

# INVESTMENT STRATEGY QUARTERLY

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# Letter from the Chief Investment Officer

## Breaking Records, Not Discipline

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Seventy years ago, a pub debate over the fastest game bird in Europe led to the creation of the Guinness Book of World Records. Oddly, the book didn't offer even a partial answer until its 36th edition in 1989. Since those humble beginnings, it has grown into a global chronicle of human extremes and curiosities. As it celebrates its 70th anniversary, the book's vast and varied records—from the tallest buildings to the most obscure talents—offer a surprisingly fitting metaphor for today's economic and financial landscape. Just as the book captures the unpredictable and wide-ranging nature of human achievement, markets today are navigating a similarly uncertain terrain: from the Federal Reserve's (Fed) next move and the path of interest rates, to ballooning deficits, to the question of which sectors will lead the next leg of the equity rally. Like the records themselves, the markets are full of outliers, turning points, and surprises. In this environment, the outlook becomes more than just a forecast—it's a strategic imperative for investors seeking to position portfolios amid volatility, dispersion, and the accelerating pace of change.

Some Guinness World Records are downright bizarre—like the man who ate an entire airplane over two years—while others are jaw-droppingly impressive, like Usain Bolt's running and Michael Phelps' swimming speed records. Just like these records, the US economy has its own mix of glory and perplexity. On the bright side, it remains the largest in the world, with consumer spending and household net worth at record levels, and business investment activity still healthy. But there's a flip side: with housing and car prices near all-time highs, just as they are in the UK, affordability is strained, the wealth gap continues to widen, tariffs are at the highest level in nearly a century, and the national debt is swelling, in common with the rest of the world. While these longer-term challenges are unlikely to derail the near-term outlook, we must keep them in mind for their long-term implications. For the remainder of 2025, we expect US growth to slow and potentially even stall, hindered by softer consumer spending, the 'digesting' of tariffs, cooling job growth, and continued weakness in the housing market. Activity across developed economies will remain pedestrian too. The good news? 2026 looks more encouraging with global and US GDP growth accelerating modestly, the latter to 2.0%. Stimulus measures, tax cuts, and the Fed lowering interest rates should help reignite consumer confidence and drive a rebound in economic activity.

In 2014, daredevil Nik Wallenda set a Guinness World Record by

completing the highest incline tightrope walk—670 feet above the ground. But even that feat might pale in comparison to the balancing act facing Federal Reserve Chair Jerome Powell. With economic growth slowing, job creation cooling, and inflation pressures mounting from tariffs, navigating these dynamics will be no easy task. Still, we believe any US inflation will prove 'transitory.' Tariffs typically cause a one-off price adjustment. With economic activity slowing and shelter costs—30% of CPI—moderating, inflation should ease. That's why we expect two more rate cuts in 2025 and at least one in 2026. And while there's been some concern about the future of Fed independence, we remain optimistic. We believe new Fed members will uphold the tradition of acting in the best interest of the US economy, even as they walk their own version of a high wire.

Some Guinness World Records are nearly impossible to break—others, like putting the most socks on one foot in 30 seconds or snapping the most selfies in three minutes, are surprisingly doable and often broken. Lately, the equity market has felt more like the latter. With 28 S&P 500 record highs already this year—on top of 35 in 2024—it's been a streak worth celebrating. Thankfully, this is one record that's meant to be broken. That said, after a 34% rally since the April lows and valuations now sitting in the 97<sup>th</sup> percentile, we expect fewer new highs in the near term as the market catches its breath.

Looking ahead, we remain optimistic. Over the next 12 months,

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we expect earnings growth to stay positive, economic momentum to pick up—especially with tailwinds from the One Big Beautiful Bill Act—and support from Fed rate cuts. Add in powerful secular trends like AI investment, defence spending, and electrification, and the bull market still has room to run. Our 12-month S&P 500 target is 6,900. However, with valuations already stretched, we see limited room for further P/E expansion, meaning earnings growth will need to do the heavy lifting.

From a sector perspective, the Guinness Book of World Records itself offers a great example of why we favour Technology. In 2024, it sold 1.7 million books—but its real reach came through digital channels: 11.1 million Instagram followers, 28.5 million on TikTok, and a total social media footprint reaching over eight billion people. That's the kind of transformation we expect to continue as the world embraces AI, robotics, and quantum computing. We also favour Industrials—benefiting from AI infrastructure, electrification, and reshoring—and Health Care, which remains a defensive growth play in a rapidly evolving world. When it comes to market capitalisation, we continue to favour US larger companies over their, in US terms, smaller counterparts (although still big by UK and European standards). While rate cuts from the Fed could provide a tailwind for smaller companies, we'd like to see a clearer improvement in their earnings trajectory before becoming more bullish. On the global front, we remain firmly in the US camp over other developed markets like Europe and Japan. Stronger economic and earnings growth support the long-term return potential of US equities, reinforcing our view that US exceptionalism is still very much intact, although those international markets retain their appeal for the holders of broadly diversified investment portfolios and are more lowly rated in stock market terms.

Unlike equities, which often grab headlines with record highs and dramatic swings, bonds are about steady performance over time and reducing overall portfolio volatility. Think of the Guinness World Records that require mental toughness and sustained effort—like the most consecutive days of running a marathon (366 days) or the most hours spent doing other endurance exercises. That's the bond market: slow, steady, and disciplined for the long term. Looking ahead, we expect the yield curve to modestly steepen. That means short-term interest rates like Treasury bills are likely to move lower as the Fed continues to cut rates, while longer-term yields, such as the 10-year Treasury, should stay in a range between 4.25% and 4.50%. Despite concerns that record levels of US debt would scare off buyers, demand for Treasuries remains strong both at home and abroad. With short-term yields starting to come down, this could be a good time for investors to consider moving cash into longer duration US bonds. From a sector perspective, we expect credit spreads to remain relatively stable. While the economy may face

some near-term headwinds, we believe those challenges will prove temporary, with growth likely to pick up in 2026. As a result, we continue to favour investment-grade corporate bonds and municipal bonds for their balance of income and quality.

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**“Stronger economic and earnings growth support the long-term return potential of US equities, reinforcing our view that US exceptionalism is still very much intact.”**

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It's fascinating that the very debate that sparked the Guinness Book of World Records took decades to be answered. But in investing, unanswered questions and vague strategies simply won't cut it. Timely insights are essential. That's why our goal, alongside your Wealth Manager, is to help you find clarity, build a strategy, and stay focused on achieving your personal financial goals. Sure, it's easy to get swept up in the headlines—the biggest, the fastest, the most record-breaking moments in the financial markets. But real success comes from consistency, not chasing the next flashy stat. A well-diversified portfolio, tailored to your long-term objectives, is what builds lasting wealth—not a one-hit wonder that's outpaced tomorrow.

And just like the Guinness Book has its share of records you wouldn't want to break, investing has its own cautionary tales: panic selling, chasing flashy trends, or not keeping your asset allocation consistent with your risk profile. Your Wealth Manager is there to help you avoid those pitfalls and guide you toward setting the kind of records that truly matter—your own. Whether it's retiring comfortably, funding a child's education, or leaving a legacy, let your Wealth Manager be your coach, your guide, and your champion in helping you reach your personal best.

Stay focused. Stay guided. Stay grounded.

Enjoy the fall,



**Lawrence V. Adam, III, CFA, CIMA®, CFP®**  
*Chief Investment Officer*

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\*Financial forecasts should NOT be considered a guarantee of future performance or a guarantee of achieving overall financial objectives. Expressions of opinion are as of this date and are subject to change. Past performance is not a guarantee or a predictor of future results.



# Data Integrity and the Economy

**Eugenio J. Alemán, PhD**, *Chief Economist*, Raymond James  
**Giampiero Fuentes, CFP®**, *Economist*, Raymond James

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Over the history of the US, US economic statistical institutes have created and maintained well-developed and managed economic statistical systems that are the envy of the world. This economic statistical system has allowed market participants and economic actors, from domestic to international businesses, individuals, and foreign governments to make informed decisions in a highly uncertain US and global economic environment. This competitive advantage is another distinct characteristic of US exceptionalism. However, the US has been losing this advantage slowly but surely, due to, among other things, failing to invest in these institutions so that they continue to be world leading.

## LONGSTANDING CHALLENGES

It is important to note that this process did not start with the first Trump administration nor with the implementation of DOGE during the first months of the second administration. However, these latest efforts have compounded the effects on the reliability of the data produced by these agencies. For decades, US statistical agencies have faced budget cuts, particularly from Republican-led efforts in Congress using the

argument that the US government is overstaffed, even though federal employment has remained almost unchanged during the last ~60 years as shown in the graph of data on the next page on employment levels.

Additionally, one of the most persistent challenges for all US (and international) statistical agencies is the decline in survey response rates. For example, the US Current Population Survey

US economic statistical institutes have created and maintained well-developed and managed economic statistical systems that are the envy of the world.

(CPS), a key source for employment data, declined from about 85% a decade ago to 80% before the pandemic, falling further during COVID-19 and currently approaching a 65% response rate. Similarly, the Current Employment Statistics (CES) programme, which tracks payroll jobs, fell from around 60% pre-pandemic to below 43% today.

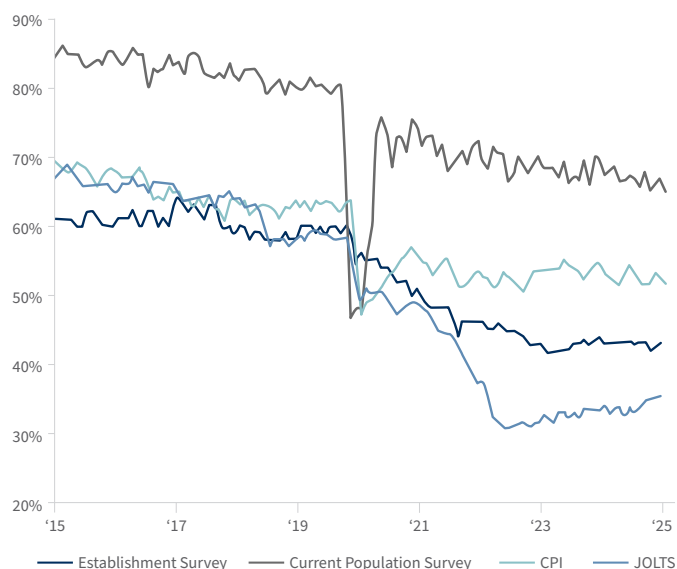
## Federal Employees (in millions)



Source: FactSet, data as of 30/9/2025

\*Data includes US Postal Service Workers. Temporary spikes in federal employees occur every ten years because the Census Bureau hires hundreds of thousands of temporary workers to conduct the decennial census.

## Survey Response Ratio



Source: FactSet, data as of 30/9/2025

\*These rates only include data received prior to the deadline for the first preliminary release for surveys that have multiple releases prior to the final release.

The pandemic created a major break in data collection processes as businesses took longer to respond to surveys, leading to delays in the collection of data prior to the deadline for the first preliminary release, and therefore resulting in larger than usual revisions in economic indicators. With limited resources, agencies have struggled to adapt and maintain data quality. Additionally, lower response rates increase the risk of bias and reduce the representativeness of Bureau of Labor Statistics (BLS) data. To address these funding/resource gaps, the BLS has relied more heavily on imputations, which are statistical methods used to estimate missing values. However, this imputation process is a second-best alternative to gathering the actual data for the surveys, lowering the quality/reliability of the end product.

### SURVEYS ARE NEVER GOING TO BE PERFECT

Government agencies collecting economic data such as, but far from exclusively, the BLS or the Bureau of Economic Analysis (BEA), are considered the gold standard of information because of the reliability and transparency of how statistical series are calculated. However, there are significant challenges when trying precisely to estimate data for a \$30 trillion economy with

**Lower response rates increase the risk of bias and reduce the representativeness of Bureau of Labor Statistics (BLS) data.**

a population of 340 million. The Establishment survey collects data from 121,000 businesses and government agencies, covering 631,000 individual worksites, which represent about one-third of all non-farm payroll jobs. Despite these large data collection numbers, as is the case for any survey, it is subject to sampling errors. As an example, at a 90% level of confidence, the BLS Nonfarm Payroll number estimated would lie anywhere between 136,000 lower to +136,000 higher than the published estimate.

### ESCALATING POLITICAL PRESSURE

Recent actions, like the dismissal of the BLS commissioner Erika McEntarfer, and mounting political pressure on other Federal

<sup>5</sup> <https://www.bls.gov/news.release/empsit.tn.htm>

<sup>2</sup> <https://www.bls.gov/news.release/empsit.tn.htm>

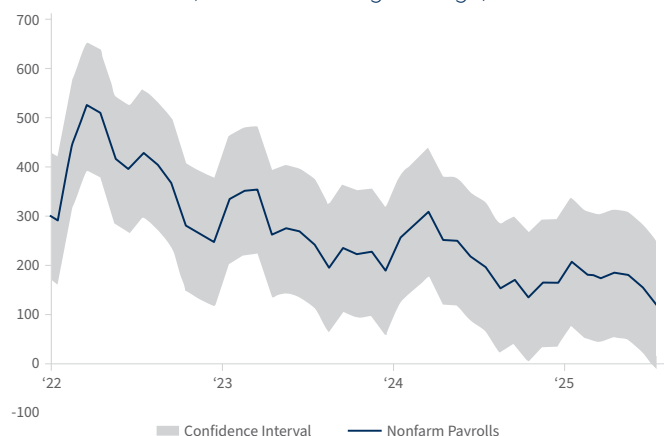
Reserve officials such as Lisa Cook and Jerome Powell (see *stand-alone piece on the Fed's Independence on the next page*), signal a dangerous shift toward politicising the intricate process of collecting and processing economic data.

Additionally, actions such as dismantling advisory committees, which occurred earlier this year, are likely to have long-term implications.

The US economic statistical system has allowed market participants and economic actors to make informed decisions in a highly uncertain economic environment.

These advisory committees played a crucial role in informing and guiding statistical agencies on best practices, improvements in methodology, and emerging economic trends. Without this counsel, agencies may face greater difficulty in innovating, maintaining methodological rigor, and ensuring transparency. At the same time, increased attention from elected officials and the public may encourage agencies to improve transparency regarding their methodologies and decisions, thereby enhancing public understanding of complex economic issues.

## Nonfarm Payrolls (3-month moving average)



Source: RJ Economics, BLS, data as of 30/9/2025

### THE BOTTOM LINE:

Maintaining the integrity and quality of economic data, not only in the US but internationally too, is essential for informed decision-making across the public and private sectors. US statistical agencies like the BLS and BEA have long set the global standard for transparency and methodological rigor, but challenges such as declining survey response rates, limited resources, and methodological constraints have impacted data reliability. Therefore, continued investment in statistical agencies, along with efforts to improve transparency and data collection methods, is critical to preserving the accuracy and credibility of economic indicators in a complex and evolving economy. ■

### KEY TAKEAWAYS

- The US economic statistical system has allowed market participants and economic actors to make informed decisions in a highly uncertain economic environment.
- One of the most persistent challenges for all US statistical agencies is the decline in survey response rates.
- Lower response rates increase the risk of bias and reduce the representativeness of Bureau of Labor Statistics (BLS) data.
- To address these funding/resource gaps, the BLS has relied more heavily on imputations, which are statistical methods used to estimate missing values.
- Continued investment along with efforts to improve transparency and data collection methods, is critical to preserving the accuracy and credibility of economic indicators in a complex and evolving economy.





# Federal Reserve Independence: Why is It Important?

**Eugenio J. Alemán, PhD**, *Chief Economist*, Raymond James  
**Giampiero Fuentes, CFP®**, *Economist*, Raymond James

Why do economists treasure an independent central bank? Very simple: it prevents politicians interfering with what needs to be done to keep an economy on the right path. On numerous occasions, politicians argue that because they are democratically elected they are the ones who should have the last word. This is probably true in many respects, but not when it comes to monetary policy. Fiscal policy is the purview of politicians; that is, how much is going to be collected from taxes and how much is going to be spent. If we see a mis-match between these two objectives and we have a fiscal deficit develops, it accumulates into a country's national debt every year. We know how badly the political process has dealt with the fiscal issue, so it is good that monetary policy is not in the hands of the politicians.

Monetary policy is even more difficult to handle. Monetary policy cannot be in the hands of the political system because politicians always want to print more money, especially if fiscal revenues are insufficient

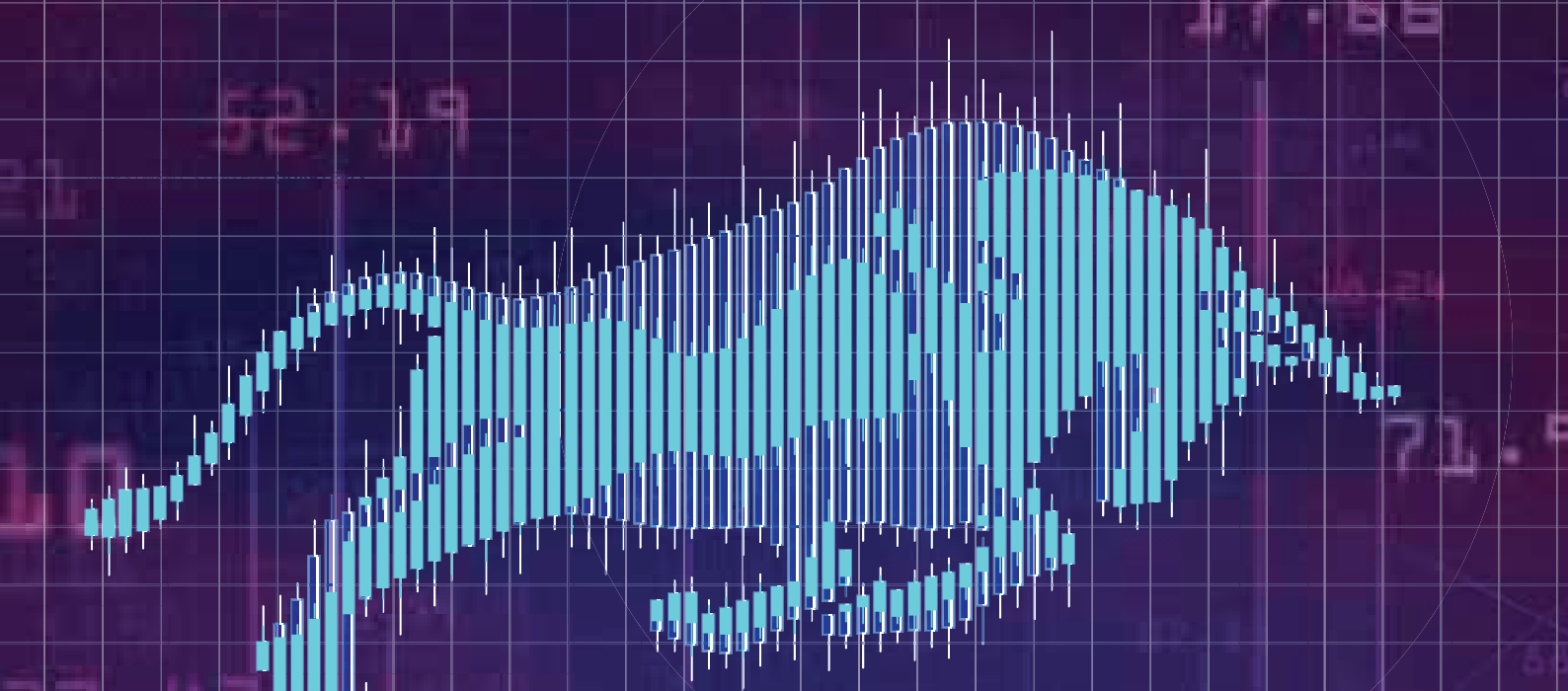
to cover fiscal expenditures and if we have a fiscal deficit. Printing money just to cover fiscal deficits would be the beginning of the end for the US dollar and numerous other currencies too. The US government borrows money to cover fiscal shortfalls but when countries cannot borrow to cover these fiscal shortfalls, they tend to print money and debase their currencies. Furthermore, politicians always want low interest rates, but that is not always the best policy.

Those who conduct monetary policy must be experts in the field of economics and on the effects of interest rates on the economy. Monetary policy cannot be dictated by political whims, as is the case with fiscal policy. If monetary policy is conducted based on the whims of politicians, then one risks debasing the currency, including the US dollar, and triggering much higher inflation than we have today.

The growth rate of the money supply, which is determined by interest rates, is just one

component of inflation. The other component is called inflationary expectations and this is the part the Federal Reserve (Fed) and, topically, the Bank of England need to keep in check. The only way a central bank can control inflationary expectations is by its commitment to keep inflation down and, in the case of the Fed and Bank of England, keep it at or very close to the 2.0% rate over the longer term. If a central bank loses its independence and follows the whims of politicians, then all bets are off, and the institution loses its ability to keep inflation controlled.

If this happens, everybody—but especially those living on a fixed income—will be worse off, the US dollar would, importantly, lose its pre-eminent status in the world economy, and the US exceptionalism on which equity market investors have become reliant would become a thing of the past. ■



# A Fork in the Road Ahead for US Equities?

**Matt Barry, CFA**, *Senior Investment Strategist*, Investment Strategy

**Mike Payne**, *Investment Strategy Analyst*, Investment Strategy

US equities have delivered exceptionally strong returns over 2025 to date and particularly so since post-2 April “Liberation Day” lows despite many perceived headwinds. The S&P 500 has gained 13% year-to-date—on pace to mark the third consecutive year of double-digit gains for the index. Following a 19% peak-to-trough decline to the April low (8 April), the S&P 500 recovered to all-time highs in fewer than three months, the fastest recovery in the last 30 years. Notably, almost everything has worked; since the April lows, performance has been robust across the market-capitalisation spectrum with large-cap stocks (+34%), mid-cap stocks (+28%), and small-cap stocks, (+38%) all posting an outstanding performance. Performance has also been strong across geographies too with the MSCI All Country World Index excluding US gaining 22% since the low to a US-based investor. The recovery and the strong performance year-to-date can primarily be attributed to progress on trade negotiations, a better than feared impact from tariffs on corporate fundamentals thus far (e.g., resilient earnings through the second quarter of 2025) and the markets’ anticipation of fiscal stimulus stemming from the One Big Beautiful Bill to occur in 2026.

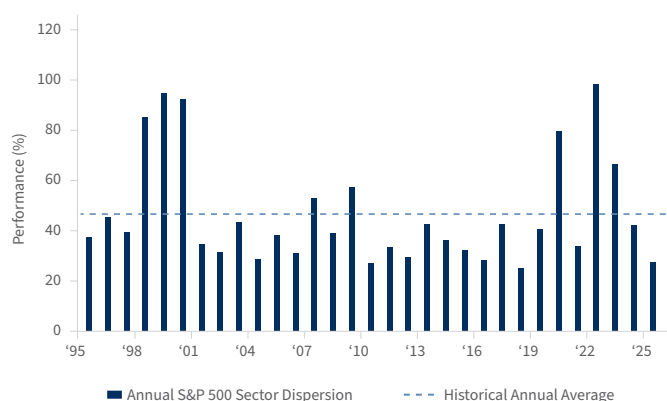
**Note for UK readers; percentages are from a US dollar perspective and with Sterling having appreciated by around 8% against the Dollar in year to date, the gains have been more muted from a Sterling perspective.**

Beyond the index level, performance has been broad based at the sector level too. Ten of eleven S&P sectors are in positive territory year-to-date, and despite the sharp moves in the S&P 500 this year, differences in performance across sectors have been surprisingly limited. For instance, the top-performing sector year-to-date—Communication Services, up 26%—is only ~28% ahead of the weakest, Health Care, which is slightly negative at -1.9%. If this trend holds, dispersion amongst sector returns is on pace to be roughly half of the historical average since 1995.

Notably, almost everything has worked: since the April lows, performance has been robust across the market-capitalization spectrum with all posting solid performance.

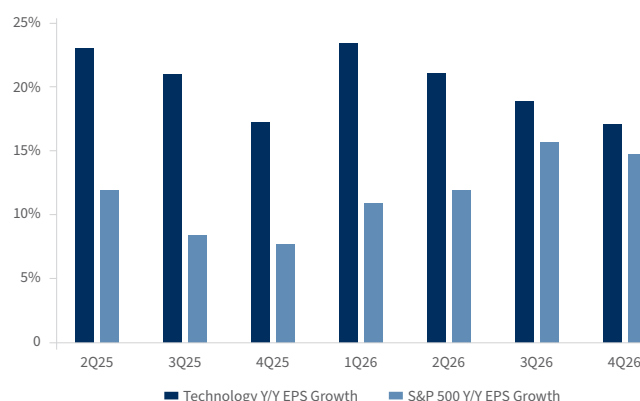


## Below-Average Sector Dispersion



Source: FactSet, RJ Investment Strategy, data as of 30/9/25

## Technology EPS Growth Expected to Outpace S&P 500 Through 2026



Source: FactSet, RJ Investment Strategy, data as of 30/9/25

However, with valuations stretched (S&P 500 Next Twelve Months PE in the 96th percentile vs history) we believe markets are now becoming too complacent about the risks ahead. As pre-tariff inventories wind down, and the August 7th tariffs feed through supply chains, the full impact on the economy and earnings has yet to unfold. As the market is pricing in ~11% and 13% EPS growth in both 2025 and 2026, we expect downward earnings estimates in the months ahead. With valuations stretched, technical indicators (e.g., relative strength oscillators, put/call ratios) elevated and sentiment measures (i.e., the percentage of investors who expect a rise in stock prices) running high, slowing growth and earnings headwinds could lead to higher volatility (and therefore greater dispersion) in the months ahead.

Given the expected downward revisions, we continue to favour areas of the market with longer-term secular themes that should provide insulation during a softening macroeconomic backdrop.

Most notably, as the effects of tariffs continue to work their way through the economy and corporate earnings, specific areas will be impacted to a larger degree. As a result, we expect greater divergence across sectors—separating future winners from laggards. For example, as growth cools and tariff impacts are felt, sectors tied to the ‘goods’ portion of the economy, and a likely weakening in

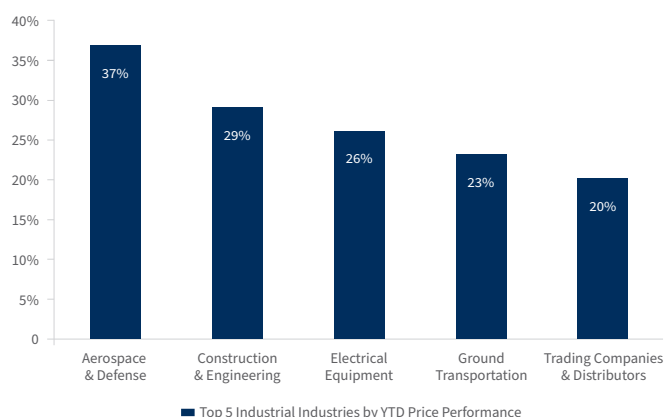
consumer demand (e.g., Consumer Staples and Consumer Discretionary), will face intensified margin and sales headwinds. Case in point: Walmart has highlighted that tariff-related costs are increasing as it restocks inventories. On the positive side, the Financials sector could benefit from Federal Reserve rate cuts if the yield curve were to steepen further from here. Bottom line: selectivity will be key.

Given the expected downward revisions, we continue to favour areas of the market with longer-term secular themes that should provide insulation during a softening macroeconomic backdrop. These are:

### TECHNOLOGY

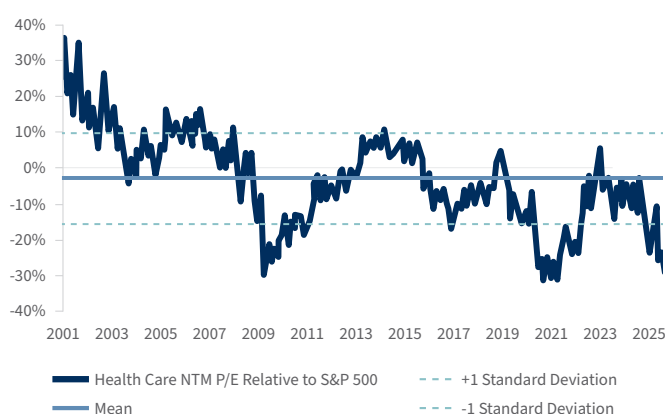
Technology fundamentals continue to be supported by AI momentum which thus far has been uninterrupted by tariff volatility and an uncertain macroeconomic outlook. In fact, capex among the big four US hyperscalers (Microsoft, Amazon, Google and Meta) is now expected to exceed \$400 billion in aggregate in 2026. Additionally, monetisation has begun to accelerate within cloud service providers, which remain constrained by supply rather than demand. Therefore, we expect AI investment tailwinds to continue to support sector fundamentals in the year ahead. Consensus currently expects Technology year-over-year earnings per share (EPS) growth to outpace the S&P 500 in each quarter through 2026, which we believe justifies the sector's premium valuation. However, following the 60% rally from the April lows, the 12-month forward P/E of 29x for the sector now sits in the 99th percentile over the last 20 years which could lead to pockets of volatility that we would seek to take advantage of opportunistically.

## Key Secular Growth Themes Driving Industrial Performance



Source: FactSet, RJ Investment Strategy, data as of 30/09/25

## Health Care Relative Valuation Near Historic Lows



Source: FactSet, RJ Investment Strategy, data as of 30/09/25

## INDUSTRIALS

The Industrials sector sits at the epicentre of multiple secular growth themes including the AI data centre buildout, global electrification and grid investment, reshoring of supply chains in response to tariffs, and increased defence spending stemming from elevated geopolitical tensions. In fact, three of the top four performing industries within the sector including aerospace & defence (+37%), construction (+29%) and electrical equipment (+26%) can be directly tied to these key themes. This has been enough to offset underperformance in the more cyclical areas of the sector. Looking ahead, we believe the strength in secular growth themes will persist along with a gradual cyclical recovery which should lead to Industrial EPS growth outpacing the S&P 500 in 2026. Consensus currently expects 17% Y/Y EPS growth in 2026 compared to 13% for the S&P 500.

## HEALTH CARE

Policy uncertainty regarding the new administration's agenda has led to year-to-date underperformance for the sector and the sector's 12-month forward P/E of 17x is now trading at a 25% discount to the S&P 500—near the historic lows seen in 2009 and 2021 despite strong underlying fundamentals. In fact, the Health Care sector is expected to see 13% year-over-year EPS growth in 2025 compared to 11% for the S&P 500. The new pharma tariff will soon take effect, but due to a range of exemptions, we expect little to no effect on earnings. Additionally, the sector should benefit from long-term demographic trends (e.g., an ageing population).

## BOTTOM LINE

With much of the good news already reflected in pricing, we no longer think the stock market will extend in a straight line similar to the rally from the April lows. As we expect the bulk of the tariff-related impacts to be ahead of us, we expect winners and losers to emerge from here. Selectivity will be critical, and we expect those sectors with persistent secular tailwinds (Tech, Health Care, Industrials) will benefit in the long-term. ■

### KEY TAKEAWAYS

- The S&P 500 has gained 13% year-to-date —on pace to mark the third consecutive year of double-digit gains for the index.
- Performance has been strong across the market-capitalisation spectrum.
- Drivers of performance include progress on trade negotiations, a better than feared impact from tariffs on corporate fundamentals thus far, lower interest rate expectations and the markets' anticipation of fiscal stimulus stemming from the One Big Beautiful Bill.
- We continue to favour areas of the market with longer-term secular themes that should provide insulation during a softening macroeconomic backdrop.



# Can The US Become Self-Sufficient In Rare Earths?

**Pavel Molchanov**, *Investment Strategy Analyst*, Investment Strategy

Whenever you drive, have an MRI test, or snap a photo, you are (indirectly) a consumer of rare earths. Cars, medical imaging equipment, and cameras are all examples of technologies whose production depends on rare earths. When rare earths show up in the headlines, it is usually because supply is at risk. That is precisely what happened during the height of the US-China trade war this past April and May, when some industries came close to outright shortages of rare earths. What is underappreciated is that the US actually mines plenty of rare earths. The bottleneck has been in turning those raw materials into magnets and other finished products. The good news is that the private sector, along with some help from Washington, is moving to ensure that the US economy eventually becomes as self-sufficient in rare earths as it already is with energy.

## **RARE EARTHS: A CASE STUDY OF CRITICAL MINERALS – THOUGH NOT AS RARE AS YOU MIGHT THINK**

Before zooming in on rare earths, let's clarify what we mean by critical minerals. The US Department of Interior has a list comprising 54 minerals, the bulk of which are metals. All of them share two attributes: 1) they play an essential role in the economy or national security; and 2) they are subject to a heightened level of supply chain risk. For example, iron ore is essential—but its wide availability means that it is not considered to be a critical mineral.

The term rare earths encompass 17 distinct metals. The most important in an economic sense is neodymium, along with cerium, lanthanum, samarium, scandium, and yttrium—all of which are on

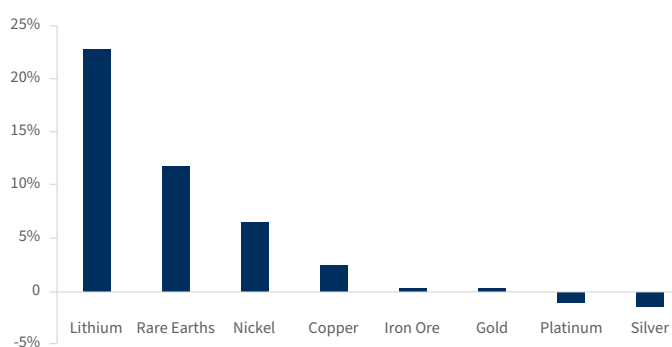
Along with other critical minerals, rare earths are subject to a heightened level of supply chain risk.

the Department's list. Not all of these metals are truly rare—cerium happens to be more abundant in the earth's crust than copper—but the sparse availability of economically viable deposits means that mining takes place only in a small number of locations.

Demand for rare earths is growing by leaps and bounds and not just in the US. The chart shows that, during the period 2019-2024, global

rare earth volumes increased faster than any of the precious metals and most of the industrial metals (except lithium). We expect annual growth in the 5% to 10% range for the foreseeable future.

## Change in Global Output



Source: CAGR 2019-2024, USGS, Energy Institute

## NOT YOUR AVERAGE FRIDGE MAGNET: RARE EARTH MAGNETS ARE IN HIGH DEMAND

At first glance, magnets do not seem like a high-tech product and indeed the type of magnets you might have on the refrigerator door are simple to make. But it's a different story when it comes to magnets that are derived from rare earths. Rare earth magnets have several features that make them a key input in a wide range of manufacturing applications.

- **Extra strength:** Even in compact size, rare earth magnets are able to generate a strong magnetic field. Neodymium is the best material from this standpoint.
- **Low sensitivity:** Magnets made from samarium can handle temperatures of up to 300 degrees Celsius.
- **Corrosion resistance:** Samarium-derived magnets are naturally resistant to corrosion, so there is no need to add protective coatings.

Magnets made from neodymium (also incorporating iron ore and boron) are valuable for products where space is at a premium, such as hard disk drives, cameras, cordless tools, and vehicles. Steering systems need magnets regardless of the vehicle type, and electric vehicles specifically also need magnets for the powertrain. The samarium variety of magnets (also incorporating cobalt) is used in machines with a larger form factor, including a notable footprint in aerospace and defence. For example, stealth

aircraft use these magnets to absorb incoming radar waves. MRI equipment is another vital—quite literally!—use case.

## WANT TO SEE RARE EARTHS BEING MINED? YOU DO NOT NEED TO GO TO CHINA

When the media refers to China dominating the rare earth market, that is correct in a broad sense. Looking at 2024, Chinese mines accounted for 71% of the world's rare earth volumes, up from 60% in 2019. The US is ranked second on this basis. US mines produced 12% of rare earths in 2024, on par with five years ago. While 12% does not seem like a lot, it is four times more than the US economy requires. Let's frame this in absolute terms: US mines extract 45,000 metric tons of rare earths per year, whereas US consumption of rare earth products (including magnets) is only 10,000 metric tons.

This is where we get to the crux of the matter. The rare earths mined in the US currently must be shipped to China for processing into magnets and other finished products. China has the good fortune to have some of the world's best rare earth deposits, but the US also has more than enough. Contrary to what some of the headlines might suggest, the constraint is on the downstream of the value chain: the US lacks the capacity to refine the rare earths that are mined domestically.

In case you are wondering, essentially all US output of rare earths in recent years has come from a single mine, located in Mountain Pass, California (not too far from Las Vegas). This past July, a new mine opened in Ranchester, Wyoming. Development-stage opportunities have been identified in Arizona, Montana, Nevada, Texas, and Wyoming—but, as with all natural resource projects, do not expect a quick turnaround.

## SCALING UP US MAGNET PRODUCTION WILL TAKE TIME—BUT IT IS HAPPENING

The fact that the Chinese government can use its control over rare earths for geopolitical leverage is not a new story. Beijing's first attempt to weaponize this resource was all the way back in 2010. At various times over the past 15 years, Chinese rare earth exports have been restricted in relation to the US, Japan, or globally. In retrospect, the US private sector and Washington should have moved more quickly to develop domestic magnet production capacity. One of the lasting consequences of this year's trade war escalation has been to highlight rare earths as a weak link in supply chain management and national security.

Under the Inflation Reduction Act of 2022, a federal tax credit exists—known as Section 45X—for domestic manufacturing of a wide range of products used in energy transition, and this includes

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“One of the lasting consequences of this year’s trade war escalation has been to highlight rare earths as a weak link in supply chain management and national security.”

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rare earths. This tax credit will be available through the end of 2032. In addition, the Departments of Defence and Energy have been providing funding, grants and loans, for companies in this space.

As production ramps up at rare earth magnet plants, the US should become fully self-sufficient by 2030.

At present, there are two large-scale US production facilities for rare earth magnets. The older of the two is located in San Marcos, Texas, and owned by a private company. The newer plant—which opened in January 2025—is located in Fort Worth, Texas, and is owned by the same public company that operates the Mountain Pass mine. This plant is gradually ramping up production toward capacity of 1,000 metric tons per year. Next up are two plants: one in Sumter, South Carolina (2,000 metric tons) and the other in Stillwater, Oklahoma (5,000 metric tons). Once all of these plants are running at full utilization, probably in 2027/2028, at least two-thirds of US magnet needs will be met. Rest assured, there will be more projects thereafter. For example, a North Carolina startup is currently producing on a small scale in the Research Triangle Park

and aims to reach several thousand metric tons by 2030. Bottom line: it is a good bet that, as this decade draws to a close, there will no longer be any need to ship US rare earths to China..

#### **WHAT DOES US RARE EARTH ‘INDEPENDENCE’ MEAN FOR INVESTORS?**

First, let’s be clear that all critical minerals are, at a fundamental level, commodities. In any commodity business, prices are volatile due to a wide range of variables affecting supply and demand. Regarding rare earths, that includes cyclicalities in the automotive and aerospace industries.

Mining companies are found in the Materials sector. The large-scale miners tend to be very diversified, so to the extent that they produce rare earths, it is only a small portion of the overall business. Companies with a focus on rare earths are smaller, and many of them are early stage and pre-revenue. All mining companies face exploration risk (before a resource is developed) and operational risks (after a resource is developed).

Regardless of whether you have direct exposure to the rare earth market, it is emphatically a good thing for the US economy to end its dependence on a geopolitical adversary—in this case, China—for critical minerals. Just as Europe has successfully disentangled its economy from long-standing dependence on Russian energy, the US is making progress along the same track with rare earths. ■

#### **KEY TAKEAWAYS**

- The term rare earths encompass 17 distinct metals. All of them share two attributes: 1) they play an essential role in the economy or national security; and 2) they are subject to a heightened level of supply chain risk.
- Rare earth magnets have several features that make them a key input in a wide range of manufacturing applications.
- The US mines more rare earths than the economy requires. However, the rare earths must be shipped to China for processing.
- The private sector, with some help from Washington, is acting to ensure the US becomes self-sufficient.



## Q&A: A Durable Peace Between Russia and Ukraine Will Be Even Harder Than It Seems

**Pavel Molchanov**, *Investment Strategy Analyst*, Investment Strategy

After more than three and a half years of Russia's relentless war in Ukraine this summer glimmers of hope on the diplomatic front were quickly followed by a realisation that there will be no quick-and-easy endgame. There are significant hurdles to a peace agreement that can stand the test of time—rather than merely serve as a pause before a resumption of bloodshed. Likewise, post-war normalisation of economic links between Russia and the West will be a marathon rather than a sprint.

**Q: Russia and Ukraine are talking to each other. Isn't that progress?**

**A:** As we think about a durable peace agreement, there are at least three major sticking points.

First, the border needs to be redrawn. Russia occupies one-fifth of Ukrainian territory—and, in addition to that, claims portions of land in the Donbas region that its troops have been unable to seize. It is unlikely that Ukraine would agree to voluntarily withdraw from these areas.

Second, international security guarantees for Ukraine need to be clarified. Russia is opposed to a peacekeeping force for the post-war period, whereas Ukraine sees it as essential. A particular deal-breaker for the Kremlin would be participation by NATO countries in such a force.

Third, Russia has made vague demands for changes in Ukrainian laws about the Russian language and the Orthodox church. Before Ukraine can consider such demands, Russia needs to clarify what it wants.

**Q: Let's imagine that a peace deal is signed. What happens to Russia's frozen assets?**

**A:** This is yet another sticking point, and it concerns not just the two sides in the war, but also Europe. Immediately after Russia invaded Ukraine, Russia's central bank reserves and other sovereign assets in western countries were frozen. The total exceeds \$300 billion, and the vast majority of these assets are in Europe, with smaller amounts in the US and elsewhere. Needless to say, the Kremlin wants that money back, but European governments insist that Russia must first compensate Ukraine for war damage.



## No Easy Off-Ramp in Russia-Ukraine War



A joint study by the United Nations and Ukraine, published in February 2025, estimated the price tag of post-war reconstruction (including damage on territory that is occupied by Russia) at a staggering \$520 billion. This equates to two and a half times Ukraine's pre-war GDP. Any viable strategy for rebuilding will require ongoing support from Ukraine's international partners. Let's keep in mind that, in the US and (to a lesser extent) Europe, willingness to provide financial support to Ukraine has been fading over time, so it will be tempting to use at least a portion of Russia's frozen assets for that purpose.

### Q: How realistic would it be for Russia to once again become a major trading partner with the West?

**A:** As part of the peace process, it is a safe bet that the US and Europe will offer Russia gradual sanctions relief, contingent on the Kremlin complying with its commitments. Certain sanctions are likely to be lifted once a ceasefire is in effect, followed by others after a full-fledged peace deal is implemented. Some restrictions, particularly vis-à-vis military equipment and advanced technologies, are likely to remain on a long-term basis.

Lifting sanctions does not mean that trade will rebound to pre-war levels—at least for the foreseeable future, and possibly ever. The most obvious example is that Europe has no appetite to return to its historical dependence on Russian natural gas. The

Kremlin's weaponisation of natural gas in 2022 taught Europe a painful lesson—and there is no going back. For its part, Russia has successfully reoriented its commodity exports to China, India, and other emerging markets—an arrangement that suits the Kremlin just fine.

On the other hand, Russia would welcome resumption of access to currently blocked western products, such as aircraft and auto parts. It is worth noting that nearly all western multinationals—even those whose products have never been subject to sanctions, such as ordinary consumer goods—exited the Russian market shortly after the war started. Some of these companies may decide to stay away permanently, but we think that most would like to get back in. Normalisation of economic ties would also give a boost to foreign direct investment flowing into Russia, including the energy and mining sectors. Meanwhile, a peace deal would also open the door for international companies to begin exploring Ukraine's mineral resources. ■



# The UK Prepares For An Autumn Of Uncertainty

Prof Jeremy Batstone-Carr, *European Strategist*, Raymond James

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If the UK's economic performance were measured solely by the index of leading one hundred companies quoted on the London Stock Exchange, there would seem to be little for investors to worry about. The index hit an all-time high on 22 August and despite dipping slightly over the weeks that followed it remains within touching distance heading into what is typically the best quarter of the year for returns from financial assets. This resilience has not been matched by more domestically focused smaller and medium-sized company stocks whose performance is much more closely interwoven with a still fragile economy and a nervous gilt-edged market ahead of Chancellor Ms Rachel Reeves Autumn Budget scheduled for 26 November.

## **GILT-EDGED PRICING REFLECTS MORE THAN INTERNATIONAL DEVELOPMENTS**

Although longer-dated borrowing costs (yields) have fallen back over September, in common with adjustments in market pricing across developed economies more generally, they remain at elevated levels having risen by more than international counterparts since early August. Whilst international factors cannot be completely discounted, developments closer to home have played a significant role in recent pricing and there are a number of reasons for this. Firstly, and most significantly, interest rate expectations have shifted higher in response to stubborn inflationary pressure, which remains much more pronounced than that in the Euro Area or even the United States and a wary Bank of England unwilling to countenance lower interest rates until it becomes clear that price pressures are easing (as is thought likely over 2026).

But changes in short-term yields do not tell the whole story. The main driver impacting longer-dated pricing has proved to be investor perceptions of a gradual, but persistent, worsening in the relationship

between demand and supply in the market for government bonds. Admittedly, the UK is far from alone in this regard, but domestic factors have played an important role too, notably the Bank of England's slow transition from being one of the biggest buyers of gilt-edged to a net seller. The Bank itself estimates that this adjustment has added 0.15%-0.25%-points to the 10-year benchmark yield, while elevated levels of issuance has also contributed to downward pressure on longer-dated prices and commensurately higher yields.

## **THE PUBLIC FINANCES HAVE DETERIORATED AHEAD OF THE BUDGET**

Pricing in the gilt-edged market also very likely reflects investor discounting heading into an autumn of elevated fiscal risk. The Chancellor will have taken no pleasure whatsoever from a deterioration in the public finances over August. The UK economy is still growing, but not strongly and this has contributed to lower-than-expected tax receipts. On the flip side, government efforts to provide support to the economy have resulted in expenditure overshooting the independent Office for Budgetary Responsibility (OBR) forecasts

made at the time of the Spring Statement back in March. As if this deterioration were not bad enough, the Chancellor's predicament is expected to be made worse by reports that the OBR is preparing to lower its outlook for productivity growth (and by extension its medium term economic growth forecast) from 1.3% year-on-year in 2029, an important year as that is when the self-imposed fiscal mandate really bites.

Why this matters is reflected in the fact that even an apparently small 0.1%-point fall in forecast average productivity per year, that could raise borrowing in the crucial 2029/30 fiscal year by as much as £10bn. If Ms Reeves wishes to maintain a buffer of around £10bn against her key fiscal rule then she's likely to have to countenance raising as much as £28bn in November largely, if the weight of media coverage is to be believed, through higher taxation.

### A POLITICAL PINCER MOVEMENT

Raising revenue through higher taxation, irrespective of where the increases might fall, is hardly a measure likely to endear an administration to its electorate and yet where else can the embattled Chancellor turn? The spectre of the disastrous Truss / Kwarteng mini-Budget of September 2022 serves as an important reminder to incumbents not to play fast and loose with all-powerful government bond market. Not for nothing did Mr James Carville, economic adviser to former US President Mr Bill Clinton, once say that if he believed in reincarnation he'd want to come back as the bond market, that way you can intimidate everyone!

Having achieved a landslide victory at last year's election a substantial majority in the House of Commons should, on paper, provide ample headroom for unpopular policy, at least in the short-term. Yet swiftly do the sands beneath the political landscape shift. In a little over six months the Labour leadership has seen its popularity plunge from post-election euphoria to the deepest depths not dissimilar to the ill-fated, and short-lived Truss administration. A big parliamentary majority in terms of seats in the lower House masks the fact that it was achieved with a built-in vulnerability, an all-time low 33.8% share of the vote. A vast number of disaffected Conservative Party voters stayed away or voted instead for the populist Farage-led Reform Party.

Meanwhile, Labour's own support is fracturing too, reflected in the left-wing Mayor of Manchester Mr Andy Burnham's pitch for the leadership, timed to coincide with the Party's annual conference in Liverpool. Although Mr Burnham is not even an MP and were he to become one he'd still require the support of at least 20% of his colleagues, his bid illustrates Prime Minister Sir Keir Starmer's vulnerability from within his own ranks. Chancellor Reeves has experienced mutiny too, having been forced into a policy "U"-turn on proposed welfare reform, a threat militant backbenchers have recently revived. Even if the passage of measures announced in the forthcoming Budget does not get derailed by a de facto no confidence vote, next May's local elections could add yet more pressure.

From the perspective of the financial markets, any attempt at appeasement through increased spending could drive longer-term borrowing costs sharply higher, threatening a fiscal crisis from which the current leadership would find it hard to survive.

Ultimately, the lesson from September 2022 is that any loosening in fiscal policy against a backdrop of a significant structural deficit and relatively high interest rates (outwith the US) carries an inordinate amount of risk. For a besieged administration this is a perilous high wire act with zero margin for any missteps. Against this backdrop it seems hard to imagine that investors might give the Labour leadership the benefit of the doubt and equally hard to believe that financial markets might adjust in such a way as to reduce the political and fiscal risk premium now clearly built in to prevailing medium and longer-term gilt-edged pricing.

### KEY TAKEAWAYS

- The internationally focused FTSE 100's resilience masks unsettling domestic undercurrents reflected in a relatively subdued performance from medium sized and smaller company stocks and a steepening gilt-edged yield curve.
- Although short-term interest rate expectations have fallen sharply over 2025, longer-dated borrowing costs have not followed suit due to a rising risk (term) premium.
- In part this reflects a widespread deterioration in demand / supply dynamics across developed economies as elevated debt and deficits require financing with ever-greater issuance.
- But in the UK the adjustment also reflects investor nervousness regarding fiscal risks ahead of the 26th November Budget and the growing vulnerability of the Labour government (and by extension its commitment to fiscal discipline necessary to avoid another fiscal crisis).
- While falling inflation in due course should allow a wary Bank of England to cut interest rates further over 2026, the scope for longer-dated borrowing costs to fall is much more limited.



# Japanese Equities Deserve A Place In Diversified Portfolios

Prof Jeremy Batstone-Carr, *European Strategist*, Raymond James

The Japanese stock market has performed well over 2025, the benchmark Topix Index returning almost 14% to a UK-based investor year-to-date (22% in US dollar terms). Although the country faces numerous challenges, overseas investors have been steadily adding exposure, buoyed both by the recently concluded trade deal with the United States and in no small measure, a weakening yen. A rising (and steepening) government bond yield has proved supportive to the country's financial sector and unlike developed market counterparts elsewhere, especially in the United States, stock market valuations are nothing like as stretched. In addition, while ongoing investor enthusiasm for generative artificial intelligence (AI) has provided a handy tailwind for US stocks, differentiated sector leadership in Japan supports the case for portfolio diversification.

## THE HUBRISTIC SUNSET

On 29 December 1989 Japan's Nikkei 225 index hit a high of 38,916 a milestone prompting The Economist magazine to ask whether it might be time to start valuing the stock market differently? The article's timing could hardly have been worse! Following the asset-inflated economic bubble of the 1980s, a period characterised by highly ostentatious consumption and wildly inflated overconfidence, epitomised by the boast that the land under the imperial palace was worth more than the entire state of California, there then followed a spectacular fall from grace. One year later the stock market had lost £1.5 trillion in value (\$2 trillion) and there then followed a prolonged and barren landscape of relentless (and unsuccessful) restructuring, persistent deflation and economic stagnation. The collapse in the wildly overvalued stock and property markets caused a banking sector crisis requiring a far-reaching

bailout in 2002 and an ultra-accommodative monetary policy including 0% interest rates and the purchase by the Bank of Japan of government bonds from embattled financial institutions. This quantitative easing proved the forerunner for policy pursued across developed economies in the aftermath of the Great Financial Crisis and a policy from which the Japanese economy is still emerging.

Simultaneously, Japan's economy and ruling administrations underwent a profound transformation, how best to cope with a sudden and dramatic adjustment from a hitherto young, and fast-growing economy into an ageing, slow growth "new normal"? Enter, for a second time, Prime Minister Mr Shinzo Abe in 2012 and the dawn of so-called "Abenomics"; hawkish on defence, conservative on social issues and deeply wedded to the Keynesian idea of the state as a benign spending force for good, manifest in a "three arrows" economic programme. The first of the arrows is still in flight, a now

prolonged programme of infrastructure rebuild. The second, ultra-loose monetary policy and central bank bond purchases, is now being addressed. The third arrow, arguably the most significant regarding societal reform and persistent fears relating to the consequences for long-term growth from an ever ageing and declining population, looks more like a badly thrown dart. It has added 0.15%-0.25%-points to the 10-year benchmark yield, while elevated levels of issuance has also contributed to downward pressure on longer-dated prices and commensurately higher yields.

## NEW DAWN

Given ongoing, and profound, challenges, investor enthusiasm for Japanese stocks has been building even as the Bank of Japan slowly normalises monetary policy under the careful stewardship of Governor Mr Kazuo Ueda. Neither, it seems, are investors put off by the travails of the ruling Liberal Democrat Party (LDP). Following Mr Shigeru Ishiba's recent decision to relinquish his role as Prime Minister having overseen his Party lose its majority in both the lower house of parliament last autumn and in the upper house last July. A "full spectrum" leadership election (in which all rank-and-file Party members can take part) will take place on 4th October, a decision likely to favour the two leading candidates, Ms Sanae Takaichi (former economic security minister and rival to the outgoing Mr Ishiba) and Mr Shinjiro Koizumi (son of the hugely popular former Prime Minister Mr Junichiro Koizumi, 2001/06). While markets are apprehensive about the conservative Ms Takaichi, they are far less so regarding Mr Ishiba's parting gift, a trade deal with the US which, according to an NHK poll has received the approval of over two-thirds of respondents. Overseeing the ongoing economic transformation while building support from a population grievous, as elsewhere, of the rising cost of living, will be no easy challenge for the election's victor but markets are, rightly, viewing the glass as half full not half empty.

## REASONS TO BE CHEERFUL

Since 2 April "Liberation Day" caused stock markets to plunge the world over, Japanese equities have fared well. Importantly, for the holders of broadly diversified portfolios, the drivers of that performance have differed from the US. Admittedly, communication services have performed very well in both countries, but while the other two big technology-heavy sectors (information technology and consumer discretionary) have performed strongly in the US they have underperformed in Japan where performance has been driven by industrials (US trade deal). Meanwhile, stock market performance has been supported by the yen which has fallen sharply against the dollar since 2021 (indeed, in real trade weighted terms the yen is near its lowest level in over half a century). This has coincided with fairly buoyant manufacturing sector profit margins. Furthermore, despite fears that tariff implementation might hit Japanese industry, the recent Q2 reporting season has confirmed the sector's resilience.

Without doubt the launch of ChatGPT in late 2022 proved the ignition for investor enthusiasm for AI and big tech earnings have grown far more strongly than those in Japan. However, the opposite has been true in the rest of the stock market, a big break in the pattern prevailing since the 2008/09 crisis to the extent that, at the index level, Japan has not lagged all that far behind in recent years. This reflects the fact that rapid growth in big tech in US indices has been offset by rapid growth in the utility, energy and financial sectors in Japanese indices. Importantly, the relative performance of Japan's equity indices does not simply hinge on earnings growth, but on valuation too. As things currently stand, the c.45%-point gap between the MSCI USA Index and its Japanese counterpart is very wide. Admittedly, it may not narrow significantly while the US technology domination holds but were a time to come where investor enthusiasm for AI diminishes the valuation discrepancy would likely narrow appreciably.

## KEY TAKEAWAYS

- Buoyed by the recent US trade deal and a weakening yen, Japanese equities have recovered strongly from post-Liberation Day lows.
- The Nikkei 225 has hit an all-time high even as the Bank of Japan normalises (raises) interest rates.
- Stock market performance is differentiated from that of the US where tech has dominated. In Japan utilities, energy and financials have led the way.
- The Japanese equity market's valuation discount to the US is hefty and may not alter much while investor enthusiasm for AI remains intact, but for diversified portfolios Japanese stocks offer an attractive counterweight.



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The VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

The MSCI Emerging Markets Index is used to measure the financial performance of companies in fast-growing economies around the world. The MSCI China A Index measures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The MSCI Pacific Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region. The MSCI USA Index is designed to measure the performance of the large- and mid-cap segments of the US market. The MSCI Europe index is a European equity index which tracks the return of stocks within 15 European developed markets.

The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

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