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ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

This has been an unusually strong quarter for international equities, primed to a large extent by the excitement around AI, which we discuss in this review. Nearly every market participated in the rise. Fixed interest securities improved too, although not by the same amount, as hopes of interest rate cuts rose and materialised in some cases. Sterling showed some weakness during the quarter with investors focused on the forthcoming budget. Gold enjoyed an exceptionally good quarter, buoyed by its status as a store of value in uncertain times.

The tables below detail relevant movements in markets :

International Equities 31.07.25 - 31.10.25

Total Return Performances (%)				
Country	Local Currency	£	US\$	€
Australia	+1.5	+4.00	+3.2	+2.4
Finland	+15.5	+17.3	+16.5	+15.5
France	+4.3	+5.9	+5.2	+4.3
Germany	-2.3	-0.8	-1.5	-2.3
Hong Kong	+3.9	+5.7	+5.0	+4.1
Italy	+5.6	+7.3	+6.5	+5.6
Japan	+15.3	+13.5	+12.6	+11.7
Netherlands	+19.9	+21.8	+20.9	+19.9
Spain	+12.2	+14.0	+13.2	+12.2
Switzerland	+3.3	+5.2	+4.5	+3.6
UK	+7.2	+7.2	+6.4	+5.5
USA	+8.2	+9.0	+8.2	+7.3
All World Europe ex UK	+5.1	+6.9	+6.1	+5.2
All World Asia Pacific ex Japan	+11.9	+12.2	+11.4	+10.5
All World Asia Pacific	+13.0	+12.6	+11.8	+10.9
All World Latin America	+10.3	+14.8	+14.0	+13.0
All World Emerging Markets	+10.8	+11.5	+10.7	+9.7
All World	+8.7	+9.4	+8.6	+7.7

Source : FTSE All World Indices

FTSE Actuaries UK Conventional Gilts All Stocks Index (total return): +2.4%

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

	31.07.25	31.10.25
Sterling	4.57	4.41
US Dollar	4.37	4.08
Yen	1.55	1.66
Germany (Euro)	2.69	2.63

Sterling's performance during the quarter ending 31.10.25 (%)

	Quarter Ending 31.10.25
US Dollar	-0.7
Canadian Dollar	+0.4
Yen	+1.9
Euro	-2.0
Swiss Franc	-2.2
Australian Dollar	-2.4

Other currency movements during the quarter ending 31.10.25 (%)

	Quarter Ending 31.10.25
US Dollar / Canadian Dollar	+1.2
US Dollar / Yen	+2.2
US Dollar / Euro	-1.0
Swiss Franc / Euro	N/C
Euro / Yen	+3.2

Significant Commodities (US dollar terms) 31.07.25 - 31.10.25 (%)

	Quarter Ending 31.10.25
Oil	-8.6
Gold	+20.6

MARKETS

- A strong overall international equity performance.
- In local currency terms, particularly strong performances from Japan, Asia Pacific ex Japan, Latin America and Emerging Markets. That pattern is broadly reflected in sterling adjusted performances.
- In local currency terms, there were underperformances, although still positive ones, from Australia, All World Europe ex UK. That, too, was broadly reflected in sterling adjusted terms.
- In the bond market, using ten year government bonds as a benchmark, prices improved, so yields fell with the exception of JGBs.
- In the foreign exchange markets, sterling was generally weaker, falling, in particular, against the Australian dollar, Swiss Franc and euro, although it improved against a weak yen.
- In the commodity markets, oil fell back but gold enjoyed another strong quarter.

ECONOMICS

The performance of international equity markets, if not bond markets, has surprised many observers who, on the face of it and quite naturally, would have equated the serious geopolitical events and problematical economic background with a less positive movement in equity prices over the calendar year to date. Certainly for equities so far this year that seemingly logical conclusion has broken down. Why might that be?

Whilst there are many significant economic problems which we have discussed at length in previous reviews this year, the economic outlook, whilst unremarkable by previous standards, is not disastrous. There are very significant problems for a number of countries, mainly related to debt levels, but if we look at the latest IMF economic forecasts they do not provide strong enough evidence that a recession is on its way. This is not to say that there will not be a recession but the chances appear to be diminishing. It was that prospect of a recession which informed the opinion of many bears of the equity markets at the beginning of 2025.

In its latest World Economic Outlook, published in October, the IMF is projecting world economic growth at 3.2% for 2025 (3.3% in 2024) and 3.1% in 2026, so little change between the years. For the Advanced Economies, the projections for 2025 and 2026 are the same, 1.6%, against 1.8% in 2024. The stand out economies in this category for both years are the USA and, within the eurozone, Spain. For the USA, growth projections are 2.0% for 2025 and 2.1% for 2026, whilst for Spain, the respective figures are 2.9% and 2.0%. But for the eurozone as a whole the growth expected this year

is just 1.2% and 1.1% next year. The figures for the three largest eurozone economies are noticeably weak with Germany at 0.2% for this year and 0.9% next year, France at 0.7% and 0.9% and Italy at 0.5% and 0.8%. The figures for the UK are 1.3% for both years and for Japan 1.1% this year and 0.6% next year. Emerging markets and developing economies show better growth prospects, although lower than sometimes in the past, with 4.2% growth expected for this year and 4.0% for next year. Within that, the figures for China are 4.8% and 4.2% and for India 6.6% and 6.2%.

Whilst these projections for growth are underwhelming, they are not enough to undermine the case for equities but the low growth projections for some economies, and we can mention here France, Italy, Japan and the UK, are a cause for concern, particularly in the context of the bond markets as these countries need to borrow heavily to finance their budget deficits. The best way for countries to improve their fiscal position is to achieve higher growth rates which should boost tax receipts. We did dwell at some length on this in our September review because we believe that one of the major threats to a number of countries is the state of their public finances. We discussed, in particular, issues around the USA, UK, France and Japan. The first three have very large budget deficits as a percentage of GDP, with the USA at around 6.4%, the UK at 4.8% and France at 5.8%. Japan's at 2.3% is unusually low by its past standards. For the moment, we think that we can treat the USA differently. In normal circumstances such a large budget deficit would spell trouble for the bond market and the currency as investors demanded higher interest rates to fund its deficit, particularly as its outstanding public debt to GDP ratio stands at around 124%. In this context we cited the USA's "exorbitant privilege" arising from the US dollar's position as the world's largest reserve currency which means that there is always a demand for US dollars whether for trade or as part of other countries' foreign exchange reserves. This means that the normal constraints on governments which have large budget deficits and outstanding public debt levels are not necessarily applicable to the USA at the moment. So the USA can follow an ultra loose fiscal policy which is keeping the US growth rate above the average for Advanced Economies at present. The US dollar has taken some of the strain, something that President Trump wants to happen to improve US competitiveness. The dollar's weighted index has declined by 7.9% so far this year, although this is off its lowest level. So, whilst the USA at the moment seems to be getting away with its idiosyncratic economic policy because of the special position of the US dollar, the levels of the budget deficit and outstanding public debt represent a future risk with the potential to turn into a crisis. Although the US and other equity markets are performing well at the moment, we need to be realistic about the threats which the US deficits pose to the world economy but we think, as we indicated in our September review, that the greater specific risks lie elsewhere, particularly in France and the UK which do not enjoy the US dollar's "exorbitant privilege". We will not dwell on Japan in this section of the review because although it has an astronomic level of outstanding public debt as a percentage of GDP, around 237%, a lot of that is held internally including by the Bank of Japan which holds around 52% of Japan's total government debt. In passing, it is worth noting that the Japanese equity market has been fired, at least temporarily, by the election of Sanae Takaichi as the new Prime Minister. She has a reputation for being market friendly and growth orientated. The stimulus package announced so far includes the abolition of the gasoline tax, support for small and medium sized enterprises and investments in growth industries like AI and semiconductors.

Whilst the UK's fiscal position is not as serious as that of France, it is not good and has been deteriorating. We will not go into the detail which we did in our September review, suffice it to highlight that neither country is able to get a grip on public spending and for different political reasons there is not much prospect of that happening so the emphasis on addressing the gap between public spending and taxation revenue falls on taxation, mainly companies and those who are perceived as wealthy individuals with the inevitable negative consequences for economic growth as a doom loop is threatened. By doom loop, economists mean that the negative effect of higher taxation on companies and individuals reduces demand in an economy and adversely affects growth and taxation revenues, thereby exacerbating the fiscal deficit. The contrast with the USA in this respect is stark. Although the fiscal position in the USA is very serious, as described earlier, the stance of government

policy is pro business both in the field of taxation and deregulation. The messaging is broadly positive for business and investors but negative in parts of Europe, the UK and France being two examples.

So, our comments are nuanced. The outlook for world economic growth is just about acceptable although the full consequences of US tariffs are yet to be felt and we cannot yet be fully sure what these will be. Within the overall economic outlook for the world economy, the relative advantage lies with the USA and probably some emerging markets against parts of Europe including the UK. However, a universal problem is debt in the form of budget deficits and outstanding public debt. Although fixed interest markets have improved as this is written, with the Bloomberg Global Aggregate Total Return Index returning about 7.6% so far this year in US dollar terms, the fundamentals for bonds look poor given the supply which will be on offer to fund governments' ever increasing needs. Deficits are also linked to creditworthiness. As an example S&P, in October, cut France's credit rating to A+ from AA-. The country's fall from grace in the pecking order of eurozone credits sees the country's ten year government bond yield at 3.43%, at the time of writing, higher than those on Italian, Spanish, Portuguese and Greek bonds. The warning signs are therefore there and, in a currency union such as that of the euro, there is always the danger of contagion. As we mentioned earlier, how the French deficit problem is addressed is important. Because of the inconclusive outcome of the last parliamentary election, there is very little common ground and none for addressing the size of public spending. Where there is some measure of agreement is in raising taxes on large companies and on wealthy people, neither of which sends out a good signal to investors. The UK appears to be moving that way with the "broadest shoulders" likely to be hit with higher taxes in the forthcoming budget although the Chancellor's latest hints suggest wider pain.

Within our equity allocation therefore, the USA remains our favoured area. It is more pro business and more pro investor and its productivity record is much better than that of, say, the UK and Europe. It is therefore likely to continue to see superior economic growth to that which we will see in Europe and the UK. This is despite the negative consequences of the President's tariff policies which will raise inflation and slow down growth but we repeat that we are considering the relative attraction of the USA compared with some other developed countries. We might add that a more positive attitude to M & A activity is apparent, raising the level of "animal spirits" amongst businesses and investors.

This then is a briefer and more basic version of what we were saying about the attractions of bonds and equities in our September review and summarises why we prefer the latter to the former whilst emphasising that this is a relative position which may be summarised as saying that, in our opinion, fixed interest securities have little going for them whilst there are at least some positive drivers for equities. One of those drivers of markets this year is the AI sector which has attracted enormous amounts of actual and potential investment and has been an important reason for the advance in equity prices this year, as we will discuss below.

So, we now want to look further ahead to what AI may bring to investors. Although non US investors have seen their returns trimmed by the weakness of the US dollar, certain sectors of the market have demonstrated strong relative and absolute performance so far this year, namely S&P 500 Communication Services and the S&P 500 Information Technology Indices with US dollar returns at the time of writing of around 26% and 29% respectively. So, it is fair to say that AI fever has concentrated the performance of the US equity market so the question arises, is this a bubble? First of all, some figures. Gartner Inc., the research and advisory firm focusing on business and technology topics, forecasts that worldwide spending on AI will, in total, amount to US\$1.5 trillion in 2025 and US\$2 trillion in 2026. JP Morgan estimates that AI related capital expenditure contributed 1.1% to US GDP growth in the first half of 2025.

In trying to answer the question about a bubble, the answer is, of course, that we will not know until after the event, but one positive argument for it not being a bubble is that the larger companies involved in different parts of the AI phenomenon have much stronger financial positions than many companies involved in the dot.com bubble in the early part of this century so, if there is significant

market rotation to more defensive stocks, it will not be because these very large companies' financial positions are in doubt, but, rather, that they stand on excessive ratings relative to their growth prospects. But, for long term investors, it is important to consider the implications of AI for the companies in which they invest and the wider economy.

One important aspect will be the cost benefits. Governments in a number of countries are becoming increasingly interventionist in the labour markets through setting minimum wages and increasing employment regulations, for example, or by taking measures which add to business costs, an example being the steep increase in UK employers' National Insurance contributions in last October's budget. This, and other measures, have adversely affected many companies but we could relate this issue to many other countries. As an investment manager, our interest has to lie in the economic and behavioural implications of these types of government actions. One is on fairly safe ground in saying that companies will use AI to mitigate these additional costs where possible, an unintended but perfectly foreseeable consequence of government interventions. Clerical jobs could be affected by the ability of AI to complete routine jobs more quickly and, in manufacturing or the service industries, automation will replace certain jobs. This is, of course, already starting to happen. This is not only a function of labour costs becoming too high for some companies to compete where they do not have sufficient pricing power to offset these but also where there are shortages of candidates for jobs, perhaps because of demographic changes. It is interesting to note that in Germany, which is facing such difficult demographics, the government is considering tax incentives for people to work on after retirement age. Elsewhere, some countries in Eastern Europe, East Asia (Japan, China and South Korea, for example) and Europe (besides Germany, Italy, Spain and Greece, for example) also face deteriorating demographics. So, apart from any cost saving and risk reducing advantages which AI can bring, the existence of a shrinking labour force will also hasten the adoption of AI where possible.

So, on the cost front, companies will look to mitigate increased employment costs where possible by using AI to perform tasks previously undertaken by humans. This, in turn, should help to protect and even enhance companies' profitability. In what other ways may companies benefit? Linked with the point just made, there are several ways in which productivity may be improved. One obvious way is that it can operate 24/7. Another is that, if everything is prepared correctly, there should be zero mistakes. Mistakes can take time and money to rectify. In customer facing businesses, responses should be more accurate and quicker thus enhancing customer relations based on higher standards of service with digital accessibility providing one of the cost savings detailed above but also more accuracy and speed of service. One example of this has just been announced by the giant US retailer, Walmart. It is forming a partnership with OpenAI to let shoppers buy its products directly with ChatGPT. Within the next few months, US based ChatGPT users will be able to buy Walmart products instantly and directly in ChatGPT, the exception being fresh food. So, customers will no longer have to use a search bar and browse along lists of terms, according to Walmart's CEO, a sign of the future death of the keyboard, perhaps. That this announcement pushed up the share price of such a vast company on the day it was announced shows how investors value a competitive advantage, which AI may bring. Businesses should also find that, as a result of being able to analyse large amounts of data and do it more quickly, their decision making will be better informed making it likely that this will improve the company's prospects. In the field of research, and the pharmaceutical industry particularly comes to mind, vast amounts of data can be assimilated more quickly, hopefully leading to an acceleration in the rate of medical advances. This can be expected to enhance the attraction of the sector from an investment point of view at a time when it is under political pressure to cut prices but if it leads to a healthier population that would not only help the individuals but the companies which employ them, not to mention the costs of healthcare to governments. Of course, a lot of these thoughts may need to be fine tuned in the light of experience but it is very likely that companies will gain on the costs front through further automation of client and manufacturing processes. But not all companies will benefit as there will be losers in the process.

What about the costs and benefits for governments? Perhaps the outcome is more nuanced here. Certainly, there should be direct cost savings. Numbers of employees in the public sector in some countries, including the UK, have been rising, resulting in pressure on public finances. Naturally, governments, including that of the UK, will look at AI as a way of reducing the number of people employed in the public sector and improve low rates of productivity. Governments will also explore if AI can increase efficiencies, say in the area of procurement and of analysis of data to help decision making. There is something called the 30% rule which suggests that AI does most of the repetitive work, 70%, with humans doing the remaining 30%. For students, it is the reverse. The remaining work requires human expertise, context and oversight. If that is correct and, given the problems which governments have in controlling public expenditure, pressing ahead with the exploitation of AI seems essential. However, there is bound to be opposition from those whose jobs are threatened, a particularly sensitive issue in the public sector. Nevertheless, with governments facing such difficult fiscal problems, there is an inevitability about the advance of AI as a cost containing measure, essential when many countries' public finances are so stretched. In the private sector, it is worth noting large job losses in some of the big technology companies like Microsoft, Salesforce and Amazon as they use AI and automation to cut costs at a time when they are spending billions on AI.

However, the rapid development of AI could cause social problems if a large number of people come on to a labour market which cannot offer them jobs which AI has taken over. Besides the problems for individuals, frustrated at being unemployed with the social problems which arise from this, the resulting payment of unemployment benefits will weaken governments' finances although the interaction with direct cost savings from employing fewer people means the outcome is uncertain. On the positive side, one would expect a faster economic growth rate which is usually associated with productivity increases and the prospect of new jobs being created. In one specific area, healthcare, it is possible to see AI bringing significant benefits not only for individuals but for governments' finances. On the cost side, substantial amounts of clerical work can be processed much more quickly and effectively and, in the field of medicine, faster analysis of trial data should improve the availability of new drugs and therefore treat people more effectively. The advancement of weight loss drugs is an example of what breakthroughs can do for people's health.

What we have tried to do is to link the short term boost which AI, through huge current investments, is giving to the world economy, but particularly that of the USA, at present, and rationalising at least part of the USA's and other stock markets' strength to the AI phenomenon and then looking past that to a future where AI will affect companies and their shareholders in the ways we have described, firstly on the cost side, and then on the demand side. Of course, these can only be preliminary thoughts and, no doubt, there will be many surprises in the final outcomes but we have to feel that these will be positive for investors. In this review, we have concentrated mainly on the financial side and not gone into detail on the non financial side, such as privacy issues, data manipulation and misuse of data. They may, in future, impinge on the financial and economic side but, for the moment, we have avoided discussing these aspects.

Are we in an AI bubble? Shares have performed strongly despite the uncertain geopolitical and economic situation and AI has attracted a lot of investors but, if we are correct in believing that AI will have positive long term outcomes for many companies and investors start to concentrate increasingly on these prospects, it seems unlikely that they will want to divest from the sector which can provide the products which can make this possible.

In the short term, we recognise that there are some risks to equities arising from their positive performance so some negative quarterly performances for portfolios may be experienced. That is why, where possible, we are allowing cash to build up from dividend payments. This, however, is in the context of a largely fully invested position and, on a meaningful setback, we would then be able to invest opportunistically. As an asset class, for long term investors, we continue to favour an

international equity exposure, with the USA remaining our favoured market because of the wide range of companies available to investors and, at least for the present, a much more pro business pro investor background. Of course, we recognise the negative aspects, especially on the tariffs which the President has imposed, but the contrast in attitude towards business and success compared to the UK and parts of Europe has to inform indirectly investors' thinking.

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