

Q4 House and economic views

The third quarter (Q3) began against a backdrop of resilient economic growth, evolving geopolitical risks and ongoing questions around the path of inflation and monetary policy.

Central bank decisions during Q3 reflected regional differences; namely between the US Federal Reserve (Fed) and the Bank of England (BoE). Some raised rates, signalling monetary policy will likely remain restrictive for longer, while others held firm.

Tensions in the Middle East and higher energy prices have challenged markets but underlying economic fundamentals have generally remained supportive, alongside strong earnings growth.

We maintain a disciplined, long-term perspective. Elevated valuations, particularly in the US, continue to warrant caution. However, opportunities remain available in regions and sectors where valuations, diversification benefits and fundamentals look more attractive.

Here is an overview of the SJP investment team's portfolio positioning. This highlights where we believe the most attractive risk-adjusted opportunities exist as we navigate the period ahead.

House views	-	/	+
Equities		◆	
Government bonds		◆	
Corporate bonds	◆		
Emerging markets			◆
GBP			◆
Inflation			◆

Equities	-	/	+
US	◆		
UK			◆
Europe ex-UK			◆
Japan			◆
Japan SMID Cap			◆
Japan Large Cap	◆		
Emerging markets			◆
Smaller companies			◆

Fixed income	-	/	+
Global sovereign			◆
Global investment grade	◆		
Global high yield	◆		
Emerging market (Local)			◆
Global inflation -linked			◆

Market outlook

In the medium term, we expect economic growth to gradually moderate, rather than contract sharply. Labour markets, particularly in the US, have demonstrated relative resilience; supporting consumer spending and helping offset some of the headwinds from higher borrowing costs. At the same time, persistent inflation means central banks are still cautious. Long-term government bond yields also remain elevated, reflecting this uncertainty.

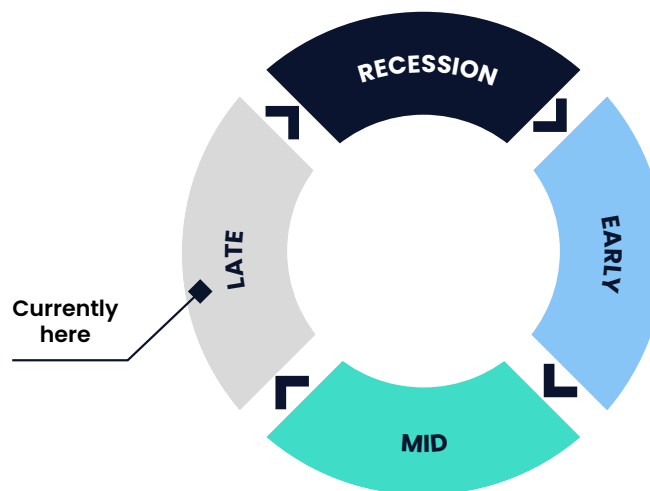
Against this backdrop, the US Federal Reserve raised interest rates by 0.25% in September, taking its target range to between 3.75% and 4%. The decision reflected ongoing inflation concerns, alongside greater confidence around growth and employment. Policymakers also suggested the rate decision could mark the beginning of a modest period of additional tightening rather than being an isolated move. While US inflation remains above target, there is limited evidence of a wage-price spiral developing. We continue to assign a 30% probability to a US recession, while our central expectation is for steady expansion, where inflation gradually moves back towards target without a significant downturn.

The US stands out as the strongest major developed economy. Labour market indicators have improved following earlier weakness, while consumer spending has remained resilient despite subdued household confidence.

Economic views: 12 to 18 month outlook

Deep recession	Stagflation	Mild recession	Steady expansion	Re-acceleration
5%	15%	10%	55%	15%

Base case



- ◆ Investing **late cycle** is always difficult.
- ◆ Historically, **risky assets perform well** in this period. However, **volatility** can increase as markets assess the likelihood of a recession. We have a neutral view on equity risk, but have a bias away from richly valued US assets.
- ◆ Remaining diversified, we believe we can create **robust portfolios** over a number of scenarios across our **IMA**.

Nevertheless, weaker income growth and depleted savings suggest consumer demand should continue to be monitored. Investment, particularly AI-related, has supported economic activity. However, recent calls for a slower pace of model development and OpenAI's decision not to pursue an IPO in 2026 indicate a path that is neither smooth nor predictable.

The outlook for the UK and Europe is more nuanced. Both regions are more exposed to higher energy costs given their reliance on imports, while growth has generally been weaker than in the US. The UK labour market remains subdued. Modest real wage growth and relatively healthy household balance sheets have provided some support to consumers. The Bank of England's decision to hold interest rates in September reflects continued caution. Policymakers are trying to balance persistent inflation against risks to growth. Both gilt yields and market expectations of near-term rate hikes have increased. Uncertainty ahead of the Autumn Budget may also encourage businesses and consumers to adopt a more cautious approach. Across Europe, stronger economic data and resilient activity strengthen the case for the European Central Bank (ECB) to maintain tighter monetary policy for longer as rates were raised by 0.25% in September following a hike in June.

Geopolitical tensions in the Middle East have been a key source of uncertainty again during Q3. Our working assumption is that the conflict persists without a material escalation. Yet significant disruption to major energy and shipping routes are tail risks that could increase energy prices,

inflation and transport costs. Together these could influence growth and monetary policy.

Overall, our central economic outlook is one of steady expansion, supported by resilient labour markets and moderate near-term recession risks. Persistent inflation, elevated bond yields and ongoing geopolitical uncertainty create a wide range of potential outcomes for investors. Therefore, we see the balance of evidence continuing to point to a gradual late-cycle slowdown rather than a recession.

Positioning

While economic growth and corporate earnings have remained resilient, global equity valuations are elevated by historical standards, particularly in large-cap US technology stocks. As a result, we remain negative on US equities overall, favouring markets with more compelling valuations and stronger diversification benefits. We hold high-conviction views on the UK, Europe ex-UK, global smaller companies and emerging markets. These regions and sectors offer more attractive valuations, improving fundamentals and less concentrated sources of returns than we see in US equities.

In Europe, we see attractive valuations and healthy corporate profitability. European companies generate strong returns on equity and offer diversified sector composition. Valuations are still attractive relative to many other developed markets. Despite softer earnings momentum, we believe the region remains appealing for long-term returns and diversification.

Japan is also attractive from structural and diversification perspectives. Corporate governance reforms, improving capital allocation, rising shareholder returns and supportive domestic policies are creating a favourable backdrop for investors. Japanese equities also offer differentiated return drivers compared with other developed markets, alongside resilience during periods of market stress. We remain positive on Japanese small and mid-cap companies, which stand to benefit most from domestic economic improvements and structural reform.

In the UK, we continue to see attractive valuations, resilient corporate profitability and strong income characteristics. Despite recent market strength, UK equities trade at a meaningful discount to global peers. This discount creates an attractive long-term opportunity, particularly in value, smaller companies and lower-volatility segments.

We are also positive on global smaller companies. While parts of the asset class have rerated, valuations remain attractive relative to large-cap equities. They provide exposure to broad domestic growth opportunities and business cycle dynamics. We see compelling opportunities in Japanese, UK and, increasingly, US small-cap markets, where valuations remain favourable relative to large caps.

Emerging markets continue to benefit from improving earnings quality and attractive long-term growth prospects. However, recent performance has narrowed their valuation advantage. Greater technology and semiconductor exposure has also reduced some diversification benefits.

In fixed income, we remain broadly neutral on duration. We continue to favour areas of the market where valuations, diversification benefits and income-generation are most compelling.

Government bond yields have risen significantly in recent quarters. This reflects higher real yields; ongoing inflation concerns and greater focus on government finances. As a result, valuations look more attractive, as do long-term returns. However, uncertainty around interest rates, inflation and central bank policy remains high. We believe a balanced approach is still appropriate.

Inflation expectations have fallen significantly despite ongoing risks, yet we like the portfolio protection available from inflation-linked bonds. As such, we recently added to our US Treasury Inflation Protected Securities (TIPS) exposure.

We are negative on investment-grade credit, noting its increasingly asymmetric risk-return profile.

Although bond yields in this asset class have risen, credit spreads remain tight by historical standards. This limits further spread compression while exposing investors to potential downside risk, should economic conditions deteriorate or corporate fundamentals weaken.

By contrast, we maintain a neutral stance on high-yield credit. Spread valuations are not that compelling, but all-in yields remain attractive. They continue to provide a cushion against moderate market volatility. Fundamentals are still supportive, with default expectations contained.

Emerging market (EM) debt continues to offer diversification and income through exposure to a broad range of economic and monetary policy cycles. Fundamentals in EM are improving but valuations no longer warrant stronger conviction.

Against this backdrop, we favour sovereign bonds and inflation-linked over investment grade credit.

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