cap US technology stocks. While concerns over stretched valuations persist, the structure of the market — particularly the influence of passive investment vehicles like ETFs — continues to favour these mega-cap names. In such an environment, capital flows are reinforcing leadership in a narrow segment of the market, raising questions about concentration risk and long-term sustainability which we must be mindful of. We are also yet to see whether the high level of capital expenditure on artificial intelligence hardware and tools by large US firms like Microsoft and Alphabet will translate into higher returns.

While we have some exposure to this theme, other regions and sectors look more compelling. For example, US small caps feature relatively attractive valuations, and this segment could benefit from a broadening of market leadership, especially if economic conditions are relatively stable and investor appetite for risk is maintained.

The recent shift toward lower interest rates, while supportive of growth assets in the short term, may undermine central banks’ ability to keep inflation in check. The risk of inflation reaccelerating — or at least remaining stubbornly above target — cannot be dismissed, particularly if policy easing proves premature. While this was damaging for Fixed Income investments in 2022, high current yields provide much more of a cushion for investors and we continue to see bonds as an important part of portfolios and a source of positive returns.

Against this backdrop, diversification remains as vital as ever. In fact, with the US dollar weakening earlier this year, non-US assets look important for portfolio returns. The US administration has given up a great deal of soft power this year, whether in its dealings with allies or attempts at undermining domestic institutions such as the Fed; this impacts appetite for American assets, particularly amongst reserve managers who may be reallocating away from Treasuries gradually. With sentiment in the Chinese market much-improved, Asian equities have been boosted, as have European stocks which trade at a discount to US indices. We are looking to maintain or possibly increase exposure to these areas.

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