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ASSET MANAGEMENT (C.I.) LIMITED

## INVESTMENT MEMORANDUM

A quarter which was progressing well for the first two months was then upended by the Iranian conflict which meant that equities and bonds moved into negative territory, although the overall result was only modestly so. As this is written in the second week of April, both bonds and equities have recovered and equities as measured by the FTSE All World Index are now higher than at the end of 2025. What happens next depends on developments in the Middle East. Our review shows our stance on equities and fixed interest markets in these uncertain times.

The tables below detail relevant movements in markets :

### International Equities 31.12.25 - 31.03.26

Total Return Performances ( % )				
Country	Local Currency	£	US\$	€
Australia	-0.4	+4.3	+2.3	+4.3
Finland	+4.1	+4.2	+2.1	+4.1
France	-4.2	-4.1	-6.0	-4.2
Germany	-6.7	-6.6	-8.4	-6.7
Hong Kong	+5.0	+6.3	+4.2	+6.2
Italy	-2.3	-2.2	-4.1	-2.3
Japan	+3.3	+3.8	+1.8	+3.8
Netherlands	+5.2	+5.3	+3.2	+5.2
Spain	-1.0	-0.9	-2.9	-1.0
Switzerland	-2.4	-1.8	-3.8	-1.9
UK	+3.6	+3.6	+1.5	+3.5
USA	-4.7	-2.8	-4.7	-2.8
All World Europe ex UK	-2.0	-1.9	-3.9	-2.0
All World Asia Pacific ex Japan	+1.3	+1.3	-0.7	+1.2
All World Asia Pacific	+1.9	+2.1	+0.1	+2.0
All World Latin America	+13.0	+18.3	+16.0	+18.2
All World Emerging Markets	-1.1	-0.8	-2.7	-0.9
All World	-2.4	-1.2	-3.1	-1.2

Source : FTSE All World Indices

FTSE Actuaries UK Conventional Gilts All Stocks Index (total return) : -1.9%

## International Bonds - Benchmark Ten Year Government Bond Yields (%)

	31.12.25	31.03.26
Sterling	4.47	4.91
US Dollar	4.17	4.32
Yen	2.05	2.35
Germany (Euro)	2.85	3.00

## Sterling's performance during the quarter ending 31.03.26 (%)

	Quarter Ending 31.03.26
US Dollar	-1.8
Canadian Dollar	-0.2
Yen	-0.4
Euro	-0.1
Swiss Franc	-0.8
Australian Dollar	-4.8

## Other currency movements during the quarter ending 31.03.26 (%)

	Quarter Ending 31.03.26
US Dollar / Canadian Dollar	+1.6
US Dollar / Yen	+1.4
US Dollar / Euro	+1.6
Swiss Franc / Euro	+0.7
Euro / Yen	-0.3

## Significant Commodities (US dollar terms) 31.12.25 - 31.03.26 (%)

	Quarter Ending 31.03.26
Oil	+94.1
Gold	+6.5

## MARKETS

- In international equities, the strong gains of the first two months of the quarter were more than cancelled out by weakness in March following the start of the Iranian war.
- In local currency terms, the stand out performer was Latin America, +13.0%, whilst the UK, +3.6%, reflected the importance of oil and commodity companies, together with defence stocks, which provided some hedge against falling markets. Japan also performed well, +3.3%.
- In sterling terms, the strength of the Australian dollar meant a solid +4.3% from Australia, whilst the return on Latin America increased to a very strong +18.3%.
- As the rise in energy prices turned inflation and interest rate expectations on their head, bonds fell sharply to leave yields significantly higher than at the beginning of the quarter.
- Sterling weakened during the quarter, particularly against the Australian dollar, -4.8%, and the US dollar, -1.8%.
- The oil price dominated the economic headlines, +94.1%, and although gold ended the quarter higher, +6.5%, it had a sharp setback towards the end of the quarter.

## ECONOMICS

For the first two months of Q1 2026, markets were performing well with good momentum behind them as investors contemplated further central bank easing and, certainly in the USA, a good earnings outlook for 2026. All that changed in March when the hostilities in Iran and now the wider Middle East flared up. So, what appeared to be going to be quite a positive quarter has turned into a negative one for equity and bond indices, although not significantly so.

As clients know, we are not prone to making knee jerk decisions on investment policy when confronted with unexpected negative events. For long term investors, and these represent our client base, the phrase attributed to Ken Fisher and Warren Buffett, “time in the market” is more important than “timing the market”, is highly relevant. Given the long term uptrend in equity prices, the danger of selling shares on seemingly bad news (take, for example, Covid in 2020) was highlighted by the sharp recovery in share prices shortly after it broke out in full force in February and March of that year. In such circumstances, the loss of profit for investors who sold on the news is never likely to be recovered given how much markets have risen since that time.

No one knows how the Iran situation will end. It could end well and we are mindful that this adverb might not seem entirely appropriate given the casualties of war but clients will understand what we mean. This outcome would involve Iran setting aside its nuclear and political ambitions, the former perhaps because the USA has dismantled its nuclear capability and the latter by withdrawing support from terrorist organisations outside its borders. This outcome might seem improbable but it lies at one end of the spectrum and the prospect of peace in the Middle East, which has proved so elusive would understandably be an outcome much welcomed by almost everyone including investors and, through them, the stock market.

At the other end of the spectrum, the war would drag on, the Strait of Hormuz be closed to most traffic, pushing up energy prices, creating shortages of oil and gas, perhaps involving rationing and lost output leading to a recession but with inflation rising sharply. In that scenario, central banks would be likely to raise interest rates to try to hold back inflation which would further depress activity in the affected economies. What central banks fear is that a temporary increase in inflation will raise inflation expectations which could feed through to higher wage demands, thus baking in inflation. This could be a “stagflationary” scenario where inflation combines with no economic growth, an outcome much feared by economists. Another scenario is that the situation drags on with perhaps ground troops involved, the Strait of Hormuz reopened to provide some relief to the supply chain and no more damage inflicted by Iran on other Middle Eastern countries’ oil and gas facilities. In this situation, markets are likely to react to day to day news as they have done so far.

This is where we are as this review is written. But what it does show is the importance of diversifying across the sectors to try to mitigate changes in sector leadership driven by geopolitical and economic developments. If we look at just two equity markets, those of the USA and UK, the point is made. In the S&P 500, year to date the S&P Energy Index, for obvious reasons, is the leader, up 28.2% at the time of writing. Also in positive territory is the Materials Index as supply difficulties drive up prices and then other sectors, Utilities and Consumer Staples, turning around previous underperformance because they are seen as defensive. At the other end of the spectrum are previously high flying sectors like the S&P Info Tech Index and the S&P Financials Index. If we look at the FTSE 100, we see oils, miners and defence sectors as amongst the best performers. At the other end of the scale are, for example, housebuilders where changes in interest rate perceptions have hit the sector hard. But if the outcome of this conflict turns out to be the positive one, as outlined above, leadership could reverse.

The above comment reflects the important micro aspect of managing a portfolio in these difficult times but, in this review, we want to look at the macro picture, in particular the issues for the main asset classes, bonds and equities.

As our previous reviews have indicated, we have not favoured bonds even when expectations of lower interest rates and inflation were widespread. The reason for this was concern about the levels of government borrowing and the consequent new issuance demands on the market as well as about creditworthiness, not in terms of default prospects but, rather, credit rating agencies’ downgrading of some sovereign debt. The Iranian conflict has brought into focus these problems and some countries’ specific weaknesses. We normally, in these reviews, concentrate on benchmark ten year government bond yields but in this section, we will look across the spectrum of maturities where the pressure on yields is evident even at the two year maturity level. If we look at the change in two year yields at the time of writing and for the year to date, we see pressure almost everywhere. In the USA, the yield has risen by 0.31% to 3.79%, in the UK by 0.53% to 4.22%, in Germany by 0.44% to 2.55% and in Italy by 0.56% to 2.75%. Going out to ten years’ maturity, the changes are less severe overall but with notable problem areas. So, whilst the gross redemption yield on ten year US Treasuries has risen by 0.12% to 4.29% and risen by 0.17% on German government bonds to 3.02%, it has risen by 0.33% in the UK to 4.80%, by 0.26% in Italy to 3.80%. In Japan, the rise has been by 0.37% to 2.42%, very high by historical standards for that country. It’s a similar order of change in the thirty year bond market. The gross redemption yield on the US Treasury bond has risen by 0.06% year to date to 4.90%. On the UK Gilt the yield has risen by 0.21% to 5.46%, on the Italian bond by 0.23% to 4.63% and on the Japanese government bond by 0.22% to 3.59%. These yields are taken ten days into the April quarter as the review is being finalised.

The magnitude of these rises tells a story albeit, in the case of the USA a nuanced one. Working on the Economist Intelligence Unit’s 2026 estimate, it will have a budget deficit of 6.5% of GDP in 2026. Its outstanding government debt as a percentage of GDP is around 124%. For most countries, this would represent a serious economic problem, at worst a creditworthiness issue and certainly a constraint on growth because of the interest rate burden. However, the threat is nuanced because as

the US dollar is the world's largest reserve currency and there is always a demand for US dollars for trade or foreign currency reserves, it can temporarily escape the consequences which other currencies could face. The USA also has an advantage at the present time of being a net total energy exporter. However, it can't go on indefinitely running budget deficits of this size without consequences in terms of the interest rate it has to pay on its debt or currency weakness. Whilst President Trump has been keen to see the US dollar weaken, even for a relatively closed economy like that of the USA it has to have some limits before currency weakness becomes self-fulfilling. At the moment, it might be considered a kind of petrocurrency. Whilst economic forecasts made at this early stage of the year are always subject to change as the months go by, this is even more the case now given the uncertainties over Iran. The OECD's latest Interim Economic Outlook, published in March, forecasts growth of 2.0% in 2026 and 1.7% in 2027. These growth rates are better than those of any other developed economy. They are not nearly high enough to stop the country's outstanding debt from growing as a percentage of GDP but with the country's strong energy advantage, it is in a better position than most other developed economies. This, we think, means that, in relative terms, the US Treasury market is in better shape than might be expected from the above budget deficit and outstanding government debt ratios but, in absolute terms, if inflation rises through first and second order effects arising from energy price increases, US Treasury bond yields should still be expected to continue their rise.

Whereas, as we have described above, the USA has some relative financial advantages at this very difficult time, it is hard to find any meaningful ones for the UK. In the sell off in the international government bond market, the UK has been one of the ones most affected and it is not difficult to see why. Unlike the position in the USA, the UK is particularly vulnerable on the energy front being very dependent on overseas supplies so the Iranian crisis could not have come at a worse time for the UK. It has a heavy reliance on natural gas for power generation and home heating and a lack of gas storage. Apart from physical supply concerns, the inflationary effect may be particularly negative for the UK. The UK has to pay more to borrow than any other G7 economy. Its nearest rival is the USA but the UK has to pay approximately 0.5 percentage points more for ten year money than the USA. One of the reasons is that the UK has relatively high inflation. In its latest report, the OECD projects inflation at 4.0% for the UK this year and 2.6% next year. Only the USA is projected higher for 2026 but, in 2027, the UK is the highest along with Germany. Because the UK is treated with suspicion in the international bond markets, the Chancellor of the Exchequer has been keen to stress her adherence to her fiscal rules. Because the budget deficit represents the difference between two very large amounts (government revenue and government spending), a swing in one side can have a big impact on the final outcome. Whilst the Chancellor may have thought she had plenty of fiscal headroom, her statement in March was made at almost the exact time that hostilities broke out in Iran and that uncertainty itself should have cast some doubt on the economic and fiscal forecasts. There are a number of problems for the UK. The best way for a country to bring down its debt levels or reduce its budget deficit is to raise its economic growth rate which should increase government revenue through taxes on income and spending and reduce it on some items of expenditure. Yet the OECD sees the UK being hit particularly hard by the current situation and is forecasting growth of just 0.7% this year and 1.3% next year. The Economist Intelligence Unit is forecasting a budget deficit of 5.0% this year which is a dangerously high figure. One of the UK's problems, which was thought to be an advantage at one time, is the size of its outstanding index linked gilt issuance, around a quarter of the total. With Retail Price Index inflation likely to rise, this presents a particular problem for the UK. When we have discussed the USA in past reviews, we have emphasised that investors should play the ball and not the man, in other words they should look at what President Trump does rather than what he says and not become fixated by him as a person given the strong feelings that he elicits. One of the positive features of his time in office is that he is generally pro business, albeit with some unusual features and he is pro investor. This can be set against bad policies like tariffs but the point to make is that there is a contrast between official attitudes to business and investors in the USA and UK. This is important. As an investment manager, we do not give any political views, that is not our business and not what clients would expect. However, it is also important to look at the economic consequences of political actions insofar as they affect the investment landscape. In the UK, the

burden of taxation has continued to grow and there comes a time when it is self-defeating in that it stymies growth and in doing so affects the nation's finances in the way described above. It would be fair to say that policy decisions made recently in the UK have had a negative effect on economic growth and inflation, for instance the increase in employers' National Insurance contributions, higher minimum wages, especially for young people, business rates and the Employment Rights Act which will make it more expensive and risky for employers to take on staff. Unemployment is therefore expected to continue to rise and with it the costs for the state. We emphasise that we are not making political points, merely outlining economic consequences with which not many will disagree. The point of this is to show that it is difficult to think of many catalysts for growth which will help to lift the UK out of an unpromising economic trajectory. The other deficit is the current account deficit running at about 4.1% of GDP. In 2017, Mark Carney, now Prime Minister of Canada but then Governor of the Bank of England, is credited with saying that Britain depends on the "kindness of strangers". This was in the context that foreign investors could potentially lose their appetite for British debt. This is very true now when the UK is facing a multiplicity of problems including energy vulnerability, above average inflation but below average growth prospects and the large deficits (budget and current account). An additional problem is political instability with speculation about the Prime Minister's position after the May local elections. Many economists believe that the way to improve government finances, given that taxation has reached the limit of what is bearable, is to cut public spending but, although the UK government has a large majority, it does not have the support of its MPs to tackle public spending. The concern for some investors is that a new Prime Minister and Chancellor might want to turn on the spending taps. So, we feel that the UK bond market is facing a very difficult problem which could be exacerbated by currency weakness given the large current account deficit which assumes greater importance in these febrile times.

Looking at Europe, it is estimated that the EU relies on net imports for 57% of its energy needs. Countries will be affected in different ways but there might be a price shock and perhaps some shortages given that Qatar is an important LNG supplier and whose exports pass through the Strait of Hormuz. The price shock alone is likely to stop any prospect of further ECB interest rate reductions and the trend may well be upwards because of the effect on inflation. In its latest economic outlook, the OECD is projecting inflation of 2.9% in Germany this year and 2.6% next year. For France, the second largest EU economy, inflation is forecast to be 1.8% this year and 1.5% next year whilst for the third largest economy, Italy, the figures are 2.4% and 1.8%. But it is the position in Germany which will carry the largest weight in the ECB's deliberations so an increase in interest rates is quite possible. We have mentioned in previous reviews that the fiscal position of France is a concern. This is not only because it has a large budget deficit, estimated by the Economist Intelligence Unit to be 5.0% of GDP this year but a large outstanding level of public debt standing at 113% of GDP. As in the UK, but for different reasons, it has proved almost impossible to rein in public spending because there is little appetite amongst the public to accept action on this and, politically, all except what might be termed the moderate parties are opposed to spending controls. The plan to raise the pension age from 64 to 62 has been laid aside to get the budget approved. The recent local elections showed a modest sign that more centrist parties were beginning to recover but it remains the situation that significant change is needed in France if the country's finances are to be restored. The government bond market shows those concerns. France has to pay considerably more for its money than Germany, about 64 basis points more for ten year money. Its relative position in the eurozone bond market has improved. Until recently, it had to pay more for its money than Italy and Greece, although the yields on ten year government bonds are now higher in both those countries. Whilst France's finances are in very poor shape its relative energy position is better than others because of its nuclear capacity. Greece and Italy, however, have higher dependencies on Gulf energy with Greece importing 30% of its energy from the region. The eurozone bond market does not have all the vulnerabilities of the UK government bond market. For example, the eurozone runs quite a large current account surplus but France's finances are a concern and they have the power at a later stage to cause problems for the eurozone bond market.

Whilst it is a vast economy, Japan has often slipped under the radar because of the lack of significant issues facing it in contrast to the USA, UK and Europe but that is no longer the case. Well before the Iranian conflict developed, there had been significant moves in the bond markets as investors began to worry about inflation, the opposite of deflationary concerns in the past. The election of a new Prime Minister, Sanae Takaichi, promised a more expansionary fiscal policy with a significant economic stimulus including an eye catching consumption tax holiday on food and beverages, reducing the tax rate to nil from 8%. This has yet to take place. But the issue which has always been there but not overexercised bond investors has been the level of outstanding Japanese public debt to GDP at around 230%, by far the largest level in the G7 economies although a substantial amount of that is held internally with the Bank of Japan holding over half of outstanding government debt. Concerns about inflation, although at 1.3% it is low by international standards, but forecast by the OECD rise to 2.4% this year and 1.9% next year and the build up of debt have caused big rises in Japanese government bond yields. The 40 year bond yield having broken through 4%, an extraordinary level for this market. The current crisis is particularly bad for Japan as the country's energy self sufficiency level is very low at a little over 15%. On the plus side, Japan has a very strong external position being the second largest net creditor nation after Germany with net overseas assets at the end of 2024 amounting to the equivalent of US\$3.7 trillion. Whilst not enjoying the highest credit rating because of its substantial debt to GDP ratio (A+ by S&P, A1 at Moody's and A at Fitch) and also longer term because of its poor demographic situation, its position is internationally relatively strong and without the concerns affecting some other countries.

Looking at regions most affected by the current energy crisis, some countries in Asia (besides Japan, South Korea, for example) Africa and Latin America will be affected from the supply side but even those countries with good self sufficiency, the USA, for example, will be affected by the inflationary impact as it feeds through to food and fertilisers amongst other many other items.

Coming out of Covid, central banks tended to underestimate the effects of the inflationary aftermath and when inflation fell back to low levels, they dismissed the start of the subsequent rise in inflation as "transitory". They are unlikely to repeat this mistake this time because even if inflation falls back whenever the current crisis ends, the concern will be that inflationary expectations have become anchored in people's minds, affecting, for example, wage negotiations which could then feed through to prices which is what happened before.

So, how can investors make sense of the current situation? We would draw a distinction between fixed interest investments and equities. As long term investors we can draw some encouragement from the speedy recovery in equity markets after recent setbacks for unexpected reasons, Covid, for example, as well as on their long term performance where even the effect of the Global Financial Crisis in 2008 on markets now starts to fade on the long term graph, painful as it was at the time. Certainly, those who stayed the course have been well rewarded with substantial gains since then. The "time in the market" rather than "timing the market" context emphasises the difficulty of trying to time the exit from markets and re-entry. Work shows that the former policy is more profitable than the latter one. We do, however, have to be realistic about the effects of the Iranian situation on the world economy. Inflation will rise as energy, food and other essentials rise in price and this will reduce purchasing power and slow down economic growth or, at worst, cause a recession. Because central banks were caught out after Covid by what turned out not to be a "transitory effect" of price rises after they had fallen back, they are likely to be more cautious this time so interest rate rises if they occur, not only reflect higher inflation but also try to ensure that higher inflationary expectations do not become embedded in, for example, pay settlements. As economic growth slows, we can expect corporate profits to be affected and, in some cases, company dividends. Assuming an outcome of the present crisis within reasonable expectations, economic growth should then be expected to recover although by how much is difficult to estimate. Does this warrant a reduction in equity positions for long term investors? We think not, because market rebounds as we have seen can be sudden when sentiment changes. Given the seriousness of the current situation, equities can be considered to have held up relatively well.

We cannot, however, be as sanguine about the fixed interest markets for the reasons which we have discussed including weak and worsening fiscal positions, the effect of the Iranian conflict on energy prices and, hence, inflation and the reaction of central banks to rising inflation and an inability to control public spending. The latter problem, whilst not confined to the UK and France, is serious for both because trying to control budget deficits by raising taxes is self defeating in terms of growth thus threatening a vicious spiral of worsening fiscal positions. Whilst we have flagged concerns about France and they are still very valid, at least the country has a better energy position. We see the UK as particularly vulnerable at the moment to economic and political events. As always, we see geographical diversification being of paramount importance and this is particularly relevant for sterling based investors. Whilst the big UK multinationals may be little affected, more UK focused companies face a difficult time. Signals are important for investors and attitudes to business and wealth creation in the UK are not comforting ones for direct or indirect investors.

The news on Iran changes from day to day, largely depending on President Trump's latest messages but it is interesting to note quite a strong recovery in equity prices since the quarter end whilst bonds are struggling. This might be an out of date observation by the time our clients receive this review but it does chime with what has happened after relatively recent market upsets such as Covid and President Trump's tariff announcements last April. Whilst we have been allowing for cash received from dividends, where it is not paid out, to build up for opportunistic purchases, if there is a really significant setback, we are not reacting to current events by changing our strategy which is to favour equities as an asset class and be very cautious about fixed interest securities.

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