CIO INSIGHT

A message from our CIO

2025 turned out to be another successful year, with equity markets reaching all-time highs after a significant correction in April. Quoting from my note last year, *"we are of the view that 2025 is a déjà vu - the rest of the world (Europe, Japan, China) will have to deal with the U.S. on Trump's term as he takes advantage of his bargaining power to impose concessions on trade"*. Indeed, the first part of 2025 was marked by some uncertainty surrounding the imposition of tariffs and their potential impact on the global economy. However, market sentiment improved once the situation settled, triggering strong gains largely driven by the AI theme, which emerged as the primary engine of performance.

In 2025 there was a clear shift in market dynamics. We witnessed structural changes, reflected in elevated levels of daily intraday volatility, an environment that would have been almost unimaginable until recently. The increase in retail participation is one of the sources of this phenomenon. It is now estimated that retail accounts for circa 20-25% of market activity, levels that help justify the market moves observed. While factually speaking, unjustified volatility is frustrating, the silver lining lies in the opportunities it creates which investors should seek to capture. This is how we strategically positioned ourselves throughout the year: retaining core holdings and absorbing their volatility, while adding to existing positions or open new ones during periods of market-wide and/or idiosyncratic overshoots.

Reflection points for 2025

- Against all odds and economists' predictions, the U.S. economy has once again proved to be a driving economic force in the developed world. Economic growth remained relatively robust compared to the euro area, with consumer spending showing resilience and emerging as the main driving force for economic growth, despite persistently high levels of inflation.
- Despite volatility in the last two months of the year surrounding its real, tangible impact on efficiencies, given the massive investment by major companies, the AI theme remained alive and was a core driver for U.S. equity markets in particular. We believe this trend is real and expect further positive momentum heading into 2026.
- The Federal Reserve has faced scrutiny amid market volatility. During his previous term, President Trump publicly criticised the Fed and its chair for not reducing interest rates more aggressively. In 2026, President Trump is expected to nominate a new Federal Reserve chair. Some market participants have raised questions about potential implications for managing ongoing inflation levels.
- In Europe, equity markets had a strong year too, although more driven by expectations than tangible economic positive data. Undoubtedly, politics in Germany played an important role, as the new Chancellor announced a €500 billion special fiscal package for the next 12 years. We view this as the main trigger for the positive equity performance, however, fundamentally, we believe clear divergence will emerge in terms of its execution. Thus, its reflection in economic growth will probably lag behind market expectations.
- In Asia, China's economic growth struggled against expectations despite heavy fiscal and monetary intervention. However, the Chinese administration's shift towards being more open and accommodative of foreign direction investment, coupled with breakthroughs in AI technology, has sparked a much-needed rally in Chinese equities. Meanwhile, despite the U.S. tariff impositions, India continues to lead the region with a strong growth of just over 8%. We remain long-term believers in India given its substantial economic potential.
- Kudos to Trump for managing to achieve an important ceasefire and initiate a negotiation process towards a peace plan in Gaza. In the Russian-Ukraine conflict which has now reached its 3-year mark, we are seeing positive developments with the intermediation of the U.S.

- Looking at the bond market, emerging markets bonds had a strong year namely triggered by the strong dollar depreciation, followed by high yield bonds, with U.S. high yield heading the lion's share. In 2025, the bond market was highly sensitive to expectations of the U.S. interest rate trajectory with investors herding into the bond market in the last two months of the year following expectations of rate cuts by the Federal Reserve which eventually materialised, despite stubbornly elevated levels of inflation. In Europe, the European Central Bank's interest path was more predictable given soft inflation numbers within the euro area.
- Within the local context, the local equity index delivered a low mid-single digit return mainly driven by high market-capitalisation stocks. Liquidity and appetite remain thin, while the opportunity cost versus international markets is high. Within the bond market we continued to experience strong primary activity with both existing and new issuers coming to the market, a pattern which should also be present in 2026.

The dollar depreciation versus major currencies

A notable development in 2025 was the depreciation of the U.S. dollar, which affected performance for Euro-based investors. President Trump's public criticisms of trading partners and the Federal Reserve were cited as contributing factors. Discussions regarding his policies and the Federal Reserve's independence influenced perceptions of the U.S. dollar as a safe-haven currency. The dollar depreciated by approximately 12% against the euro on average, impacting returns for euro-based investors in U.S. assets.

Heading into 2026, although the choice of the next Fed Chairman and upcoming monetary policy decisions will continue to influence the dollar's trajectory, the currency has shown some stability over the past few months. While we do not rule out the possibility of further depreciation, current conditions suggest that a repeat of the extreme volatility seen in 2025 is unlikely.

The year ahead

Heading into 2026, we believe that there are a couple of pressure points which are now less blurred compared to 2025. Primarily, tariffs were a big uncertainty in 2025, while now we have more clarity. Thus, we move into 2026 with markets in a much more positive frame of mind about the growth outlook than was the case at the start of April. We think that 2026 will be shaped by the interplay of monetary policy, fiscal dynamics, and evolving market structures.

In 2026, central banks should be accommodative for bond investors. We expect more rate cuts in the U.S., while in Europe, despite the European Central Bank having paused further rate cuts so far, we do not exclude additional tweaks to the interest rate trajectory if inflation in Europe trends consistently lower. Such expectations augur well for investors favouring the bond market, namely high-yield and emerging market bonds.

Looking at equities, despite the recent noise surrounding the AI bubble debate, we view major tech companies as drivers for earnings growth. Questioning the costs of AI implementation and its monetisation is legitimate; however, it is also legitimate to assert that AI can eventually reduce costs, increase efficiencies, and ultimately increase profits. More importantly, there is a positive ripple effect on other parts of the economy as more companies adopt AI in their processes. While we believe that volatility within the sector remains real and that expected interest rate cuts provide a cushioning that can mitigate AI volatility.

From a regional point of view, we continue to favour the U.S., as we have a more positive fundamental view on the U.S. economy given its macroeconomic backdrop deregulation, more mergers and acquisitions activity, rising business investment, wage growth, falling policy rates, and low energy prices.

In Europe, despite possible signs of regeneration, we still believe growth potential is relatively limited compared with other regions and sectors. However, selectively, we still see pockets of opportunities in themes which should emerge in 2026 and beyond, such as the 'reconstruction theme' which should augur well for selective industrial companies.

Our strategy has been to capitalise on opportunities through a disciplined stock-picking process, while holding onto fundamentally strong companies during periods of heightened volatility. This approach remains unchanged. More importantly, as we continue to navigate shifting market dynamics, we remind ourselves to act rationally when volatility spikes. A simple piece of advice: sit back, think carefully, and act deliberately. Over the past months, we have learned that irrational decisions such as sudden selling are far more detrimental over the long term than measured, rational actions. April 2025 would be a typical example.

We enter 2026 with a clearer macroeconomic perspective, which gives us optimism for the year ahead. One key point to keep in mind is that volatility is here to stay. Agility and selectivity will continue to be essential drivers for long-term wealth creation. As a reminder, it's the time in the market that counts and not its timing.

Jordan Portelli
Chief Investment Officer