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Quarterly investment commentary March 2025

January saw the return of Donald Trump to the White House, setting the stage for a politically and economically volatile start to 2025. His first weeks as president proved unsettling for markets and international relations, having unveiled plans to fold Canada and Greenland into the United States (US) and impose hefty tariffs on key trading partners.

The US Federal Reserve (Fed) left interest rates unchanged in the first quarter, while the Bank of England (BoE) trimmed its rate once and the European Central Bank (ECB) cut twice.

Inflation in the UK and US rose in January before easing back in February. EU inflation ticked up slightly in January before dipping in February, with predictions it will fall further in March.

The US stock market was in relatively healthy territory in the weeks either side of Donald Trump's second inauguration on 20 January. Strong policy action and rhetoric from the Oval Office then started to take a toll and markets eased back in late February, as investors grew cautious. The first three months of 2025 were more of a mixed bag for the UK, while Europe recorded a strong start to the year.

£ UK economic update

Chancellor of the Exchequer Rachel Reeves presented her first spring statement on 26 March against an economic backdrop of rising global uncertainty, increasing borrowing costs and weaker growth forecasts. Reeves has committed to using the autumn budget to make major policy announcements, so expectations were low that any significant changes would be unveiled in the spring statement. The two biggest headline grabbing changes were cuts to the UK's welfare budget and an increase in defence spending.

Inflation climbed unexpectedly to 3% in January, up from 2.5% in December, to reach a 10-month high. It dipped to 2.8% in February, but expectations are that inflation will rise during the second quarter before cooling in the second half of the year.

The BoE's Monetary Policy Committee met in February and March. Its first meeting saw seven members of the committee vote to lower the UK interest rate to 4.5% from 4.75%. Two members were in favour of a larger cut to 4.25%. Sentiment in March was much changed, with eight members voting to keep the interest rate at 4.5%, while one member favoured a cut to 4.25%.

Uncertainty is the only certainty in 2025 so far. Geopolitical tensions and domestic economic challenges are weighing on markets and investors. That said, the first quarter of the year saw respectable growth for the more internationally facing FTSE 100 Index, which reached a record high in March. The same cannot be said for the domestically focused FTSE 250, however, which ended the quarter at its lowest point in nearly a year.

What's happened around the world?

United States

A "tide of change" was what President Trump promised during his inaugural address and that is what he has delivered. With both the House of Representatives and Congress under Republican control, he swiftly moved forward with sweeping changes, which are too numerous to mention but include tightening immigration controls, withdrawing from climate agreements and imposing higher tariffs.

January saw inflation tick up to 3%, its highest level since June 2024, having been steadily rising since September. It dipped to 2.8% in February, which was lower than had been expected. The path inflation is expected to take in 2025 is far from clear, as there is little agreement about what impact the threatened tariffs will have on domestic prices and consumption.

The Fed chose to take no action during its meetings in January and March. Fed chair Jerome Powell said the Federal Open Market Committee (FOMC) was "not in a hurry" to make changes amid the elevated levels of uncertainty. The US interest rate, which sits in a range, has been at 4.25%-4.5% since the committee's December meeting.

US stock markets were buoyed by Trump's victory in November and started 2025 at record levels. Early enthusiasm waned, however, with key indexes falling in February amid growing rhetoric around tariffs. The S&P 500, Nasdaq and Dow Jones Industrial Average all ended the quarter down, compared with the start of the quarter, with the S&P 500 and Nasdaq retreating to levels last seen in September 2024.

Europe

Elections in February saw German Chancellor Olaf Scholz's Social Democrats come in third (with 16.4% of the vote) behind far-right Eurosceptic party Alternative for Germany (20.8%) and the conservative Christian Democrats (28.5%). Led by Friedrich Merz, the Christian Democrats are on course to form a coalition with the Greens and Social Democrats, with Merz set to replace Scholz as chancellor.

In France, the leader of the National Party, Marine Le Pen, was banned from running for political office for five years. Alongside others, she was convicted of embezzling EU funds at the end of March. Fellow populist politicians across Europe spoke out against the verdict, which Le Pen is appealing.

The ECB lowered rates twice in the first quarter, taking the number of cuts since June 2024 to six. Much like the US and the UK, inflation across Europe reached its lowest point last summer before steadily creeping up during the second half of the year. In January it was 2.5%, dropping to 2.3% in February. The expectation is it will fall to 2.2% in March.

The start of 2025 saw the Euro Stoxx 50 reach highs last seen in the first quarter of 2000. January got off to a particularly strong start before easing back as the geopolitical environment became more volatile.

Asia Pacific

The first quarter of 2025 proved relatively steady for Chinese stock markets despite the threat of tariffs by the US. China typically targets an annual inflation rate of 3% or higher but has reduced it to around 2% for 2025, which is the lowest target in more than 20 years. Inflation has not been at or above 1% since February 2023. Some progress was recorded in January 2025, when inflation rose to 0.5%, but it plummeted to -0.7% the following month.

The Bank of Japan raised its interest rate in January to 0.5%, marking its third increase in less than a year. Between January 2016 and March 2024, it was -0.1% before rising to 0.1% and then 0.25% in July 2024. The Nikkei 225 ended the quarter down compared with the start of the year, amid threats of tariffs targeting the country's automotive sector.

Emerging Markets

There seems to be no imminent ceasefire in the conflicts in the Gaza Strip or Ukraine, the latter of which entered its fourth year in February. US involvement in the war between Russia and Ukraine shifted during Q1, creating further uncertainty about how and when it will come to an end.

After a national election last summer saw Indian Prime Minister Narendra Modi's Bharatiya Janata Party (BJP) win far fewer seats than anticipated, three local election victories since have provided his government with a shot in the arm. The most notable was in February, which saw the BJP return to power in Delhi for the first time in 27 years. After the disappointing results in June, the latest wins are being seen as a reaffirmation of Modi's mandate.

Outlook

Tariffs look set to be the primary theme of Q2 2025, with President Trump using the economic measure to rectify what he views as an imbalance in world trade. His actions are highly likely to provoke strong reactions, especially from countries most impacted. Fluctuations in the stock market and rising prices in the US could also see growing domestic opposition to his tariffs.

This year is likely to see a substantial shift in international relations, which could result in long-established trade and defence agreements fundamentally changing.

What these developments will mean for inflation and interest rates is unclear. Early expectations for 2025 were two cuts by the Fed and four by the ECB. The BoE's path was less clear. Tariffs will invariably have an impact on prices, which will have a knock-on effect on inflation and dictate the pace at which central banks can bring down interest rates.

Further information about the economic outlook, including views and opinions on the financial markets, can be found at zurich.com/economics-and-markets/overview.

A long-term commitment

We believe it's important, where possible, to take a long-term view when investing. Looking back over the years, volatility has always been a feature of world stock markets, with each setback followed by a recovery – some taking longer than others.

The usual way to deal with volatility is to invest for the medium to long-term – a period of at least five to ten years. It's important to find the right product and invest in the right funds, and this depends on your investment objectives and attitude to risk. If either has changed, your adviser will help you review your investment to make sure it continues to meet your needs.

Although we don't give investment advice, we do offer a wide range of funds suitable for almost all investment objectives and attitudes to risk. We strongly recommend you speak to your adviser before making any changes to your plan.

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