



INVESTMENT UPDATE

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INVESTMENT UPDATE

Index	Level 31 August	Level 30 Sept	Change*
S&P 500	6460	6688	+3.5%
FTSE 100	9181	9350	+1.8%
Euro Stoxx 600	550	558	+1.4%
Nikkei 225	42718	44932	+5.2%
Shanghai	3857	3883	+0.7%
US 10 Yr Treasury Yield	4.23%	4.15%	-0.08
UK 10 Yr Gilt Yield	4.73%	4.69%	-0.04
Bund 10 Yr	2.72%	2.71%	-0.01

*all returns in local currency terms. Past performance is not a guide to future returns.

Overview

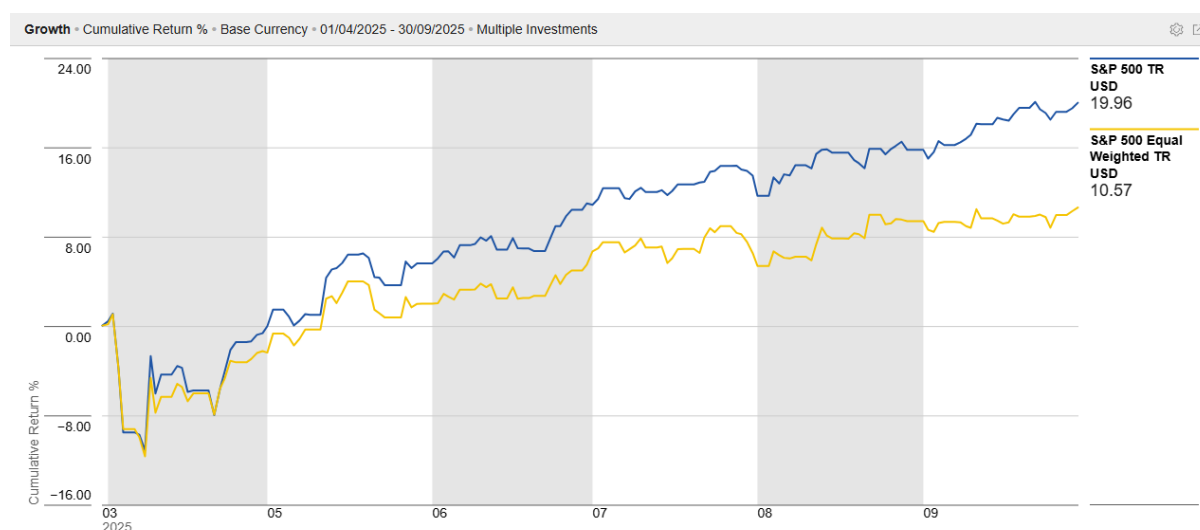
The US Federal Reserve (Fed) cut interest rates for the first time this year, as inflationary concerns they may have had were overridden by perceived weakness in the US labour market. This coincided with a rally of over 3.5% in the S&P 500, although much of this was driven by the larger technology companies. Asian and emerging markets did even better, with the S&P pan-Asia index up over 4% and the Latin American equivalent up over 6%. This continues the trend year to date and perhaps reflects the more attractive valuations that exist in the various regions within these asset classes.

Politics continued to influence markets, with the now almost commonplace announcements on tariffs being shrugged off. The political backdrop in the UK, Germany and France weighed on sentiment, particularly around the volume of borrowing and spending. Bond markets, however, shrugged this off with lower volatility exhibited by sovereign bonds than had been experienced in recent months. This was most likely due to investors awaiting the outcome of significant events such as the impending UK budget and uncertainty over the ability of the new Prime Minister in France being able to push through significant fiscal reforms.

Overall, equity markets globally exhibited positive returns. With lower volatility in sovereign debt, the majority of bond markets were also able to replicate this. Those bonds with a longer term (and hence more sensitivity to interest rates) struggled, notably in the UK, as longer-term government borrowing rates continued to climb. Notwithstanding this, all portfolios were also in positive territory, which continues the almost month-on-month trend following the markets bottoming in April, post 'Liberation Day' in the US.

US

With the first interest rate cut of the year, one might expect interest rate-sensitive areas of the stock market to benefit. However, US Mid and Small cap indices struggled to make much headway, as returns were dominated by five of the largest US stocks, with Tesla alone returning in excess of 30% over the month. The narrow nature of the exceptional performance of the S&P 500 since 'Liberation Day' can be evidenced by the difference in returns between the standard company size weighted version of the index, where the Magnificent 7 represent over 35%, and the equally weighted version, where they only represent around 1.4%:



Source: Morningstar

Much of this divergence can be attributed to the boom in AI, which has led to speculation over a bubble emerging in this area. While the valuation of the S&P 500 is near its historic highs, the equally weighted version is at a significant discount, which suggests not all stocks are expensive.

It is suggested that the AI spending boom is responsible for propping up the US economy, and there is certainly an element of truth in that. There is an enormous amount of corporate capital expenditure being invested in the technology, and ultimately, investors will need to see evidence of a return on that equity. At present, there is an element of the jury being out, but should the returns be in the form of increased

productivity growth, then this could help to alleviate the level of US national debt, with a knock-on effect of lowering long term borrowing rates. These have already declined from their peak of over 5% in early summer. That contrasts with some mature economies, where debt-to-GDP levels may be lower than the US, but longer-term government bond yields remain elevated. This suggests that there may be increasing confidence in the US's ability to service its debt or grow its way out of it.

The latest Consumer Price Index (CPI) figure published on 11 September rose to 2.9% from 2.7%, underscoring ongoing Fed challenges in bringing inflation back to its 2% target. While tariffs typically cause a temporary rise in inflation, the jury is still out on what impact tariffs will have on inflation. The impending US Government shutdown isn't currently expected to have any significant impact on markets, other than delaying data releases that may make the picture on both jobs and inflation clearer, thus making the Fed's job harder.

UK

At home, we saw continued upward pressure on inflation, with food prices up over 4% from the same time last year. Overall inflation, at 3.8%, remains significantly above that of other major economies and the Bank of England's 2% target. The bank's Monetary Policy Committee voted by 7-2 to keep interest rates on hold. Meanwhile, party conference season kicked off with the British Chambers of Commerce warning government not to increase taxation on business in the November budget. This probably chimed with the Bank of England, given higher costs to business, such as National Insurance and minimum wage, have been cited as partially responsible for higher prices. Meanwhile, the FTSE 100 continues to reflect its components more international, rather than domestic, earnings exposure, with the index experiencing another strong month, making it one of the better major markets year to date.

Europe

France was one of the standout markets in Europe during September, which was impressive given the increasing political turmoil. Newly appointed Prime Minister Lecornu struggled to find a consensus among the different political factions within the French parliament in his attempts to address the budget deficit. Long term French bond yield did manage to decline from their post-2008 high of 4.5%, but still hover around the levels of Italy's, which has a significantly worse debt-to-GDP profile than France. The country is increasingly likely to face a general election, as President Macron looks to be running out of options. At least such an event could remove uncertainty around the budget issue. The uncertainty over the political impact on the economy was reflected in the Purchasing Managers Index (PMI) business sentiment survey, which showed a nudge up in private sector activity. However, Germany's strong pick up contrasted with France's 13th consecutive monthly decline.

Meanwhile, a slightly higher EU inflation figure of 2.2% lead ECB president Lagarde made it clear that the direction of monetary policy was not fixed, with interest rates having settled at 2%, which dampened any expectations that there may be room for further cuts.

Japan

Politics also dominated headlines here, as PM Shigeru Ishida resigned following the ruling LDP party's poor showing in recent elections, which triggered a leadership election. This prompted a rally in Japanese stocks, as one of the two leading contenders Sanae Takaishi, who would be the country's first female Prime Minister, is seen to be pro-economy. However, her spending plans would likely increase the level of government

borrowing, so Japan's long term government bond yields hit a multi-decade high of 3.29%. Whilst this may appear at face value to be challenging for a country, where up until recently, long-term rates ranged between 0% and 2.5%, this reflects the country's shift from systemic deflation to an inflationary environment. The lift in inflation has helped to increase government tax receipts, making the servicing of debt easier. Additionally, unlike the UK, which is reliant on foreign ownership of its government debt, Japan's is mostly held domestically, making it less vulnerable to external sentiment over its deficit.

Asia and Emerging Markets

Once again, the regions performed well with both pan-Asia and Emerging Markets indices up around 25% year to date. This has been driven by a combination of factors: the AI spending boom has benefitted related chip and infrastructure producers, particularly in Korea and Taiwan, with the former's stock market up over 10% in September. Taiwan Semi-Conductor Manufacturing, the world's major chip producer, now represents over 10% of the regional Asian index, echoing Nvidia's dominance in the US market. The region has also benefitted from stronger currencies, which have made it less expensive to pay interest on debt denominated in US dollars. Overall, relative market valuations are low, especially versus the US. It should be remembered that this comes after years of underperformance, so this year's returns are to be welcomed.

Argentina was an outlier, where accusations of corruption within President Milei's government and a slowing economy has led to a sell off of the peso as well as Argentinian equities, which are down over 30% year to date. The libertarian and major reformer now faces a tough challenge to convert support for his presidency into seats at the next parliamentary elections.

Summary

While strong market and portfolio returns so far this year are to be welcomed, we need to remind ourselves that this has been in the face of exceptional geopolitical events, such as imposition of tariffs in the US. We don't fully know the tariff impacts yet. Much of the economic activity, and stock market returns, have been driven by AI spending and speculation over its ultimate impact. Currently, the earnings picture has been supportive of market returns and this is also to be welcomed. However, as portfolio managers, we need to ensure portfolios are not over exposed to any one theme. The good news is that recent returns outside the US have come from low valuation bases and driven by different themes globally. So, we are currently being rewarded for our globally diverse approach to investing. We should expect volatility at the market highs, and whilst AI may be grabbing the headlines, we are not wholly reliant on its continuing growth to deliver returns.

Rockhold Asset Management, with contributions from 7IM, Marlborough and LGT, October 2025



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