OUTLOOK 2025

DECEMBER 2024

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Outlook 1H 2025: Executive Summary

We believe 2025 will be another good year for equity investors, as the key macroeconomic backdrop that has driven market returns in recent years is likely to continue.

The new US administration will be more inward-looking, with an overall **pro-growth** agenda that includes tax cuts and deregulation. It has also significantly reduced fears of an imminent recession. However, these measures, combined with higher tariffs and more restrictive immigration policies, will add to **inflationary pressures,** and could force the Fed to slow or even question its rate-cutting cycle.

The combination of robust growth, loose financial conditions and healthy corporate balance sheets means that we remain optimistic about the credit segment. We **favour high yield** (HY) across all regions due to the attractiveness of the all-in yield. We are more **cautious on investment grade** (IG), not only because of extremely tight spreads, but also because of greater interest rate sensitivity.

Despite rising **policy risks**, the overall environment remains **supportive for equities**. With earnings growth expected to reach 15%[1] in 2025, the US market should retain its structural advantage over other developed markets, but these ambitious estimates will be difficult to achieve and could lead to negative surprises, particularly for technology mega-caps.

In **Europe**, economic growth will remain subdued, but some of the headwinds should ease in 2025, both on the macro and earnings growth fronts. At 13 times forward earnings, European equities trade at a discount of around 40%, a **multi-decade low relative valuation**. The resolution of the war in Ukraine or the adoption of a recovery and investment plan based on less restrictive fiscal policies could act as a catalyst for a re-rating.

The external dynamics of **emerging markets** changed dramatically after the US election. The soft-landing scenario of a gradual decline in interest rates without triggering a recession gave way to a scenario in which US interest rates would remain high, the dollar would strengthen, and the risk of new tariffs would be the order of the day.

We are all familiar with the non-confiscatory nature of **gold**. However, contrary to expectations, gold has risen in a strong dollar environment. A pause in US interest rate cuts could mean a pause in gold's rally.

[1] Factset Earnings Insight published on December 12

In a Nutshell

Economic Outlook

US election resolution brings clarity to markets

Global growth remains resilient in 2025, in line with 2024 estimates

Growth divergence among developed economies widens

Global developed market policy rates normalizing

Fed rate cuts to be more measured

Inflation tilted to the upside, especially in the US under Trump 2.0

Key Risks

Fed forced to raise rates by one-off and persistent inflation shocks

Economic slowdown without fall in inflation leads to rise in term premiums

Ineffective policies lead to Japanification of Chinese economy

Japanese real interest rates on the rise

Investment Convictions

Eurozone growth headwinds give European Central Bank (ECB) room to cut rates

US yield curves could rise in 2025, adding duration if 10Y yield rises to around 5.0%

EM corporate spreads attractive, but volatility expected as trade tariffs unfold

Supportive policy should continue to underpin US Small and Mid-Caps

Interest-rate differentials remain as catalyst for flows into dollar-denominated assets

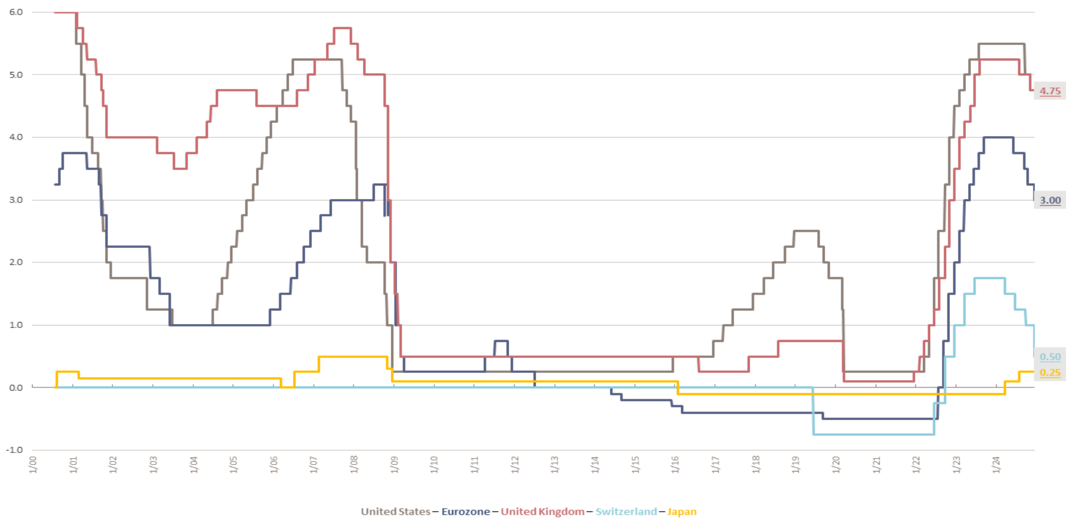
2024 Review : Key Highlights

Towards a Cycle of Monetary Easing in Developed and Emerging Economies

The global battle against inflation appears to have been largely won. Inflation has fallen and is moving convincingly towards central bank targets. Policy normalisation is well under way in most of the world's economies. The most remarkable achievement of central banks is that they have brought inflation under control without triggering a global recession.

The **Federal Reserve** (Fed) cut interest rates in September, starting with a 50 basis points (bps) reduction, followed by a 25 bps cut to 4.75% in November. The **Bank of England** (BoE) cut twice by 25 bps reduction to 4.75%. The **European Central Bank** (ECB) has cut rate four times since June to 3.0% while the **Swiss National Bank** (SNB) has cut for the fourth time with a 50 bps reduction in December to 0.5%. In Japan, however, the forecasts for the policy rate have been revised upwards, reflecting the **Bank of Japan**'s rate hike in July.

Exhibit 1: Policy Rates (%)



Source : Bloomberg as of December 13, 2024

FDTR Index: *US Fed Funds Rate –* ***EUORDEPOA Index****: European Central Bank –* ***UKBRBASE Index:*** *Bank of England –* ***SZLTDEP Index:*** *Swiss National Bank –* ***BOJDTR Index:*** *Bank of Japan*

An Aggressive Stimulus Package to Revive China's Growth and Consumer Confidence

In September, the Chinese authorities have stepped up their stimulus announcements in a bid to revive the country's economy. The PBoC cut its reserve requirement ratio by 0.5%, injecting 1 trillion yuan ($141.82bn) of long-term liquidity into the financial market, and reduced the seven-day reverse repurchase rate from 1.7% to 1.5%.

In October, China's Ministry of Finance unveiled a fiscal stimulus package aimed at boosting the economy and achieving the government's growth target. These measures, announced just before the National Day holiday, sent the Chinese stock market soaring. By 9 October, China's stock markets had given back almost a third of the rapid gains they had just made.

Exhibit 2: Shanghai 300 Index

Source : Bloomberg as of December 13, 2024

On November 8, some details emerged of the 10 trillion yuan (USD 1.4 trillion) package over five years that aimed to tackle local government debt problems.

Half the World's Population Voted in National Elections

From Taiwan's parliamentary elections in January to the US presidential race in November, countries with almost half the world's population are going to the polls.

In **France**, the president called a **snap election** after the far right made big gains in the European Parliament elections. After the final round of voting, the country will have a hung parliament. Prime Minister Barnier proposed a budget without a parliamentary vote (Article 49.3), but the opposition parties then brought down the government with a motion of no confidence. President Macron remains in office, but has appointed centrist François Bayrou as France’s fourth prime minister in 2024. This uncertainty and political gridlock will continue to weigh on the French assets.

The **UK general election** resulted in a landslide victory for the Labour Party. Shortly after taking office, Chancellor Reeves announced £40bn tax rise to fund the NHS and other public services. The spending boost is expected to add 0.75% to GDP and 0.5% to consumer price inflation in a year's time, while the tax change - a £26bn increase in employers' National Insurance contributions - is much harder to assess.

The main event risk this autumn was the US election. The election of Trump - who controls both the House of Representatives and the Senate - and the announcement of a smooth transition of power reverberated through financial markets, pushing US equity indices to new highs on the prospect of tax cuts, tariffs, and deregulation, while fears of punitive tariffs on imports weighed on international markets such as Europe.

Despite the uncertainties surrounding the implementation of his programme, with the US election behind us, greater political clarity is creating a backdrop that will allow companies to make decisions and start a new cycle of investment that will further accelerate the trend towards friendshoring in both supply chains and innovation.

Historic levels of Concentration: Rising Dominance of US Equities and Technology

Since the Great Financial Crisis, the dominance of US equities in global equity indices has accelerated, with a weighting of over 66% in the all-country equity index, up from around 42% in 2007. This hegemony is unprecedented in recent history, as the Japanese stock market peaked in the 1990s at around 40% of global market capitalisation.

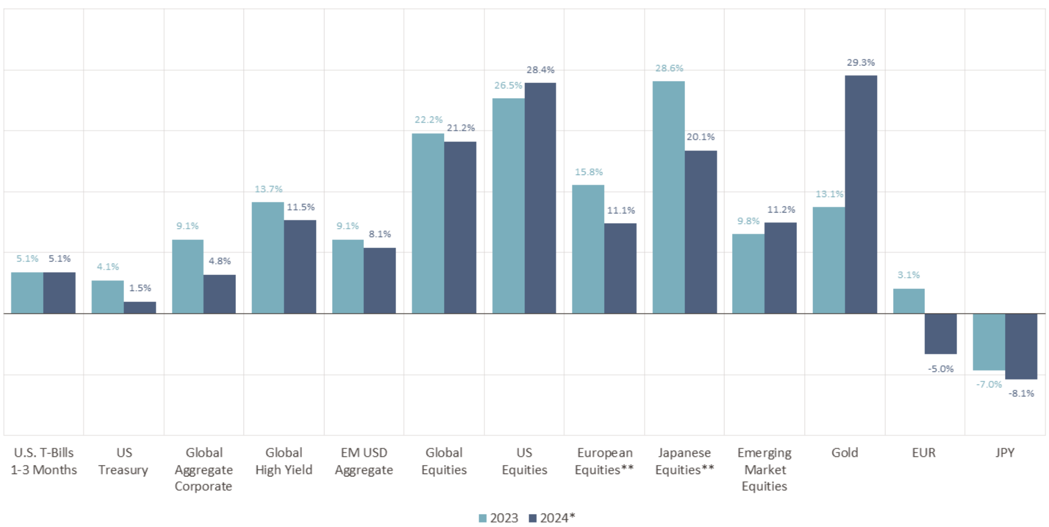
The high concentration in US equities has been a great source of returns, but also of investor anxiety. This stellar performance has been driven by the so-called Magnificent 7, which have returned 41% year-to-date versus just 18% for the remaining 493 stocks and have accounted for an astonishing 47% of the index's gains.

The Magnificent 7 effect has pushed this concentration in the US stock market to almost its highest level in 100 years. The only other time it has reached current levels was during the Great Depression and it is well above the levels reached during the dotcom bubble in 2000.

Concentration in the US stock market reached a record high in 2024, with the top 10 companies accounting for around 36% of the market. With almost a third of the market, the top 10 stocks have a significant influence on the direction of equity indices, as seen in 2023 and 2024. Recently, breadth has improved dramatically.

The Year in a Few Numbers: Continued Strength for Risk Assets

Exhibit 3: Total Return in U.S. Dollar



*Source: Bloomberg - Note: * As of December 13, 2024 ** In local currency*

Outlook for 2025

Global Outlook 2025: Policy Risk Playing a Growing Role

The pro-growth policy mix of the second Trump administration (Trump 2.0) will focus on:

Tariffs – Trump has floated the idea of imposing tariffs of up to 60% on imports from China and 20% on imports from the rest of the world. Even if these threats are just a tool to negotiate trade terms, the uncertainty created by trade tensions could be detrimental to global growth. Early estimates of the economic headwind from such a policy are that it will weigh disproportionately on **euro area** and **Chinese** GDP, by 0.9% and 0.7% respectively.
The tariff hike could lead to a one-off inflation shock of around 250 bps, like the price increase observed in 2018-2019 for goods subject to these new tariff conditions. Perhaps anecdotally, higher tariffs could have a positive impact on tax revenues of up to $450 billion, although this remains small compared to the impact on growth and inflation.

Immigration – One of the key election promises was to tighten controls on immigration, particularly illegal immigration, including the deportation of up to 8 million undocumented immigrants, which will put unprecedented pressure on an already tight labour market.
Even if the administration wants to make good on its campaign promises, it seems unrealistic to envisage mass deportations, given the logistical challenges involved, not to mention the fact that the US economy has become highly dependent on these immigrant workers.

Taxes – The 2017 tax cuts are expected to be fully extended rather than allowed to expire, potentially reducing the corporate tax rate for domestic manufacturers from 21% to 15%.
A more favourable tax regime will potentially increase pressure on the budget deficit. Initial estimates suggest that the deficit will increase by around USD 7.5 trillion over the next decade, bringing the debt to 142% of GDP. These recent announcements will exacerbate concerns about debt sustainability and the unsustainable trajectory of this deficit.
On the interest rate front, however, we should see some fiscal relief as monetary easing continues. However, given the inflationary policies advocated by the new administration, the potential fall in final rates is likely to be more muted.

Deregulations – The president-elect is in favour of a new wave of regulatory easing. It is still difficult to gauge the extent and impact of this easing. However, we can already assume that regional banks and the energy sector will be among the winners.

Implication for financial markets
Rates – In contrast to 2026, the Federal Reserve is now normalising monetary policy. It's likely that the fed funds rate will continue to fall, but we can't rule out the possibility that the decline in 2025 will be less than the 100 bps that the market has priced in or that FOMC members projected in the September dot plot.

Equities – On the face of it, the measures announced are positive, particularly for cyclicals, value stocks such as financials and energy, and small and mid-caps. A broader participation was expected and desired after the first Fed cut, as it would confirm the thesis of a healthy market whose progress is not entirely linked to a few stocks.

Dollar – If the trade war launched under the first Trump administration (Trump 1.0) in 2018-19 is anything to go by, we can reasonably expect the US dollar to appreciate.

Key risks

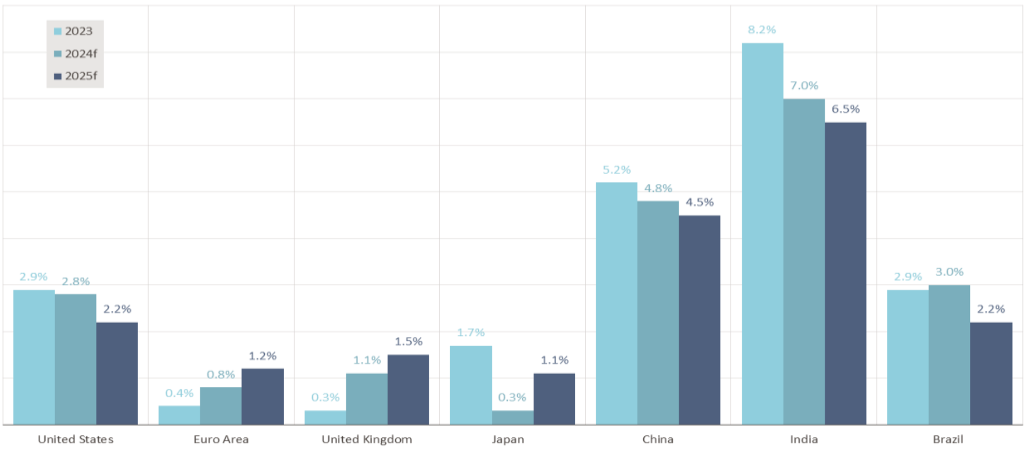
Recession risk – A sharp economic slowdown due to a nasty trade war, with retaliatory measures creating significant uncertainty would, undoubtedly increase the likelihood of an economic downturn. The probability of this scenario remains low as the implementation of Trump's policy agenda is likely to be much more moderate than his campaign promises.

Inflation shock – Higher inflation will lead to an upward trend in long-term yields and could derail the current bull market in equities. If the Fed is forced to intervene by raising interest rates, we will enter a period of significant volatility that will lead to significant market corrections, especially given the high valuations of certain growth segments such as technology.

Growth Outlook: Stable Growth Matching 2024 …

In the developed economies, growth is expected to remain stable at around 1.8% in 2024 and 2025. However, specific cyclical dynamics are emerging in different countries as economies gradually converge towards their growth potential. The US economy will remain the strongest, with projected growth of just over 2.0% in 2025. Emerging economies are also expected to remain remarkably stable, with growth of 4.4% and 4.3% in 2024 and 2025 respectively.

Exhibit 4: Real GDP Growth Forecast (y/y, %)



Source: IMF – Global Economic Outlook – October 2024
Note: f = forecast

In the **United States**, the growth profile for 2024 has been revised up to 2.8%, 0.2 percentage point higher than in the previous forecast, on the back of resilient consumption, largely driven by strong real wages and wealth effects.

In the **euro area**, economic activity is expected to pick up in 2024 and 2025, after reaching a cyclical trough in 2023. The recovery in 2024 is driven by improved merchandise exports. The continuation of this trend in 2025 is mainly the result of stronger domestic demand. Consumption will be boosted by real wage growth, while the easing of monetary conditions will support investment demand. However, weakness in the manufacturing sector will persist, particularly in economies such as Germany and Italy.

In the **UK**, the improvement in the growth trajectory will continue. After accelerating to 1.1% in 2024, the UK economy is expected to grow at an annual rate of 1.5% in 2025, thanks to domestic demand stimulated by lower inflation and interest rates.

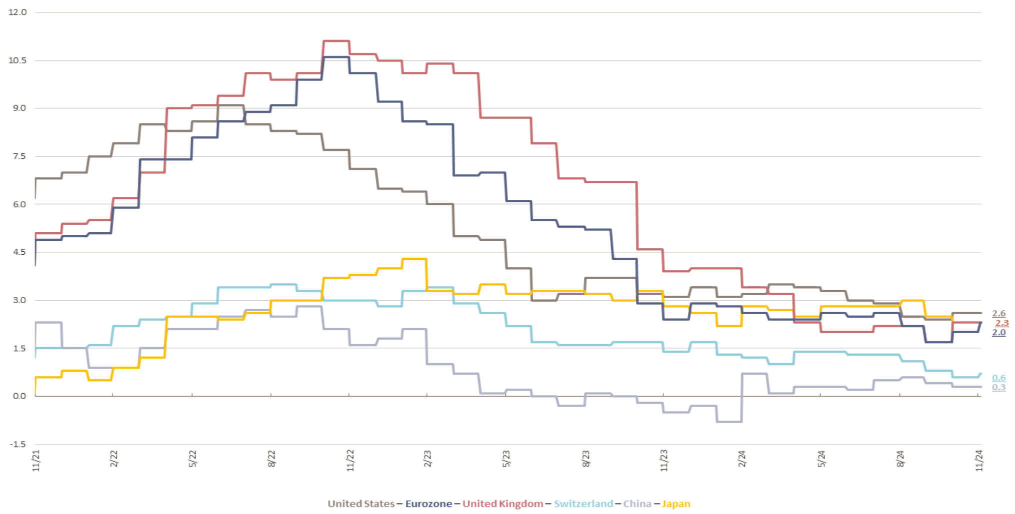
In **Japan**, growth is expected to slow in 2024 and the forecast for that year has been revised down to 0.3%. However, growth is expected to reaccelerate to 1.1% in 2025, once the temporary disruptions have passed. As in other developed economies, growth will be driven by private consumption, well supported by strong real wage growth.

In **China**, despite continued weakness in the property sector and declining consumer confidence, growth is projected to slow only slightly to 4.8% in 2024, with a gradual deceleration to 4.5% in 2025 due to deleveraging in the property market and potential pressure on exports from trade tensions. In India, growth is also projected to slow from 2023 to 7% in 2024 and 6.5% in 2025, in line with the growth potential of the Indian economy. In Brazil, growth expectations have been revised up to 3.0% in 2024 before declining to 2.2% in 2025, mainly due to tighter monetary policy and a more flexible labour market.

Inflation Outlook: … Amid Diverging trends

As highlighted in our June issue, global inflation is falling and approaching the 2% target generally expressed by the major central banks. Although the normalisation of inflation levels will not be linear, it is continuing. After averaging 6.7% in 2023, global inflation should reach 5.8% in 2024 and 4.3% in 2025. However, since the election of Donald Trump, it seems likely that the implementation of his programme could lead to a re-acceleration of inflation.

Exhibit 5: Headline Consumer Price Index (y/y, %)



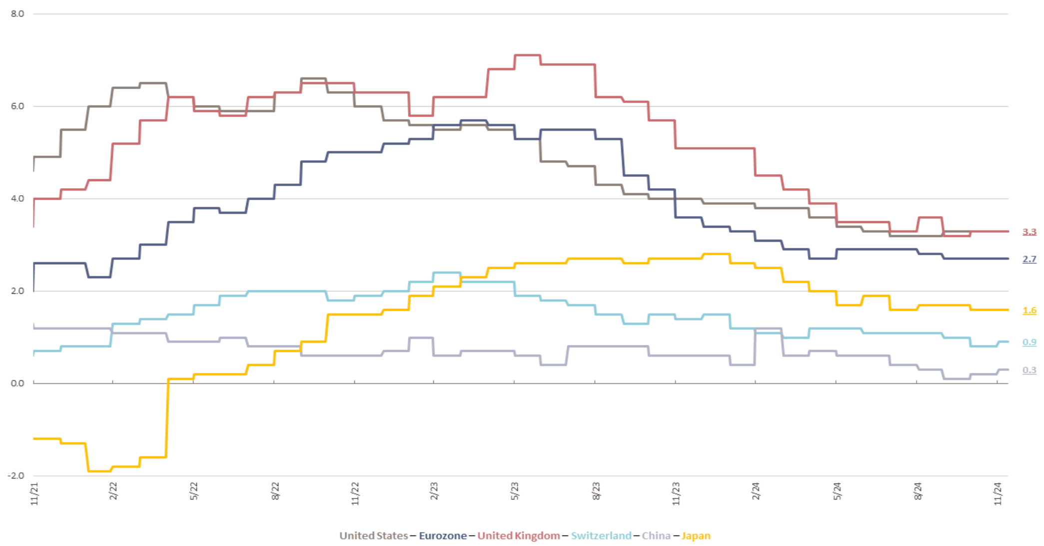
Source: Bloomberg as of December 13, 2024

Disinflation will be faster in advanced economies than in emerging markets. After falling by around 2% in 2024 compared with 2023, inflation in the advanced economies is expected to stabilise at 2% in 2025, although, as mentioned above, there is an increasing risk of this being exceeded because of the adoption of more inflationary policies in the United States.

In **emerging markets**, inflation is expected to decline moderately from 8.1% in 2023 to 7.9% in 2024. However, expectations are more pronounced for 2025, when inflation is projected at 5.9%. There are significant regional differences within Emerging Asia. In Emerging Asia, inflation is expected to be in line with developed countries, at 2.1% in 2024 and 2.7% in 2025.

In most Latin American countries, inflation rates have already come down significantly from their peaks and this trend is expected to continue. However, expectations have risen in some of the region's largest countries due to robust wage growth (Brazil, Mexico), climatic events (Colombia) or the increase in regulated tariffs (Chile).

Exhibit 6: Core Consumer Price Index (y/y, %)



Source: Bloomberg as of December 13, 2024

In the US, October consumer price data came in as expected, with headline prices up 0.2% m/m and core prices (excluding food and energy) up 0.3% m/m, bringing the headline inflation rate to 2.6% y/y, while the core rate was unchanged at 3.3% y/y.

The crux of the problem remains shelter, which accounts for a third of the CPI basket. If we exclude shelter, CPI inflation would be below the famous 2%, as it was before Covid. Core goods inflation is already in negative territory and shelter inflation is expected to moderate.

The growing uncertainties regarding the evolution of goods prices will depend on the scope and level of tariffs. For the record, the increase in tariffs in 2018 did not have a negative impact on goods price inflation. All in all, the inflation forecast is slightly higher than a few months ago, but not significantly so.

In the **euro area**, the downward trend in energy prices, including gas and electricity, has reduced inflationary pressures, and is expected to decline significantly, implying subdued energy inflation. However, the differential strength and speed of the pass-through of energy prices into consumer prices is expected to make a negligible contribution to headline inflation.

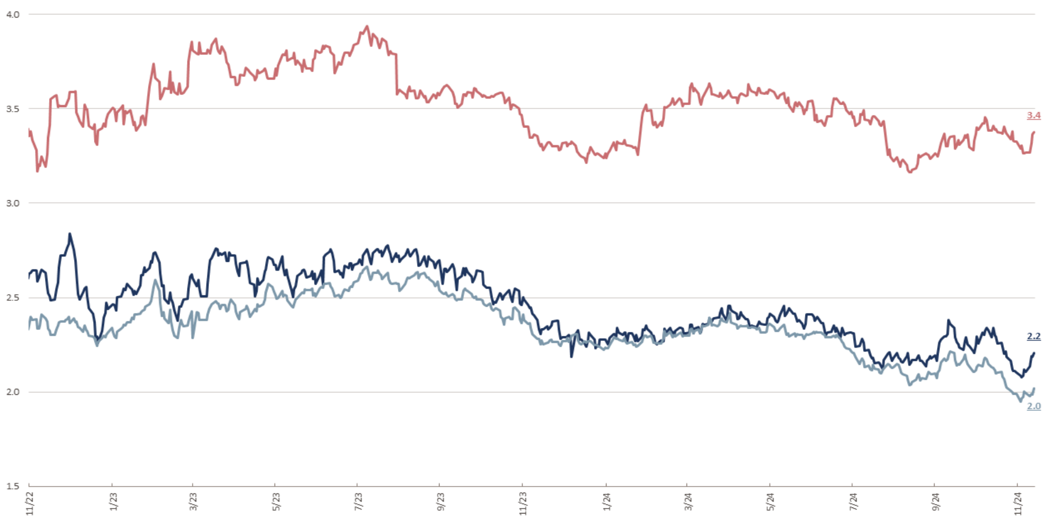
The gradual disinflation in services is expected to bring headline inflation down to 2% by the end of 2025 and then below that level by 2026. Excluding volatility due to the phasing out of energy subsidies and base effects, inflation is expected to average 2.6% in the first half of the year, before falling to 2.2% in the second quarter of 2025 and reaching 2% by the end of 2025.

In line with these expectations, market-priced inflation expectations have shifted further to the downside at all horizons. Market-priced break-even inflation expectations have moved steadily lower since the end of May, before rising again recently, with the break-even inflation rate currently at 2.2%.

In the **UK**, the recent government policies announced in the Autumn Budget - a £70bn annual increase in government spending and a £40bn increase in taxes - are unlikely to derail the fall in inflation (as measured by the Consumer Price Index) over the next few years, but they will affect the speed at which that fall takes place.

These policies have led Capital Economics to revise its forecasts for UK inflation slightly upwards to 2.8% and 2.1% for 2025 and 2026 respectively, from its original 2.6% and 2.0%.

Exhibit 7: Inflation Breakeven (%)



Source: Bloomberg as of December 13, 2024
UKGG5Y5Y Index: UK 5yr5yr Forward Breakeven – FRGG5Y5Y Index: France 5yr5yr Forward Breakeven – FWUSEU55 Index: EUR Inflation Swap Forward 5yr5yr

In Japan, our central scenario assumes that the CPI will increase by 2.5% in 2024, followed by increases of around 2% in 2025 and 2026. Core inflation is expected to rise gradually to a level consistent with price stability.

In China, the persistence of near-zero inflation is the latest evidence that China's domestic demand remains subdued, with various demand headwinds despite the stimulus measures announced by Beijing since September, including interest rate cuts, more cash for bank lending and support for the stock and property markets.

Monetary Policy Outlook: Return to Neutral Stance by 2025

The global monetary easing is underway, except in Japan, as central banks move from restrictive to neutral policies, implying a reduction in interest rates over the next few quarters.

Exhibit 8: Policy Rate Forecasts (%)

	US[2]	Euro Area	CH	UK	JP
Current[3]	4.75	3.00	0.50	4.75	0.25
Q4 2025[4]	3.50	1.75	0.25	3.75	1.00
Neutral Rate	3.75	2.00	0.25	4.00	0.75

Source: Factset, Bloomberg

In the **US**, the Federal Reserve is expected to continue to cut interest rates until 2025, with a target range of 3.25%-3.50%. The pace of these rate cuts is expected to be at each meeting in the first quarter and then at a slower pace thereafter. At the end of November, the market was pricing in a 60% probability of a 25 bp cut in December. The market also appears to be less optimistic about future rate cuts throughout 2025 than is currently forecast. This may reflect concerns that inflation could rise again due to the inflationary policies of the incoming Republican administration.

We might have expected a synchronised decline in interest rates in response to the ongoing disinflation, but the recent election results have changed this dynamic somewhat. In the **euro area**, uncertainties surrounding punitive tariffs on European exports, are likely to weigh on European economic growth. These clouds should therefore allow the ECB to adopt an even more dovish monetary policy and cut the eurozone's key interest rate to 1.75%.

In the **UK**, the more expansionary Autumn Budget has led to a reassessment of the path and level of interest rates across the yield curve. However, the disinflationary trend is not in question. We therefore expect the base rate to be cut by 25 bps each quarter in 2025, reaching 3.75% by the end of the year.

In **Japan**, the path to sustainable inflation will allow the Bank of Japan to gradually normalise monetary policy. Current expectations are for two rate hikes in 2025, probably 25 bps in January and a further 25 bps in the summer, bringing the policy rate to 0.75% at the end of 2025.

In **China**, the long-awaited strong policy shift towards domestic demand and consumption began in September when the People's Bank of China cut short-term interest rates and the reserve requirement ratio to combat deflationary pressures.

[2] Upper Limit
[3] As of December 13, 2024
[4] End of Period

Asset Valuation: Stretched Valuations are Not Limited to Equity Markets

As inflation has come down significantly from its peak, **real policy rates** have moved out of negative territory and back to levels seen before the global financial crisis or in the 1990s. These restrictive levels give central banks room to ease policy rates further. However, concerns about excessive budget deficits are reducing the upside potential of long-dated government bonds (bear steepening), as investors demand an extra yield for such risk.

In the **US**, the combination of these factors will lead to higher terminal interest rates than previously expected and, at the same time, to higher long-term yields over time. Although the case for long duration in Europe is becoming clearer as the growth outlook deteriorates due to global trade and geopolitical uncertainties. In addition, the political stalemate in France and the upcoming elections in Germany could lead to further fiscal loosening and therefore more differentiation in the intra-European bond markets.

So far, the obvious beneficiary of these developments and uncertainties has been the Swiss bond market, where the 10-year government bond yield has reached between 20-25 bps. In the UK, the government's autumn budget will lead to a significant increase in borrowing needs, pushing up interest rate expectations and gilt yields.

Credit spreads have tightened considerably in 2024. In the US, the investment grade (IG) spread is well below 100 bps, while the high yield (HY) spread is below 350 bps. They are indeed tight but should remain so in 2025 thanks to supportive fundamentals and technicals.

Despite the tight spreads, we expect them to remain around current levels in 2025. Spreads are expensive, but valuations alone are not enough to trigger massive spread widening. Can spreads stay at these levels and if so, for how long? There have been short-lived episodes where spreads have been this tight, but there have also been sustained periods where USD IG and HY spreads have stayed below 100 bps and 350 bps respectively.

Exhibit 9: Credit Spread (Option Adjusted Spread in %)

Source: Bloomberg as of December 13, 2024

LUACOAS Index: *US Agg Corporate OAS –* ***LECPOAS Index****: Euro Agg Corporate OAS –* ***LF98OAS Index:*** *US Corporate High Yield OAS –* ***LP01OAS Index:*** *Pan European High Yield OAS*

Emerging market sovereign credit spreads, along with other credit spread products, are at their tightest levels for several years. The tightening of hard currency sovereign spreads has been a major contributor to the nearly 7% total return so far this year.

As in the US credit market, current spread levels are pricing in a constructive macro backdrop, but changes in US fiscal and trade policy could create headwinds for EM growth, and the inflationary nature of these policies could support a higher-for-longer scenario for US interest rates, which would ultimately be challenging for EM sovereign total returns.

Therefore, the combination of pressure from a stronger US dollar and interest rates warrants a cautious approach to the EM sovereign space. As in 2024, we focus our EM bond investments exclusively on the hard-currency corporate segment. Within this very specific segment, we favour an approach focused on issuer selection (idiosyncratic), particularly in countries where the sovereign rating prevents a more favourable rating for the issuing company ("good company in a bad country").

Exhibit 10: EM Spreads (Option Adjusted Spread in %)

Source: Bloomberg as of December 13, 2024
BEBGOAS Index: EM Sovereign High Yield OAS – EMUSOAS Index: EM USD Aggregate OAS – BEHGOAS Index: EM Sovereign Investment Grade OAS

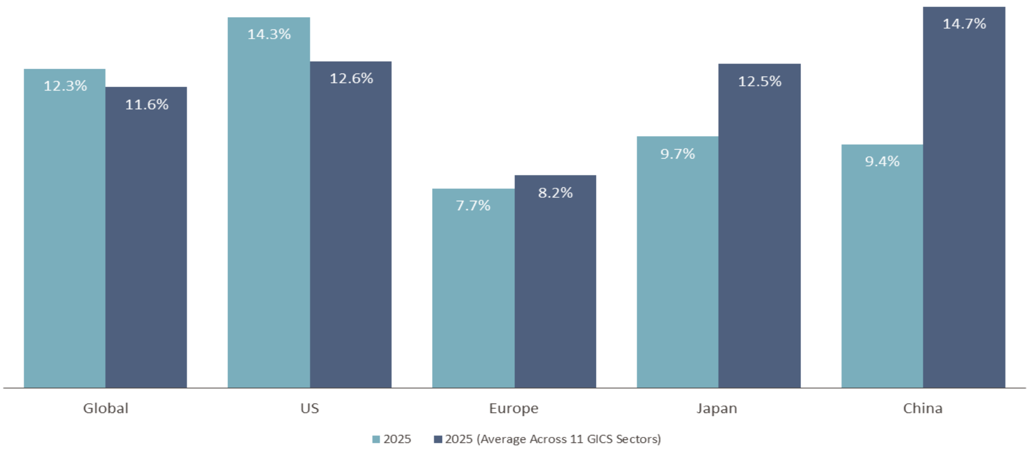
Equity Valuation: All About Earnings Growth

The main concern at the start of 2023 was the threat of an economic slowdown, but this did not materialise as the economy showed a resilience that surprised many economists. Politics then monopolised investors' attention and the uncertainties surrounding the elections exacerbated fears, leading to higher levels of volatility. The resolution of the US election with the Republican victory has brought clarity and greater policy certainty, at least initially for the time being.

Trump's agenda should be supportive of US growth and therefore US equities, and are likely to be a headwind for growth in the rest of the world and ultimately for earnings.

To put it bluntly, earnings growth is important, but earnings surprises are even more important and will determine future returns. Given the ambitious earnings expectations in the US, where the consensus is for earnings growth of around 15% in 2025, the risk of disappointment is greater and even higher for technology mega-caps.

Exhibit 11: FY EPS Growth Estimates by Region (%)



Source: I/B/E/S, MSCI, Standard & Poors', and Thomson Reuters Datastream as of November 30, 2024

US Equities: Valuation Overstretched

We expect the positive earnings momentum to continue. At the index level, the US market is expected to deliver earnings growth of 5.8% in Q3 2024 and a whopping 12.0% in Q4, while the consensus forecast for 2025 is for earnings growth of 15.0%.

In terms of earnings per share (EPS), the median of the top-down consensus estimates is $268 for 2025 and $288 for 2026, while the bottom-up consensus estimates are $274 and $300, respectively, while revenue growth is expected to be 5.7%, consistent with a forecast for real GDP growth of 2.2%-2.5% and inflation of 2.5% by the end of 2025.

Exhibit 12: Earnings Growth (Y/Y in %)

	Q4 2024	CY 2024	CY 2025
S&P 500	**12.0**	**9.4**	**15.0**
Communication Services	20.7	21.6	15.5
Consumer Discretionary	12.5	14.5	12.5
Consumer Staples	(1.7)	2.7	5.6
Energy	(23.3)	(16.9)	6.1
Financials	38.9	16.4	8.6
Health Care	12.6	4.1	20.7
Industrials	(2.9)	(0.1)	19.0
Information Technology	13.9	17.6	23.2
Materials	1.1	(8.6)	18.9
Real Estate	6.6	4.5	4.7
Utilities	12.9	10.4	9.0

Source: FactSet (November 22, 2024)

The 12-month forward P/E is 22.0x, above the 5-year (19.6x) and 10-year (18.1x) averages. Over the past two years, the index's P/E multiple has risen by more than 25%. At the end of 2022, a tough year for the "Magnificent Seven", which were down 45.3%, the market traded at a trailing P/E of 22.1x, down from 28.4x on 1 October 2024.

While valuations alone are weak predictors of near-term returns, they could amplify the correction in the event of a negative shock, but expansionary fiscal policy and a more dovish Fed are undeniable tailwinds for the market. On the other hand, if the Fed were to become more hawkish in response to supply shocks, e.g. tariffs, deportations, this could create a shockwave for which the market is not fully prepared and could lead to market turbulence.

The superior earnings growth of the Magnificent Seven has been the main driver of outperformance versus the broad market. However, the earnings growth gap between these two cohorts will narrow in 2025 and 2026. As a result, we believe that mid-caps are well positioned to benefit from solid domestic economic growth in 2025, as they generate a higher proportion of their earnings domestically and are therefore less exposed to trade tensions.

European Equities: No Immediate Relief but ...

Looking ahead to 2025, economic growth will remain subdued, with expectations for the euro area (below 1.0%) and the UK (above 1.0%) mainly driven by US tariffs, fiscal conservatism, and manufacturing headwinds. We expect some of the headwinds to ease in 2025, both on the macro and earnings growth fronts.

What's more, we think the lag in eurozone equities is completely overdone. Since October 2022 (13/10/2022), eurozone equities have underperformed the US index in local currency terms. In our view, all these headwinds appear to be fully reflected in European equity valuations. At 13x forward earnings, European equities trade at a discount of around 40%, a multi-decade low relative valuation.

While the lack of growth will remain the main issue, and without wanting to gloss over the challenges facing the region and the huge amount of work that needs to be done to regain competitiveness, current levels seem to reflect much of the bad news. The resolution of the war in Ukraine or the adoption of a recovery and investment plan based on less restrictive fiscal policies could act as a catalyst for a re-rating.

Japan: Vulnerable to Global Slowdowns

Apart from the indiscriminate imposition of tariffs by the US, the confluence of positive factors such as constructive economic growth, post-election clarifications and hopes for economic stimulus in China should support corporate earnings growth.

The mixed results published for the second quarter were largely due to the yen strengthening against the dollar. However, since the US elections and the rebound in the US dollar, some of these concerns have abated.

The exit from deflation should continue to support domestic flows, while reduced political uncertainty could attract international flows, especially as countries such as China become more difficult for many developed market investors to invest in.

Emerging Markets: Headwinds Under Trump 2.0

Trump's return to the White House, often referred to as Trump 2.0, is a worrying factor for emerging markets. Indeed, the protectionist agenda is likely to pose challenges for China and Mexico as it challenges the previous US election scenario of a soft landing accompanied by a gradual decline in interest rates without a recession.

China Equities: Challenging External Backdrop

China's real GDP growth is expected to slow from 4.9% in 2024 to 4.5% in 2025. The low absolute level of inflation reflects the headwinds to domestic demand. The Chinese authorities have launched a large monetary and fiscal stimulus to revive the economy and pre-emptively offset the potential impact of trade tensions.

Consensus earnings growth for the CSI 300 is currently +14% in 2025, as higher tariffs will eventually be partially mitigated by a more competitive currency and more forceful policy measures. In terms of valuation, the broad China index currently trades at 46% and 23% discount to developed and emerging markets ex-China.

Investment convictions

Scorecard for 2H 2024

#1 – Long-Dated Government Bonds[5]:

Long-dated EUR government bonds, posted a strong return in November, taking their return to almost 9.0%, well above the market. Performance in the US Treasury market performance was less stellar and varied across maturities.

#2 – Emerging Market Corporate Bonds[6]:

EM and US spreads have tightened, while US 10Y yields were almost flat over the period despite the October sell-off, which was partially reversed in November. The US side has benefited the most from Trump's victory.

#3 – « Fantastic Five »[7] versus «Magnificent Seven »[8]:

Once again, the momentum of the Magnificent Seven took its toll, with a 27.4% rise in the second half of the year. How could the Fantastic Five lead the way when this group of titles fell by more than 9%!

#4 – Adding Diversification (Value vs Growth)[9]:

Again, there is a discrepancy between Europe and the US: while value stocks in Europe benefited from the interest rate environment, US growth stocks made a stunning comeback in December.

#5 – European and U.S. Small and Mid-Caps[10]:

Small and mid-caps outperformed large caps in both regions. In the US, US small and mid-caps gained 11% in November, largely driven by the US election results. In Europe, returns were more stable but similar in direction.

Source: Bloomberg

[5] Bloomberg US Long Treasury Total Return (+2.73%) vs Bloomberg US Intermediate Treasury Total Return (+2.76%); Bloomberg Euro Agg Treasury 10+ Total Return (+8.7%) vs Bloomberg Euro Agg Treasury Total Return (+5.6%)
[6] iBoxx USD EM Broad Corporates IG (+3.6%) vs Bloomberg US Corporate IG Total Return (+4.6%); iBoxx USD EM Broad Corporates HY Total Return (+5.7%) vs Bloomberg US Corporate High Yield Total Return (+6.4%)
[7] ASML holding, AstraZeneca, Novo Nordisk, LVMH and SAP
[8] Apple, Alphabet, Amazon, Meta, Microsoft, Nvidia and Tesla
[9] Russell 1000 Value Total Return (+11.5%) vs Russell 1000 Growth Total Return (+10.8%); MSCI Europe Value Net Total Return (+5.5%) vs MSCI Europe Growth Net Total Return (-1.1%)
[10] Russell 2000 Total Return (+17.6%) vs Russell 1000 Total Return (+13.0%); MSCI Europe Net Total Return (+2.0%) vs MSCI Europe Mid Cap Net Total Return (+5.8%) and MSCI Europe Small Cap Net Total Return (+3.0%)

Convictions for 1H 2025

#1 – US Mid-Cap: The Way to Go

The small- and mid-cap segment is very sensitive to changes in interest rate expectations. The fact that the Federal Reserve has become more dovish and has started its cycle of rate cuts has played into the hands of this market segment.

Monetary easing should restore management confidence and boost M&A activity. In terms of absolute valuation, the segment is in line with long-term averages and attractive relative to large caps, with a discount of around 11%, below historical averages.

Finally, the re-shoring initiatives that have been advocated for several quarters and are at the heart of Trump 2.0 should help this segment of the market to make a sustained comeback.

#2 – EM Corporate: Spreads and Yields still Attractive

The US presidential election in early November was one of the most important events of the year. Trump's pro-growth policy mix could be somewhat inflationary and will lead to fewer interest rate cuts by the Federal Reserve until 2025.

Like US high yield, EM high yield is less interest rate sensitive and should therefore be less negatively affected by a significant rise in the US Treasury yields.

In addition, and as highlighted in our last issue, EM corporate credit fundamentals remain supportive and on an improving trajectory, particularly on the high yield side.

#3 – US Curve: Bear Steepening

The US 2Y/10Y spread has normalised in 2024 and even turned positive again in September. The steepening of the curve took place well before the election in early November, in contrast to 2016, when a similar move took place immediately after the election.

The rise in the term premium reflects the accelerated deterioration in the fiscal situation in the context of the change in US fiscal policy doctrine.

We recommend selling the long end of the curve in favour of shorter maturities. The election of Trump in 2024 was followed by a modest steepening of the US Treasury yield curve, much less than in 2016. Same playbook: stocks rise, curves steepen and the term premium rises.

#4 – U.S. Dollar: Bullish for Now

Donald Trump's agenda is certainly full of conflicting dynamics, and yes, the US dollar, like other assets, is generously valued. However, US growth will continue to outpace the rest of the world and this trend is unlikely to be reversed given the pro-domestic growth policy mix.

At the same time, measures such as tariffs will weigh on activity outside the US, which could lead to a more aggressive response in terms of monetary easing. As a result, interest rate differentials between zones will widen, acting as a catalyst for flows into dollar-denominated assets.

Asset Class Views

Asset Class

	H1 24	H2 24	**H1 25**
Cash	=/+	+	**-**
Fixed Income	-/=	=	**-**
Equity	+	=	**=/+**
Alternatives	-/=	-/=	**+**
Currencies (USD vs. G10)	=	=/+	**=/+**
Commodities	-/=	-	**-**

Fixed Income

		H1 24	H2 24	**H1 25**
Government Bonds	US	=/+	+	**-**
	EU	=/+	+	**=/+**
	UK	=	=	**=**
	CH	-	=	**=**
Corporate Bonds	US IG	+	+	**=**
	EU IG	+	+	**=**
	US HY	+	+	**+**
	EU HY	+	+	**+**
Emerging Market Debt	Sovereign HC	-/=	=	**=**
	Sovereign LC	=	=	**-**
	Corporate	+	+	**+**

Equity

		H1 24	H2 24	**H1 25**
U.S.	Large	-/=	-/=	**=/+**
	Small	=/+	=	**+**
Europe	EU Large	=/+	+	**=**
	EU Small	+	+	**-/=**
	CH Large	=	=	**=**
	CH Small	+	+	**-/=**
	UK	=	=	**=**
Others	Japan	-	-	**-/=**
	China	+	=/+	**=**
	India	=	=	**+**
	Other EM	=	=	**=**

(-) Negative, (=) Neutral, (+) Positive

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