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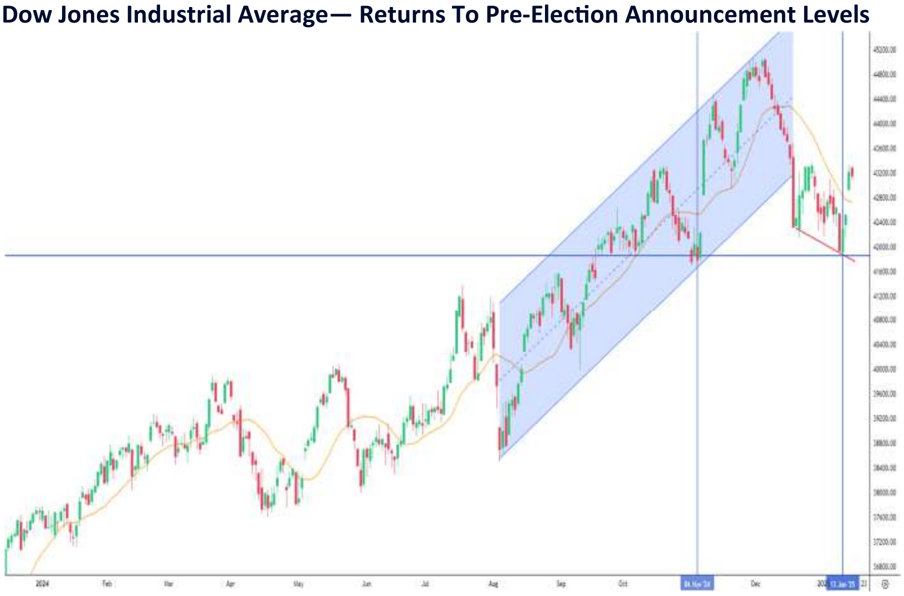
GLOBAL INSIGHT

Overview

- In our Market Review, we provide an analysis of 2024 through a macroeconomic lens, assessing the key trends and underlying forces that shaped global capital markets.
- We look into the upcoming change in US President with Donald Trump due to take office on the 20th of January, and highlight potentially significant macroeconomic impacts of policies he has proposed so far.
- In our Investment Outlook, we will attempt to contextualise the key macro developments and market movements highlighted in the Market Review.
- We assess financial conditions, indicators and forecasts to assess prospective returns amidst elevated starting valuations.
- We present our house view, noting broad market resilience, while remaining mindful of areas of risk to ensure portfolios are well-positioned for both opportunities and potential downsides in an evolving market landscape.
- We view the current economic environment and robust corporate fundamentals as supportive of risk assets, allowing for a selectively positive stance on equities and specific areas of credit.

Dow Jones Industrial Average— Returns To Pre-Election Announcement Levels



Source: *LSEG Datastream*

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The Highlights

- US Exceptionalism—Set to continue, or a trade to fade?
- With political turmoil amongst regions and President Trump incoming, what are the drivers for Eurozone returns in 2025?
- Inflation, stimulus and monetary policy—a multifaceted test for bond markets.
- We review 2025's key themes and trades.
- What are the prospects for future returns when we are facing high starting valuations?

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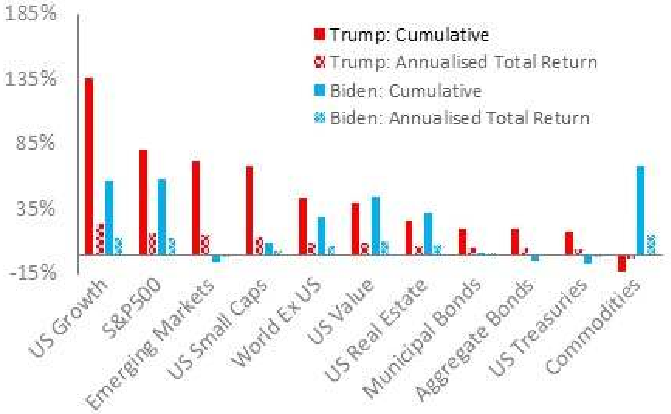
Based upon information available up to and including:

17th January 2025

Key Issues in Charts

President Biden vs Trump—Asset Class Returns



Source: *Ycharts—How do presidential elections impact the markets.*

- Equity performance has been nothing less than strong under both presidents, however sector and asset class performance is varied massively when compared against one another.
- While past data is supportive for the incoming president, the landscape for Trump 2024 is a very different scene than the one that was set back in 2016.
- With heightened geo-political tensions, tighter fiscal conditions and with many more political enemies, areas such as Emerging Markets (China especially) for example are less likely to see such a boost considering the tariff rhetoric exhibited throughout the Trump campaign trail.

US Exceptionalism

- 2024 was a positive year for the majority of indices, with inflation falling widely and central banks underway on rate cutting cycles.
- The US captured the majority of investors attention due to strong performance stemming from mega-cap technology & software names such as those within the MAG7, which accounted for over 50% of the index's performance in the year.
- Elsewhere in the world, Japan enjoyed strong gains, particularly in the first half of 2024, prior to the breakdown of the crowded Yen carry trade.

Source: *LSEG DataStream*

Key Sector Performance 2024

Source: *LSEG DataStream*

- While the majority of sectors closed out 2025 in the green (Utilities, Real Estate and Materials being the exceptions) Technology, Communication Services and Financials were the best performing sectors, as all enjoyed strong earnings per share growth and steady equity market performance through 2024.
- Technology and Communication Services names saw large gains amidst narrow markets due to a combination of macro and industry specific tailwinds such as the AI boom along with strong earnings growth in cloud computing and enterprise software solutions.
- Financials enjoyed an uptick in deal activity, strong equity and fixed income trading results, alongside financially healthier-than-expected customers.

Markets Review

2024 was another strong year for risk assets and US exceptionalism continued from 2023. Although most major equity markets registered a positive return, US equities were impressive leaders again as the Artificial Intelligence (AI) theme continued to dominate returns. US economic performance also largely decoupled from other regions, particularly Europe, having achieved annualised growth of 2.6% quarter-on-quarter for 3Q24 (3Q23: 3.0%) and a broadening out of earnings growth, even if market leadership remained narrow. It seems to us that market expectations favour the continuation of US exceptionalism in 2025, even if returns normalise and there is more convergence with the rest of the world.

2024 was another strong year for risk assets and US exceptionalism continued from 2023.

Global equities returned approximately 17% in dollar terms in 2024, while the S&P500 was the only regional index to outperform, up 25%. The extent of US exceptionalism can be seen when we look at the performance of the rest of the world, with Asia ex-Japan recovering in the second half of the year as China stimulus helped equities gain 10.5%, with Japan up 5.5%, the UK up 3.4%, and Europe up 1%; conversely, Latin America lost 30% in dollar terms.

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MSCI World vs S&P 500 2024

Source: *LSEG DataStream*

The concentration in the AI story has significantly favoured the US markets, with some of Nvidia's largest customers being Microsoft, Apple, Amazon.com, and Meta Platforms. Europe's relative lack of exposure to AI and Technology has seen the more traditional sectors of Banks, Insurance, and Defence outperform. Another comparison, linked to the export of competitively priced Chinese electric vehicles, has seen European Auto companies really struggle to compete while the US Auto sector, dominated by Tesla, was a top sector performer in 2024.

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We believe 2025 could see geopolitics have a meaningful effect on global financial markets, not least in Central Europe, with the implications of Donald Trump's re-election being a key consideration as well.

Bond markets struggled with the changing outlook for monetary policy in the US, as investors came to terms with a US soft landing scenario and the changing outlook for Federal Reserve rate cuts.

Resilience and momentum prevalent in the US economy, supported by the beginning of the rate cutting cycle in most major economies, were the major drivers of equity market performance.

The European manufacturing sector has had a torrid year, hindered by high energy costs, falling economic momentum, and political turmoil. More than half the world's population saw elections in 2024, and in many instances, voters showed their disappointment with the substantially high cost of living by replacing incumbents with more populist governments. We believe 2025 could see geopolitics have a meaningful effect on global financial markets, not least in Central Europe, with the implications of Donald Trump's re-election being a key consideration as well. Both the Barnier government in France and the Scholz-led coalition in Germany lost no confidence votes, with further elections due in 2025. The collapse of two French governments led to investor concerns over the level of French debt and the widening of bond spreads relative to the European periphery (led by Italian BTPs, which gained 5.3%[ii]) and German Bunds, likely due to the prospect of economic weakness and consequent further rate cuts. However, the European economy with high GDP growth of approximately 3.3%, low core inflation, and its lowest unemployment rate since 2008 is… Spain[i].

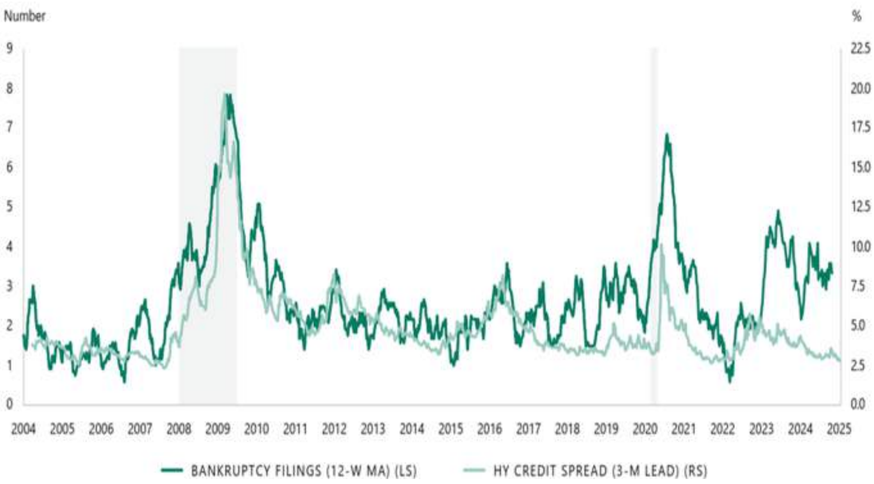
Bond markets struggled with the changing outlook for monetary policy in the US, as investors came to terms with a US soft landing scenario and the changing outlook for Federal Reserve rate cuts. The US economy exhibited resilience and momentum, supported by the beginning of the rate cutting cycle in most major economies, were the major drivers of equity market performance. Valuation expansion saw price-to-earnings ratios rise further, but earnings also showed signs of recovery in both the US and Europe (where earnings-per-share growth turned positive on a quarterly basis). However, we feel investors had started to believe that the fight against inflation was over, and headline inflation rates would continue falling towards target, despite US resilience. Through the second half of the year inflation proved to be stickier than markets anticipated, culminating in Fed Chair Powell's speech after the "hawkish cut" in December. The promise of further stimulus in 2025 from policy changes by a Trump administration also threatened the benign path to lower inflation, causing 10-year US Treasury to push yields higher passing the psychological 4.5%, at which high yields tend to impact equity prices and valuations (chart below, left). Simultaneously, US equity indices' correlation to nominal yields has recently turned negative (chart below, right).

Equity Multiples (left) and Equity/Bond Correlation (right) vs 10Y Yields

Global government bonds lost 3.1% over the year, led by UK Gilts (a traditionally long duration market) and Japan, where the Bank of Japan finally ended negative interest rate policy, including yield curve control, in March (as the economy finally pulled away from deflation). Despite the aggressive selloff in US Treasuries in the final quarter, high prevailing yields at the beginning of 2024 meant that US Treasuries still returned 0.6% over the year[ii].

The strength of the US economy, and the level of re-financing that took place when interest rates were still low, probably accounts for the continuing low default rates within bond markets, increasing investor confidence and pushing credit spreads to historically narrow levels. In this environment, investors seem to concentrate on nominal returns, meaning that global high yield bonds were the best-performing fixed income sector in 2024 for the fourth consecutive year, with total returns of 8%[ii].

US Weekly Bankruptcy Filings



Source: *Apollo*[iii]

The strength in the US economy, and the possible re-emergence of inflation in the US, could have major implications for currency markets in 2025; perhaps inhibiting Central Bank policy as the interest rate differential between major developed markets widens. In 2024 the strength of the dollar (+7%) was not helpful for Emerging Markets and hindered the potential broadening out of market returns. Although the economic fortunes of Europe may have benefitted from Central Bank stimulus, the weakness of the Euro may have hampered the European Central Bank's ability to ease rates, with the Euro declining by 6%.

The Yen carry trade (which has seen investors borrow in Yen to invest in high-yielding currencies such as the Mexican Peso and the Brazilian Real) unwound spectacularly in the summer when the Bank of Japan (BOJ) unexpectedly raised rates. This action pushed the Yen higher, to approximately 140 versus the dollar. The threat of Chinese "near-shoring" in Mexico was put at risk by a Trump administration. The new Mexican government, under Claudia Sheinbaum, put pressure on the Peso, which fell 22% over the year. Further weakness for the

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The respective economic outlooks for the major developed economies look very divergent to us, and this is likely to continue to be reflected in currency markets.

The Chinese authorities have shown that they wish to bolster Chinese household sentiment by supporting the stock market.

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Further measures in 2025 may tackle this major impediment to consumer sentiment but we think it is likely that further consumer-focused stimulus will be forthcoming.

Yen versus the dollar took place when the BOJ left rates on hold in December, pushing the Yen back above 156; a level where intervention occurred to protect the currency during the summer. The respective economic outlooks for the major developed economies look very divergent to us, and this is likely to continue to be reflected in currency markets.

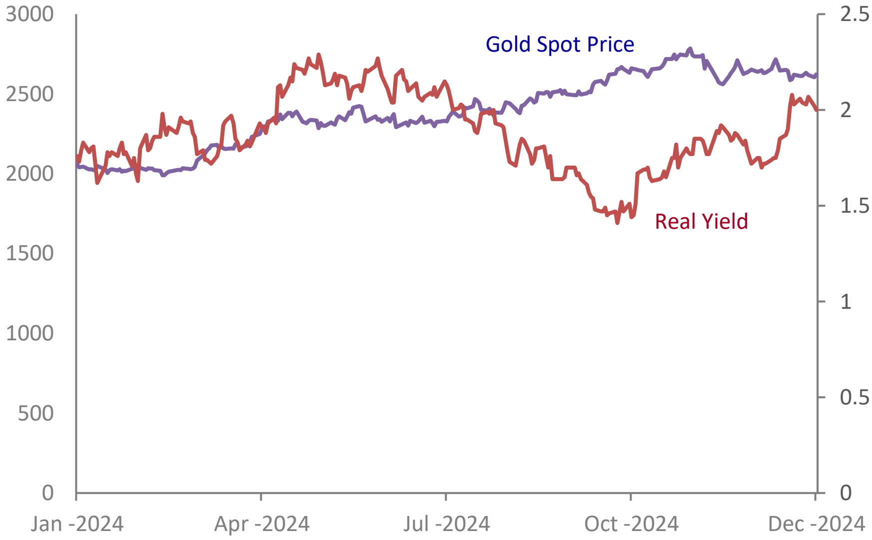
JPY (left scale) and USD (right scale) vs GBP

Source: *LSEG DataStream*

Throughout 2024, China was not the engine for growth that it had been historically, as the country grapples with the negative consumer wealth effects of falling property prices, lower equity prices, and falling deposit rates. The Chinese authorities have shown that they wish to bolster Chinese household sentiment by supporting the stock market. The Chinese Central Bank (PBoC) in an unusual western-style announcement on September 24 lowered bank reserve requirements, cut interest rates by 0.1%, and stated that it will provide funds to brokers to buy stocks. The announcement pushed Chinese stocks higher, leaving the Shanghai SE up 17.4% on the month, and 12.4% on the quarter, and the Hong Kong index up 19.3% on the quarter.

Some would argue that these measures will not be enough to turn the situation around, but we believe they signify a determination by authorities to support the economy. We expect further measures once the effect of US tariff policy on global trade is clearer. Residential property prices have fallen 12% from their highs in 2021[iii] and there remains a supply glut, meaning market movements are severely affecting consumers' propensity to spend. Further measures in 2025 may tackle this major impediment to consumer sentiment but we think it is likely that further consumer-focused stimulus will be forthcoming, which will probably also impact China's major global trading partners.

Gold Price (left scale, $/oz) vs Real Yield (right scale, %)



Source: *LSEG DataStream*

The price of gold is normally strongly influenced by the strength of the dollar, the level of real yields, and its position as a safe-haven asset at times of financial stress or high geopolitical risks affecting financial assets.

The "weaponisation" of the dollar by the US during the Russia – Ukraine war has led many Central Banks to diversify their reserves away from the dollar, underpinning large Central Bank buying of gold.

In summary, portfolio returns in 2024 were dominated by US AI-related equity returns while US economic resilience caused a widening in economic prospects between the major regions.

A review of financial assets in 2024 would not be complete without mentioning gold, which looks to have defied the odds to return over 27% in 2024, delivering 46 new all-time highs during the year[i]. The price of gold is normally strongly influenced by the strength of the dollar, the level of real yields, and its position as a safe-haven asset at times of financial stress or high geopolitical risks affecting financial assets. However, the "weaponisation" of the dollar by the US during the Russia – Ukraine war has led many Central Banks to diversify their reserves away from the dollar, underpinning large Central Bank buying of gold. This, coupled with traditional Indian retail buying and safe-haven flows, has allowed gold to ignore traditional fundamentals and finish the year at $2,624 / oz, slightly off its highs set during the quarter.

In summary, portfolio returns in 2024 were dominated by US AI-related equity returns while US economic resilience caused a widening in economic prospects between the major regions. This has been reflected most clearly in FX markets, as well as changing monetary policy expectations, and may impact the ability of Central Banks to implement effective policy in 2025 .

[i] Dominic White _ Absolute Strategy Research _ ASR's end-of-year awards _ December 20, 2024
[ii] Max McKechnie _ JPMorgan Asset Management _ Review of Markets over 2024 _ January 2, 2025
[iii] Karen Ward et al _ JPMorgan Asset Management EMEA _ Investment Outlook 2025 _ November 2024 rclays _ Global Macro outlook _ All eyes on the US _ September 12, 2024

Investment Outlook

Having reviewed the key macro developments and market movements in the prior year, this section will focus on the interplay between growth, inflation and monetary policy (as well as forecasts for these by macroeconomic region). Against this backdrop, we'll contextualise financial conditions, rates, and current valuation levels for key asset classes against long term ranges, and consider prospective returns given valuations prevailing at year end.

The schematic below reflects that: economic activity has been positive but remains below trend, inflation has moderated but remained stubbornly above target, and monetary policy, despite recent rate cutting actions, remains moderately tight.

Current Growth, Inflation, and Monetary Policy

These trends are set to continue in 2025. The chart below, left, reflects consensus forecasts for annual GDP growth, anticipating higher growth in Japan, the Eurozone and the UK in 2025 than in 2024, borne of a combination of lacklustre 2024 growth and, in the case of the Eurozone and UK, continued monetary policy stimulus. The US, although forecast to grow less this year than last, is expected to outperform other developed markets, due to its unique blend of lower effective interest rates (with corporates and households in aggregate having previously locked in lower rates than those currently prevailing), post-Covid fiscal stimulus outpacing developed market peers and legislation supporting investment, innovation, infrastructure and job creation. China's growth prospects are expected to moderate and, while its forecast growth is set to outpace developed markets, it is not expected to return to historically higher levels. The chart below, middle, reflects five-year annual inflation expectations in five years' time, based on swap rates. While these rates are volatile, and inflation is notoriously difficult to predict, the recent downward trajectory for the

Forecast Growth (left), Inflation (middle) and Monetary Policy (right)

Source: *JPM*[i]. *Growth reflects consensus forecasts for annual real GDP, inflation reflects the 5Y5Y inflation swap rate and monetary policy reflects market expectations for central bank policy rates.*

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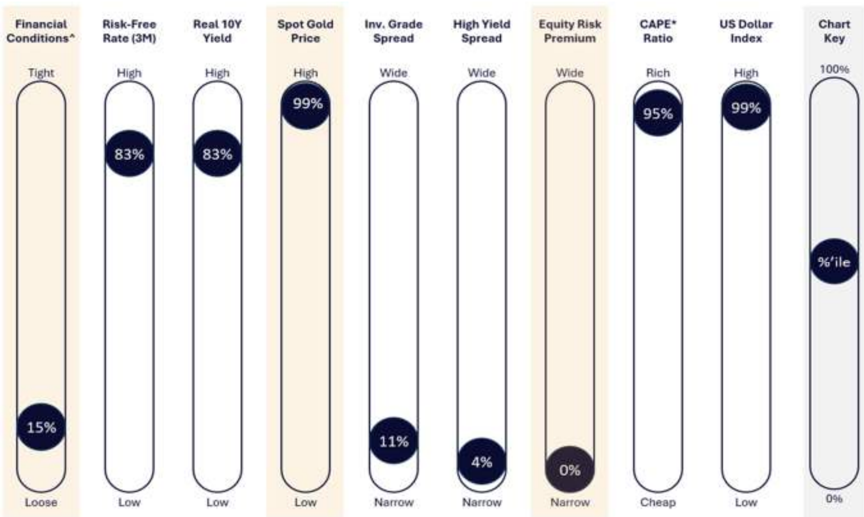
China's growth prospects are expected to moderate and, while its forecast growth is set to outpace developed markets, it is not expected to return to historically higher levels.

major regions reflected is encouraging for risk assets and ongoing monetary policy easing. Finally, the chart above, right, forecasts further interest rate cuts for major developed market regions apart from Japan, which stands alone in employing restrictive policy to combat burgeoning inflation. Across the US, Eurozone and UK, rates are anticipated to decline over the next year, troughing in the Eurozone a year hence, supporting asset prices in the near term.

The next chart shows key market measures' current readings as a percentile relative to the past 20 years. For example, a reading of 100% reflects that the measure is at a 20-Year high, while the opposite is true for a reading of 0%. The leftmost bar – Financial Conditions, an index published by the Chicago Federal Reserve that comprises 105 measures of financial activity, spanning risk, credit and leverage – stands at 15%ile, meaning that this measure, relative to the last 20 years, has been easier (more accommodative) only 15% of the time. Critically, this is the adjusted measure, which controls for growth and inflation, facilitating more meaningful comparisons over time and across the economic cycle.

Macro and Markets Barometer



Source: *Federal Reserve Banks of St. Louis and Chicago, LSEG Datastream, Robert Shiller via Yale Department of Economics. *Cyclically-Adjusted Price-to-Earnings. ^The Financial Conditions Index (FCI) considers 105 indicators of risk, credit and leverage. The Adjusted Index presented controls for growth and inflation, to isolate from the economic cycle.*

The combination of resilient economic growth, moderating inflation, and accommodative monetary policy (all set to continue), together with fiscal stimulus and historically easy financial conditions, has supported asset prices. The risk-free rate and real 10-Year yield remain high historically (both 83%ile) and represent higher current hurdles for invested portfolios to overcome. The spot gold price, despite high real rates (gold's opportunity cost) has continued to surprise to the upside and defy elevated (but moderating) real rates, aided by central bank buying, particularly from emerging markets. Investment grade and high yield spreads – the additional compensation that investors demand for assuming credit risk over equivalent government paper – have continued to narrow, although more recently this narrowing has been driven by weaker government bonds, as opposed to stronger corporate bond performance (more on which below). The equity risk premium, as equities have rallied and government bonds have sold off, is at more-than 20-year lows (0%ile).

Therefore, particularly in the US, spreads and equity risk premia are historically narrow. The charts below examine prospective returns for global govern-

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From respective points of departure, prevailing government bond yields have historically presaged five-year annualised returns of 4%-8%, while the S&P's 22.5x forward earnings multiple has precipitated subsequent three-year annualised returns of c.3%.

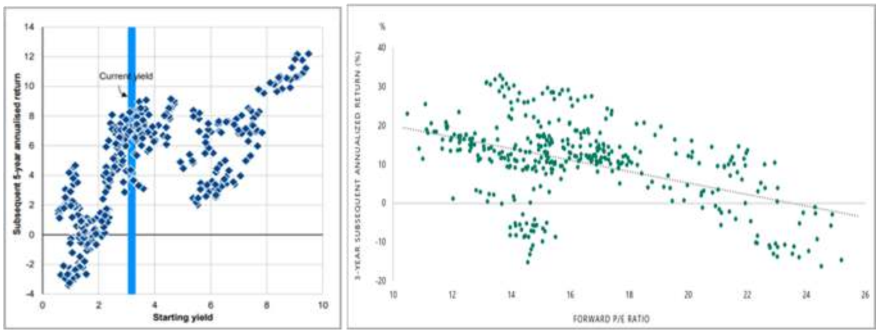
While US equities appear historically rich at the index level, opportunities remain for active management and stock selection, and valuations are less demanding on a global basis.

Therefore, we continue to target opportunities to invest in high quality individual companies, on a global basis and at sensible valuations.

Turning to bonds, there are three principal sources of risk, and associated risk premia to target: duration, foreign exchange and credit.

ment bonds (left) and US equities (right). From respective points of departure, prevailing government bond yields have historically presaged five-year annualised returns of 4%-8%, while the S&P's 22.5x forward earnings multiple has precipitated subsequent three-year annualised returns of c.3%. These longer-term prospective returns argue for pursuing a multi asset approach, while acknowledging that, in the near term, momentum is a tailwind for equities and headwind for government bonds.

Subsequent Returns for Government Bonds (5Y ann., left) and US Equities (3Y ann., right) from Current Valuations



Source: *JPM*[i] *(left) and Apollo*[ii] *(right).*

While US equities appear historically rich at the index level, opportunities remain for active management and stock selection, and valuations are less demanding on a global basis (with the MSCI developed markets index trading at 19x forward earnings, a 20% premium to the average since 1990, and at a double-digit discount to levels seen in 2021). Therefore, we continue to target opportunities to invest in high quality individual companies, on a global basis and at sensible valuations. Note that the Mag-7 (to which we have selective exposure but remain below market index weights) is trading at more than 4x PEG (forward earnings multiple divided by growth rate), significantly richer than the S&P 500 index (c.2.8x) as the Mag-7's higher forecast earnings growth is insufficient to negate that cohort's valuation premium to the S&P 500.

Turning to bonds, there are three principal sources of risk, and associated risk premia to target: duration, foreign exchange and credit.

Firstly, considering duration, the components of the 10-Year nominal treasury yield are: (1) the 10-Year Treasury Inflation Protected Securities (TIPS) yield, representing the real (inflation-adjusted) yield, (2) the 10-Year Breakeven inflation Rate (yield differential between US bonds and TIPS, which rises on expectations of rising inflation), and (3) the 10-Year Treasury Term Premium, being the compensation that investors require to hold longer term bonds compared to shorter dated paper for the same time period. These measures contribute approximately 40%, 40% and 20% to total nominal yield. All three of them rose during 2024. While the TIPS yield and breakeven inflation rate have moderated more recently, the term premium continues to climb, as market participants price in the impact of a fiscally expansionary Trump presidency.

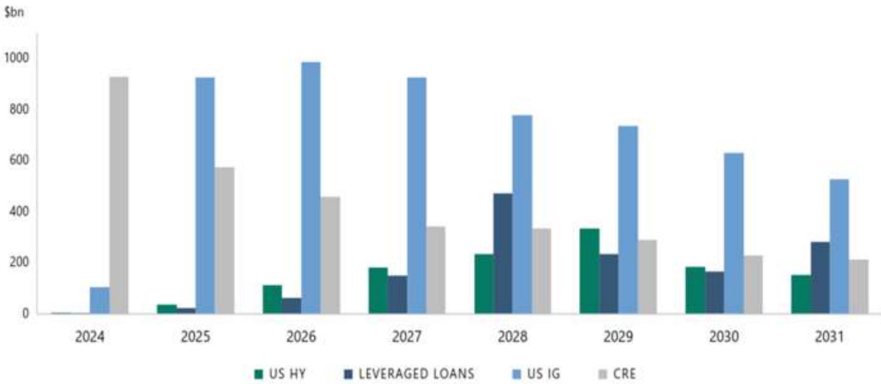
Secondly, on foreign exchange, while the key tenets of Trump's policies (lower tax rates, higher tariffs, and lower immigration) are expected to have a mixed effect on corporate profitability and economic growth (stimulative, restrictive, and restrictive, respectively), collectively they embody potentially higher inflation and rates alongside a stronger Dollar, representing a translational currency headwind for Dollar-denominated investors in non-domestic bonds that are denominated in local currency.

Thirdly, with respect to credit, spreads are historically tight, as noted above. However, corporate fundamentals remain robust, on various metrics, for example: debt servicing costs, captured by US nonfinancial net interest payments as a percentage of operating surplus, are at 50 year lows (as companies 'termed out' their debt while lower interest rates prevailed, while corporate profits have grown, and now represent c.13% of GDP, up from c.10% during Covid) and bankruptcy filings which, having spiked to almost eight per week at the height of the Covid pandemic, and almost five per week during the post-Covid rate hike cycle, have moderated to around three per week, coinciding with tighter credit spreads. Against this backdrop, nominal yields in the US are c.4.5% for 10 -Year treasuries, c.6% for investment grade credit (duration of almost six years) and c.8% for high yield credit (duration below of four years). Further, as reflected in the chart below, the maturity wall for commercial real estate is demanding (as terms are typically five years and 2020/21 vintages are maturing), and for investment grade credit is front-end-loaded for 2025-2027. High yield bonds, by contrast, face a more 'bell-shaped' distribution, with limited refinancing needs from 2025-2027, increasing markedly to peak in 2028 and broadly declining subsequently.

While the TIPS yield and breakeven inflation rate have moderated more recently, the term premium continues to climb, as market participants price in the impact of a fiscally expansionary Trump presidency.

While the key tenets of Trump's policies are expected to have a mixed effect on corporate profitability and economic growth, collectively they embody potentially higher inflation and rates alongside a stronger Dollar.

Maturity Wall by Instrument Type



Source: *Apollo*[ii].

With respect to credit, spreads are historically tight, however, corporate fundamentals remain robust, on various metrics, With expanding term premia and currency volatility, and, for high yield bonds, compelling nominal yields, we are considering diversified and short duration exposure to this asset class.

With expanding term premia and currency volatility, alongside strong corporate fundamentals and, for high yield bonds, compelling nominal yields (albeit at low spreads) together with benign near-to-medium-term refinancing needs, we are considering diversified and short duration exposure to this asset class.

Going into 2025, although risk premia (credit spreads and the equity risk premium) are tight relative to 20-Year histories, we believe that the underlying economic environment and corporate fundamentals continue to favour risk assets and therefore remain selectively constructive on the prospects for equities, and subsets of credit. Simultaneously, we remain overweight cash and government bonds, given attractive nominal yields and as diversifiers intended to preserve capital in the event of a disruption to currently optimistic expectations of a benign macroeconomic and market environment. We retain our positions in liquid alternative trading strategies – although we continue to assess prospective returns for this asset class, given typically higher associated fees and bearing in mind the prevailing risk-free rate – and continue to favour gold.

Going into 2025, we believe that the underlying economic environment and corporate fundamentals continue to favour risk assets and therefore remain selectively constructive on the prospects for equities, and subsets of credit.

[i] JPMorgan Asset Management _ Guide to the Markets _ UK Q1 2025 _ December 31, 2024

[ii] Torsten Slok et al _ 2025 Economic Outlook: Firing on All Cylinders_December, 2024

[iii] MacroMicro website. [Online]. Accessed 16 January 2025. Available from: https://en.macromicro.me/charts/86836/us-10y-treasury-yield-composition

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