

Investment review

As we close out the year, it is timely to reflect on what has been a challenging, volatile, yet ultimately rewarding period for investors. Overall, 2025 has been a very satisfactory year in terms of making investment gains, with real, inflation-adjusted returns allowing investors to make good headway whether invested cautiously or more adventurously.

It was certainly not a plain-sailing year, however. China's allegedly cheap artificial intelligence ('AI') chip newcomer, *DeepSeek*, tested investors' mettle early on, raising concerns about pricing power and competitive dynamics in the technology sector. This was followed shortly afterwards by President Trump's extraordinary tariff rhetoric, which wreaked havoc on markets in early April and triggered sharp, if mercifully brief, declines across global risk assets.

More recently, renewed questions around potential AI market exuberance and over-investment have caused some jitters. Yet in between these episodes of uncertainty, markets have repeatedly demonstrated their ability to recover and restore confidence with surprising speed. This has once again illustrated the benefits of staying the course rather than taking risk off the table at what often proves to be a sub-optimal moment, risking damage to long-term investment returns.

We are pleased to have held our nerve throughout these more challenging periods, concentrating instead on longer-term fundamentals which, in our view, remained broadly unchanged, and deliberately ignoring the shorter-term noise.

The global economic backdrop – resilience amid disruption

At the start of the year, many forecasters expected a sharp global slowdown or even outright recession across much of the developed world. In reality, the global economy has proved more resilient than feared, with growth moderating but remaining positive.

That resilience has not been evenly distributed, however, and 2025 has been characterised by increasing regional economic divergence. The US and much of Asia have continued to grow at a faster pace than the UK and eurozone, reflecting differences in productivity, fiscal flexibility, demographic trends and exposure to fast-growing sectors such as technology and AI. Global trade, meanwhile, has held up better than expected despite higher tariffs, aided by negotiation, supply-chain re-routing and the increasingly nimble response of companies reassessing manufacturing locations. In short, the global economy has shown a degree of flexibility that was perhaps under-appreciated at the outset of the year.

Importantly, AI-related investment has contributed meaningfully to economic resilience this year, particularly in the US, where the surge in capital expenditure required to build AI infrastructure has provided a tangible boost to growth. By some estimates, AI has already added around half a percentage point to US gross domestic product ('GDP') growth during the year.



Inflation and monetary policy – a turning point

Inflation pressures have continued to ease across most developed economies. In the UK, December's inflation figure saw a larger-than-expected fall, driven mainly by slower food, drink and hospitality inflation. Similar trends have been evident elsewhere, supported by easing supply-chain pressures, softer demand in some sectors and falling energy prices. A lower oil price, now below \$60 a barrel versus more than \$80 in January, has provided an additional tailwind to the inflation outlook. Hopes that Russia's war in Ukraine may be moving closer to an end – potentially allowing frozen Russian oil supply back onto global markets – have further weighed on prices.

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This disinflationary backdrop has steadily allowed central banks to introduce more supportive financial conditions. The impact of tariffs on inflation has been less severe than markets initially feared, which has enabled central banks – most notably the US Federal Reserve ('Fed') – to begin cutting interest rates. These cuts have helped extend the recovery in both equity and bond markets since the rather tumultuous weeks of the spring.

Market performance – volatility, but ultimately rewarding

As noted, equity markets have experienced several periods of stress during the year, yet overall have delivered strong positive returns. Each episode of stress – whether sparked by AI concerns, tariffs or geopolitics – has been followed by a recovery that has rewarded patience and discipline.

Fixed income as an asset class has also enjoyed a renaissance. Higher starting yields combined with falling inflation and lower interest-rate expectations have restored bonds' ability to provide both income and diversification, reinforcing their role, particularly within lower risk portfolios.

We did trim some exposure at the beginning of the year as inflation worries continued to circulate, but the subsequent reinvestment into the 'alternatives' sector, increasing the exposure to market-neutral investment funds, has worked well so far with steady returns in excess of cash being achieved without capital being subject to the vagaries of inflation, interest rates and general market movements during the year.

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Regional positioning – focusing on growth and fundamentals

For some time our asset allocation has reflected a clear emphasis on regions with stronger growth dynamics and more favourable long-term fundamentals. As a result, our highest equity allocations remain directed towards the US and Asia, where economic momentum, corporate earnings growth and structural drivers appear most compelling, while maintaining more selective exposure to the UK and eurozone. These differentials in regional positioning are likely to remain going forward.



United States – growth, innovation and policy debate

At an economic level, the US economy has once again outperformed other developed world economies this year. Growth has remained robust, supported by consumer spending, corporate investment and technological leadership. AI-related capital expenditure has been a particularly important contributor, helping to underpin growth even as other parts of the global economy have slowed.

That said, the Fed has faced a more nuanced policy challenge. Policymakers have become somewhat divided about what they should prioritise: still-elevated inflation, or what appears to be a gradually weakening labour market, with affordability pressures beginning to mount, particularly for lower-income households.

The most recent 0.25% interest rate cut, resulting in a total of 0.75% in monetary easing since the beginning of September, was widely expected in the end, but opinion has waxed and waned in recent months, not helped by a dearth of economic data, often unreliable, following the US government's extended shutdown.

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Now that the Fed has got its feet wet with some meaningful rate cuts, markets are now dissecting the accompanying narrative: is the economy in need of support or, more likely in our opinion, has it merely reached a point of economic self-sufficiency where, unlike the UK and parts of the eurozone, monetary policy intervention is now needed less? It seems likely that the Fed will now ease up on rate cuts in 2026, whereas central banks in Europe may need to take further stimulative action. This dynamic should, in theory, see the US dollar at least maintain its current level, if not see some relative strength versus other currencies, after a somewhat troubled year.

Even allowing for the near-term impact of higher tariffs raising the cost of imported goods and raw materials, the US economy is still expected to outgrow most other developed economies, supported by productivity gains and innovation – particularly in AI. So, the need for more monetary intervention by the Fed in 2026 does seem to be diminishing.

Asia – structural growth and adaptability

Asian economies continue to play a central role in global growth. While China faces well-documented structural challenges, the broader region is benefitting from favourable demographics, rising domestic consumption and a critical position within global manufacturing and technology supply chains.

Emerging Asian economies are still expected to be key contributors to global growth going forward, reinforcing our positive stance on the region.

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Importantly, the gradual broadening of AI innovation beyond the US could increasingly benefit Asian technology markets, where valuations are generally less demanding and market concentration risks lower.



Japan – reform, deflation and renewed opportunity

Japan stands out as a notable exception to the global trend of monetary easing. After decades of deflation and zero interest rates, rising consumer prices and wage growth have allowed the Bank of Japan to raise rates, restoring pricing power and improving both economic and investor confidence.



Japan's new prime minister – the country's first woman to hold the role – is seeking to continue the pro-growth legacy of the late Shinzo Abe, while accelerating corporate reform and shareholder-friendly initiatives. These include encouraging companies to reduce excessive cash hoarding through increased share buy-backs and higher dividend payments.

Higher interest rates are also likely to support some recovery in the yen, which has depressed unhedged returns for overseas investors in recent years. While markets must absorb higher funding costs and rising bond yields, encouragingly the new prime minister and the new governor of the Bank of Japan appear to have found some common ground. We remain confident that further investment gains can be made in Japan, particularly among under-researched domestic companies to which we have generally increased our exposure quite recently.

The UK – fiscal pressures, subdued growth and a fragile currency

The UK economy appears to face a more difficult domestic backdrop. The recent Budget and accompanying Office for Budget Responsibility forecasts have underlined the challenging economic and fiscal position. While the government's growth forecast of around 1.5% for the coming year represents an improvement, we are sceptical that this will be achieved, particularly after the recent announcement of a decline in GDP, with the UK economy not growing at all since May. Fundamentally we see economic growth tracking much lower than that of the US and Asian economies and with high UK public debt, limited fiscal headroom and productivity growth remaining extremely weak, we cannot see this translating into anything other than poor prospects for the pound.

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However, it is important not to confuse the UK economy with the UK stockmarket. Many of the largest companies listed in London are global businesses earning the majority of their revenues overseas. A weaker pound can therefore be supportive for these companies as foreign earnings are translated back into sterling. This dynamic was a key reason why we increased exposure to large-cap, internationally-focused companies over the summer at the expense of some UK domestic smaller-company exposure.

Artificial intelligence – opportunity, exuberance and perspective

Returning to AI, this has been one of the defining themes of the year, both economically and for financial markets, but also for the world's ever-expanding lexicon of words and terms.

Many investors will be familiar with the stellar growth in demand for AI-designed chips (i.e. the graphics processing units, or GPUs, that trace their origins in the video gaming industry but now power AI machine learning), where Nvidia is the global leader by a country mile.

We also have the so-called ‘hyperscalers’, the huge technology companies like Microsoft, Amazon and Alphabet (Google) operating the massive datacentres that are providing the backbone to the on-demand and highly scalable cloud computing, storage and digital services now becoming widespread in all our personal and business lives.

AI-related investment has provided a meaningful boost to economic growth, particularly in the US, where the surge in capital spending required to build AI infrastructure has underpinned activity. This investment-led support is expected to continue into 2026, reinforcing our view that the improved US growth backdrop can persist. It also helps explain why the US stockmarket, bulging with innovation and technology opportunities, remains at the core of our global equity market exposure.

Optimism around AI has, yet again, been a major driver of some strong equity market performance in 2025, particularly in the US, where technology and communications services companies have delivered exceptional earnings growth. AI adoption and investment have been far slower, however, outside the US, which helps explain why Europe continues to lag and why Asia – particularly China and India – may offer attractive opportunities as innovation broadens.

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Markets forever blowing bubbles

Valuations in parts of the market are undeniably elevated, and market concentration has reached uncomfortable levels, with the largest US technology companies now accounting for a striking share of global equity markets. These characteristics rhyme with past investment bubbles, and history reminds us that periods of transformative innovation, including what we are witnessing now, are often accompanied by over-exuberance. However, there are some important differences this time. Unlike the late-1990s technology bubble, today’s leading AI-related companies are highly profitable, possess strong balance sheets and are funding investment largely through internal cash generation rather than speculative leverage.

Valuations may appear stretched, but on most measures remain below bubble extremes, with strong earnings growth, rather than speculation alone, being the primary driver of superior share price returns. Moreover, much of the current investment reflects the build-out of foundational infrastructure, with most of the eventual value creation likely to come later as AI is more widely adopted across the economy.

That said, risks are rising: capital intensity is increasing, competition is emerging and expectations are high. Returns may broaden beyond the current market leaders, both geographically – including into Asia – and across sectors where, currently, it may be difficult to imagine how AI can be of benefit. For investors, this reinforces the importance of diversification and selectivity rather than narrow market concentration.



We are in frequent contact with the managers of both our dedicated global AI fund and many of the active managers (principally in the US and Asia) who are closely watching current trends and sifting through financial data in search of opportunities in this evolving and increasingly ubiquitous theme. We agree with their assessment that valuations are not immune to some form of a correction at some point – it would be unrealistic to expect any transformative technology not to have some growing pains – but there is no doubt in our minds that AI represents a structural shift rather than a fleeting fad.

It is worth remembering that significant capital expenditure cycles have preceded previous general purpose technology productivity booms (think of the electrification of manufacturing in the late 1920s and the development of the internet in the 1990s). For some players in this AI revolution, particularly those fighting to catch up through prior underinvestment, today's heavy spending on AI infrastructure and hardware may ultimately prove to be a poor return on their investment.

For others, the challenge will be to maintain their current dominance. But once the infrastructure has been built there should be plenty of secondary beneficiaries, including in areas such as computer software, finding their way into all manner of business sectors, that can become the dominant next leg of this AI upswing. This is where the role of active, rather than passive, investment is likely to have a specific edge.

Looking ahead – optimism, but still some risks

Looking ahead to 2026, the global investment backdrop is likely to be shaped by a number of identifiable, but manageable, risks. Near-term economic activity could yet soften as higher effective tariff rates gradually feed through. However, the longer growth remains more resilient than expected, the greater the likelihood that tariff impacts fade into the background.



A change in leadership at the Fed introduces some uncertainty around the future pace and timing of monetary easing, particularly if inflation proves slower to settle due to lingering effects from tariffs or renewed supply-side pressures. This raises the possibility of policy error, either through easing too quickly or remaining restrictive for longer than markets expect.

China remains another important variable: while still contributing to global growth, structural challenges such as high debt, property-sector weakness and uneven domestic demand could generate periodic volatility. Elevated public and private debt levels across major economies also warrant monitoring, especially if growth disappoints. Alongside this, geopolitical risks – from ongoing conflicts to strategic tensions between major powers – are likely to continue creating episodes of market uncertainty. However, we expect these risks to sit within a broadly stable macroeconomic environment rather than derail the global cycle.

Positive outlook for corporate earnings and fixed income markets

Set against these risks, the outlook for global corporate earnings in 2026 and beyond remains positive. A likely backdrop of lower inflation and gradually easing policy rates should help reduce financing costs and support both profit margins and equity market valuations. Continued capital expenditure – especially in productivity-enhancing areas such as automation, digital infrastructure and AI – alongside healthier corporate balance sheets should provide a solid foundation for sustained earnings growth.

This environment should also be supportive for fixed interest markets: lower policy rates and a more predictable inflation outlook are positive for government bonds, while generally strong corporate health and stable growth should underpin credit fundamentals, helping to contain default risk and support income returns. Together, these factors suggest a more balanced and supportive environment across both equity and bond markets as we move into the next phase of the economic and market cycle.

Final thoughts

2025 has been a year that rewarded patience, discipline and a focus on fundamentals. While volatility has tested investors' resolve at times, a strategy of staying invested has ultimately been well rewarded.

Going forward we remain comfortable with stockmarket exposures sitting at the upper end of strategic ranges but as noted have made various changes during the past year to underlying positioning within the UK, US and Japanese markets to reflect evolving economic and market dynamics. Similarly, we are happy with the balance between government and corporate bonds within fixed interest exposures, and the mix between this asset class and alternative investments, which together form the backbone of less adventurous investment mandates where downside risk protection is more important.

Looking ahead, we believe the combination of easing inflation, more supportive monetary policy and continued technological progress provides a constructive backdrop for long-term investment. Overall, we feel well positioned for the year ahead and see no immediate need to make further changes, but as always, we remain focused on protecting and growing clients' capital in line with longer-term objectives. We therefore remain alert and ready to make further tactical or strategic moves as 2026 unfolds.

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