SCOTTISH WIDOWS

Investment Matters

Scottish Widows Platform | January 2026

Looking back: market review Q4 2025

Summary

The MSCI ACWI Index, a representative measure of global equities across developed and emerging markets, increased 3.4% over the fourth quarter of 2025. Japan, Europe, the UK and emerging markets were among the main gainers in local currency terms. Many markets closed the year close to record highs in a quarter that saw further US interest rate cuts and better performance from value sectors. In fixed income, the ICE BofA Global Government Index declined by 0.7% in sterling terms but was up 0.2% in local terms. After weakening for the first half of the period, sterling recovered to finish broadly flat against the US dollar.

Crude oil futures prices fell back as a ceasefire was agreed in the Middle East and on the back of estimates that supply will exceed demand in the coming months. European natural gas futures price also decreased.

UK equities

The FTSE 100 Index, a commonly used representative benchmark of the UK's largest equities, added 6.9%. The UK's annual inflation slowed from 3.8% in September to hit 3.6% in October, and 3.2% by November, helped by a slowdown in food and alcohol prices. The Bank of England reduced its policy rate by 25 basis points (bps) in December. In a divided vote, five policymakers were in favour of a cut and four preferred to keep rates steady. Meanwhile, unemployment reached 5.1% in the three months to October, its highest level since the first quarter of 2021. Year-on-year (y/y) gross domestic product growth in the UK slowed to 1.3% in the third quarter, from 1.4% in the previous quarter. More positively, the flash UK manufacturing Purchasing Managers' Index (PMI) figure stepped further into expansionary territory, as did the preliminary UK services sector PMI report. (Note that a PMI figure over 50 indicates expansion.)

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Looking back: market review Q4 2025 (continued)

US equities

In US equities, the S&P 500 Index rose 2.7% in sterling terms. The Nasdaq Composite Index, which has a growth focus, was up 2.8% in sterling terms. The longest-ever US government shutdown, which lasted 43 days, hampered the release of economic data. Annualised GDP growth hit a better-than-expected 4.3% in the final reading for the third quarter of 2025, as exports and consumer spending rose. The Federal Reserve (Fed) continued to reduce interest rates, with two 25 bps reductions during the quarter. The December vote was divided, as some members voted for rates to stay put, while another wanted an even steeper cut. November's inflation eased to 2.7% from 3.0% in September. October's data was not collected due to the government shutdown. The non-farm payroll report was also impacted by the shutdown, but showed an increase of 64K jobs in November, helped by new hires in health and construction. Meanwhile, the preliminary reading of the US manufacturing PMI for December showed a slowdown in expansion for the third successive month. This softening was mirrored in the services PMI.

Europe equities

There was an increase of 6.1% in the MSCI Europe ex UK Index in sterling terms. At the country level, Spain, Switzerland, the Netherlands and France were among the main winners in local currency terms. French politics created most of the headlines as the country's newly installed prime minister, Sébastien Lecornu, resigned but was reappointed soon after. Additionally, his government came through several no-confidence votes. Eurozone third quarter GDP reached 0.3% quarter-on-quarter (q/q) growth, which compared with the first quarter's 0.1%, helped by GDP growth in Spain, France and the Netherlands, while Germany and Italy lagged. Spain's GDP expanded by 0.6% q/q and France's grew by a much better-than-expected 0.5% q/q, while GDP in Germany and Italy lagged. The European Central Bank (ECB) kept rates on hold for its two meetings during the quarter as policymakers continued to focus on a data-dependent approach. Annual inflation of 2.1% was announced for October and November, representing a slight slowdown from 2.2% in September. Flash eurozone manufacturing PMI slipped slightly further into contraction in December. The preliminary services PMI for December remained in expansionary territory.

Looking back: market review Q4 2025 (continued)

Japan equities

The MSCI Japan Index was up 3.3% in sterling terms and 9.6% in local terms. The yen weakened against the US dollar over the quarter. Japan's stock market gained as Sanae Takaichi, was named as the country's new prime minister, as investors expected her government to have a pro-business stance. Rising tension with China did not stop the equity market making robust headway. Having stepped up from 2.9% to reach 3.0% in October, annual inflation finished the period at 2.9% as food inflation slowed. The Bank of Japan (BoJ) increased its short-term interest rate by 25 bps to 0.75% in December given growing confidence in the underlying economy. Nevertheless, the country's annual GDP slowed to 1.1% y/y growth in the third quarter, compared with 2.0% in the previous quarter.

Emerging market equities

The MSCI Emerging Markets Index was up 4.8% in sterling terms. Korea, Taiwan, South Africa and Brazil advanced, while China and Saudi Arabia declined in local currency terms. India's annual inflation stepped below the RBI's inflation target band threshold of 2% and remained there for the rest of the quarter. As expected in the market, the Reserve Bank of India (RBI) lowered its key rate by 25 bps in December. The RBI also increased its full-year GDP growth expectations and reduced its inflation estimates. At the same time, third-quarter GDP came in strongly, with 8.2% y/y growth, up from 7.8% in the second quarter. This rise was despite the tough trade tariff backdrop and rupee weakness, amid a pickup in consumer spending. China's economy grew 4.8% y/y in the third quarter, in line with market consensus but lower than the 5.2% y/y growth in the second quarter, in part due to trade tensions. However, Chinese industrial production slowed over the period, from 6.5% y/y in September, to 4.9% y/y and 4.8% y/y growth in October and November, respectively. Meanwhile, after 8.3% y/y expansion in September, exports declined in October, before rebounding to 5.9% y/y growth in November, as non-US exports improved. Brazil's annual GDP growth continued to tail off, reaching 1.8% y/y in the third quarter of 2024, compared with 2.4% in the second quarter. Annual inflation also softened from 5.17% in September to 4.46% by November. However, the country's central bank kept interest rates at 15% as it aimed to contain inflation. Meanwhile, Brazil's unemployment rate hit an all-time low of 5.2% in the three months to November, compared with 5.4% in the previous reading.

Looking back: market review Q4 2025 (continued)

Asia Pacific equities

Over the quarter, the MSCI AC Pacific ex Japan Index added 3.4% in sterling terms. At the country level, Korea, Taiwan and Indonesia gained ground, while China and Australia declined in local terms. South Korea's main equity market hit record highs helped by optimism in the semiconductor sector amid the AI drive. Korea also sealed a trade deal with the US. Similarly, Taiwan's equity market reached new highs on positive sentiment towards technology stocks. The Bank of Korea kept its interest rate at 2.5% on ongoing caution about house prices and the currency market. Having remained at 2.4% in November, annual inflation in Korea stepped down to 2.3% in December. Bank Indonesia held rates steady at each of its three meetings during the quarter, as it aimed to keep bolstering the currency and keeping inflation within its target range. Indonesia's annual GDP growth for the third quarter was in line with market expectations at 5.0%, broadly matching the pace in the second quarter. In October, Australia's inflation rate stepped up from 3.6% to 3.8%, moving it further above the central bank's target range of 2-3%. The country's GDP came in at 2.1% y/y expansion compared with 1.8% in the previous period.

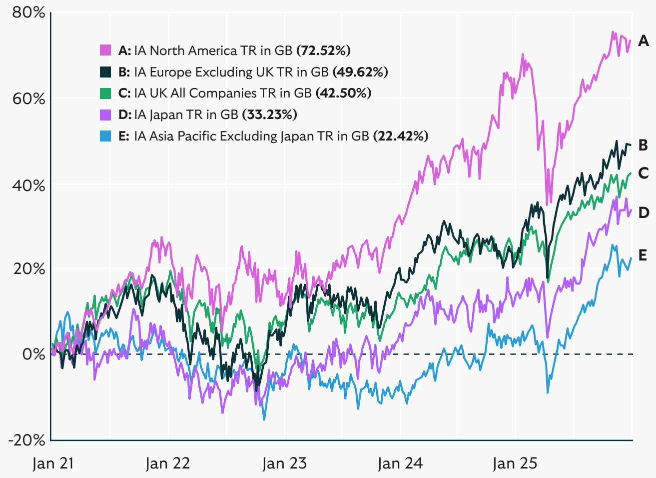
Bonds

Fixed income markets were mixed in sterling terms. Government bonds moved broadly lower, while spreads tightened in high yield and investment grade corporate bonds. The 10-year US Treasury yield moved broadly sideways, starting and ending the quarter at 4.15%. The environment of broadly lower rates continued to bolster corporate borrowing, but expectations for further cuts from the Fed in 2026 were reeled in, with just one reduction now signalled by policymakers. The UK gilt yield fell overall. It saw a sharp reduction in October (prices rose), partly on the prospect of further rate cuts. Budget uncertainty led the 10-year gilt yield up again in November, before expectations of reduced supply and news of an improved fiscal situation pushed it lower soon after. The UK gilt yield then edged up in December. In Germany, bund yields rose on updates about the government's large borrowing plans. Japanese government bonds saw yields gain (prices fell) on expectations of further interest rate hikes.

Property

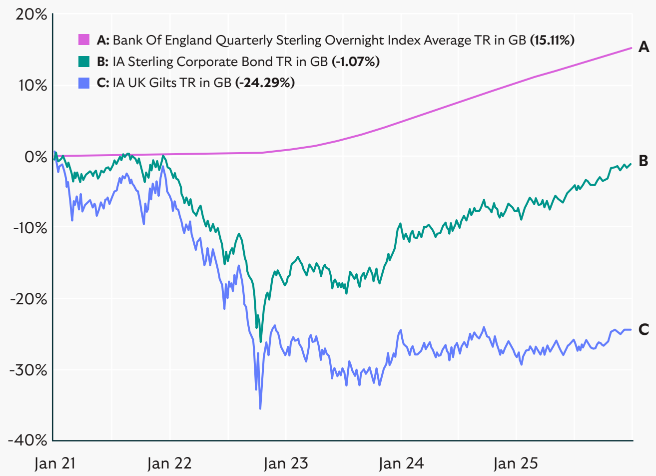
The FTSE EPRA Nareit Developed Index, a measure of the performance of Real Estate Investment Trusts (REITs), fell 0.7% in sterling and local currency terms. Note that REITs tend to be sensitive to interest rate expectations. During the three months to end-November – the latest period with available figures – the MSCI UK Monthly Property Index increased 1.5%. Prime office rentals, including regional prime office space, appear to have been relatively strong for much of the year. The industrial segment looks to have remained robust, and there have been some signs of recent improvements in demand for retail property, helped by UK interest rate reductions.

Average total returns of funds in IA equity sectors over 5 years to December 2025 (in UK sterling terms)



Source: FE fundinfo (31/12/2020-31/12/2025). Past performance is not a reliable indicator of future results. The value of investments, and the income from them, may fall as well as rise. Investors may not receive back the full amount originally invested.*

Average total returns of funds in IA bond sectors over 5 years to December 2025 (in UK sterling terms)



Source: FE fundinfo (31/12/2020-31/12/2025). Past performance is not a reliable indicator of future results. The value of investments, and the income from them, may fall as well as rise. Investors may not receive back the full amount originally invested.*

* These graphs reflect the average performances of funds that feature in different IA (Investment Association) sectors. The performances are in sterling terms, which means that the effects of changes in the value of sterling versus other currencies are incorporated in the performance figures. Performances are calculated on a bid to bid basis, which means that any costs associated with the purchase or sale of shares/units are not included.

All index data are shown in total return sterling. Source: FE Analytic

Looking forward: outlook as at 31 December 2025

Though we manage funds for the long term, here are our thoughts on markets as we look forward over the coming quarters.

Global equity valuations remain relatively full in our view. The US equity market was outpaced by other regions in 2025, and we believe some lower-valued regions could continue to see further periods of market leadership. We believe in having a geographical spread of equity market exposure, while continuing to monitor risks, such as the impact of trade tariffs, market concentration and geopolitical conflicts.

In fixed income, credit lacks an obvious spur for outperformance amid tight spreads over government bonds. There may be further rate cuts from key central banks, but rhetoric from policymakers has broadly signalled that we are nearing the bottom of the rate cycle. In our view, holding a diversified blend of government bonds and credit, in different geographies and with different characteristics, can continue to provide income-generation benefits.

UK equities

Inflation has been running at a higher rate than many developed market peers. However, in a close vote, the Bank of England (BoE) reduced rates again in December 2025. Sentiment towards the UK improved last year, despite relatively muted earnings growth potential and lacklustre GDP growth.

US equities

Given valuation differentials, growth equities have lost some of their lustre versus value stocks and this might continue. The impact of the country's trade tariff policy, and the ongoing evolution of AI and investment in AI could be important in the coming months. Looking out over the longer term, we believe US economic growth prospects remain superior to many other developed markets, but this currently looks to be priced into valuations.

Looking forward: outlook as at 31 December 2025 (continued)

European equities

The European Central Bank has not reduced rates since June 2025. Inflation appears relatively well contained. Political risk at the individual country level could reemerge, but proposed capital investments and relatively attractive valuation levels could help it produce a robust showing in the coming quarters, while GDP growth is likely to remain lacklustre.

Japanese equities

In December, the Bank of Japan hiked interest rates to 0.75% (their highest in 30 years) as it continues to move towards monetary policy normalisation. Japan's stocks have benefited from positivity about long-term structural reforms, but we remain watchful on valuation levels.

Asia/Emerging Markets

Despite trade tariff uncertainty, emerging markets performed well in 2025. Valuations still appear relatively attractive, in our view. Any further US dollar weakness could prove helpful. Overall, emerging markets represent an important long-term growth opportunity.

Developed Market Government Bonds

We appear to be close to the bottom of the interest rate cycle. Growth and inflation data will have to be carefully monitored by policymakers. Government debt levels in some markets may be an important focus for investors. We think government bonds have an important role to play in multi-asset portfolios, particularly during periods of negative shorter-term market adjustments.

Credit

Credit spreads are tight, which limits the near-term potential of the asset class. However, volatility may present opportunities in credit.

Emerging Market Debt

We monitor for idiosyncratic risk on an ongoing basis. However, over the past few years, several emerging economies have benefited from fiscal pragmatism. Any further US interest rate cuts or US-dollar weakness may prove helpful. In our view, valuations and yields are generally attractive.