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BILBoard January 2025 – Snakes and ladders



While western New Year celebrations are already behind us, January 29th will usher in the Chinese New Year of the Snake. People belonging to that year are said to be intelligent and intuitive, with refined taste. They are considered creative and extremely diligent. For investors, such attributes will be more crucial than ever in the coming year...

2024 saw markets continue to climb. The S&P 500 hit 57 new all-time highs, rising by around 25%. The Nasdaq enjoyed gains of over 30%, the Dow 12%, and even the EuroStoxx managed gains of around 8%. As we wrote in our [2025 Investment Outlook](#), the next twelve months promise a new state of play. Equity valuations are stretched, earnings expectations are elevated, fixed income remains vulnerable to renewed inflation fears, and the political sphere promises it's fair share of volatility. Selectivity and adaptability will be key, with active management coming back into the spotlight.

THE MACROECONOMIC CONTEXT

The **US economy** ended 2024 on a high note, and things look promising for 2025, with the Composite PMI now at its highest level since April 2022. Hopes are high that the Trump administration will push America First policies that ignite growth and take stock markets to new heights, but the flipside is that his agenda could also fan inflation, potentially halting the Fed's easing campaign in its tracks. The Federal Reserve has already reduced the number of rate cuts it projects this year from four to two. Bond markets corrected strongly on the idea of higher-for-longer; a move which we viewed as overdone, and which has partially unwound. Trump's first 100 days in office will be crucial in gaining more clarity on how he will operate this time around, and as to which items he prioritises. Several businesses remain in a wait-and-see mode, especially in the manufacturing sector and with regard to hiring.

For the **Eurozone**, we envision meagre growth. Any residual strength is concentrated in services, while the two-year contractionary streak in the manufacturing sector continues. The bloc's major economies, namely Germany and France, will hardly grow in 2025, and risks are tilted to the downside, specifically from Trump's trade policies. Deregulation and tax cuts across the pond also threaten to erode the competitiveness of European firms.

Inflation in the Eurozone is expected to gradually decrease, reaching 2.1% in 2025, and 1.9% in 2026, according to the ECB's latest forecasts. Energy could create some bumps on the road, however. As of January 1, Russian gas is no longer being transported to the bloc via Ukraine, while a cold winter means gas reserves are being drawn down at the fastest pace since the energy crisis. Overall, however, a weak economy, and initial signs of cooling in the job market should keep the ECB on track for sequential rate cuts until it reaches the terminal rate. A potential get-out-of-jail-free card?: Consumer confidence has retreated, but if it can recover, the fact that the savings rate is at a three-year high means the potential for an uptick in spending is there.

China's economy just, and only just, managed to meet the official 5% growth target for 2024. However, looking beneath the bonnet reveals that growth was imbalanced, driven by industry and exports. Export-led growth is partly due to factory gate deflation which makes Chinese goods more competitive on the international stage, as well as a rush by factories to send inventories overseas before Trump 2.0. Indeed, China's trade surplus soared to a record last year, ahead of a potential deluge of tariffs.

Domestic demand continues as a pain point, while unemployment is creeping up too. It is yet to be seen whether the expansion of a trade-in scheme for appliances and more subsidies for digital purchases will lather up demand among households. The key issue is that the unresolved property crisis continues to weigh on confidence and coffers: Property investment contracted 10.6% in 2024, marking the worst year since records began in 1987. In a nutshell, improving growth will remain the priority in 2025 and fiscal policy will take the forefront, with the scope for

further monetary easing constrained by mounting pressure on the yuan. Beijing will only reveal its specific economic roadmap for the year-ahead at an annual legislative meeting in March.

INVESTMENT DECISIONS

Equities

In light of the current context, at our Asset Allocation committee on January 14th, we maintained our **neutral allocation to equities**, with a **preference for the US**. There, the economic backdrop remains solid, which in turn could keep corporate earnings supported. If this happens, the rally in US stocks could well continue, with broader participation likely in non-megacap tech companies. We see opportunities in, for example, small- and mid-cap equities that have a local US exposure, banks, and enablers of manufacturing reshoring. Companies with a local supply chain are expected to outperform companies with a global supply chain due to potentially antagonist trade policies. In acknowledging that markets could be rattled as Trump enters office and starts to hammer out his agenda, we do maintain hedging on 50% of our US equity exposure in case the market retreats below the level at which it began the year.

We remain underweight on the other key regions, namely Europe, Emerging Markets (including China), and Japan.

In terms of sectors, we downgraded the **US Consumer Staples sector from neutral to negative**. For a long time, investors didn't have to worry too much about currency risk, but it is re-emerging as a watch item: The greenback has risen 8% versus the euro since September, edging closer to parity. Dollar strength could negatively affect income statements, especially those of big US multinationals which earn a good chunk of their revenues abroad. If such companies have not properly hedged their currency risks, they could see the value of their overseas profits come down. The upcoming earnings season will reveal which companies have been swimming naked.

NEGATIVE	NEUTRAL	POSITIVE
EUR Consumer Discretionary	EUR Financials	IT
US Real Estate	US Healthcare	EUR Utilities
Energy	EUR Consumer Staples	EUR Healthcare
US Consumer Staples	EUR Industrials	EUR Real Estate
	Materials	US Communication Services
	US Utilities	US Industrials
	US Consumer Discretionary	US Financials

We continue to overweight **IT** on both sides of the Atlantic. With that said, we emphasise that AI should be considered as a strategic play. While it might be easy to be charmed by compelling narratives about the game-changing impact that artificial intelligence and LLMs will have on our world, it is also true that companies are still seeking ways to monetise these tools. We do see a risk that the forward guidance of companies operating in the space fails to satisfy starry-eyed investors.

Within industrials, the tailwind that the new US administration is offering the defence sector are difficult to ignore. President Trump has opined that NATO members should spend 5% of their GDP on defence, a significant increase from the current 2% target. He seems to be playing the card that says either European NATO members increase their defence spending to keep the US in the alliance, or they spend more to adapt to a world without the biggest spender in the club. NATO estimated that 23 of its 32 members would meet its current goal of spending 2% of GDP in 2024.

Fixed Income

Our fixed income strategy remains centred around **investment grade corporate bonds, complimented with high-quality high-yield** to boost income.

Perceiving that longer-term yields had moved up too far too fast (primarily in the US, but European rates followed in sympathy), we **stuck to our guns on duration**, expecting a degree of normalisation on the EUR curve; indeed that has started to play out. For the time being we are keeping our hands off US Treasuries.

Note that in Defensive and Low profiles, we **switched a portion of our Sovereign exposure into UK Gilts**. Gilt yields had seen significant upward pressure ahead of our Committee, with sticky domestic inflation, an ambitious Labour budget and higher US rates pushing the 30-year gilt to the highest level since 1998. That left the pick-up over Bunds at the highest level since the nineties, a period where the UK was suffering from weak growth and high inflation (+8%). Believing UK inflation will trend lower and that economic growth could disappoint, opening the door for the BoE to turn more dovish, we suspected a normalisation in the rate differential between Gilts over European government bonds, leading Gilts outperform European Government Bonds.

In Defensive profiles, we also made the decision to **lower investment grade in favour of increasing high-yield**, simply to boost income generation (in the absence of equities to power gains). Low levels of distressed bonds (5%, lowest level since April 2022) and relatively high recovery rates (53% vs 42% in 2023) are reassuring elements for investors in the high-yield. Distressed levels for loans are even lower at 3%.

CONCLUSION

Investing might sometimes feel like a game of snakes and ladders, but over the long-term, data shows that not being invested is a sure-fire way to lose money, thanks to the corrosive effects of inflation. Relative to previous years, we have an inkling that 2025 could potentially hold more snakes than investors have become accustomed to as of late. By adhering to **stable** asset allocation guidelines that ensure adequate diversification, we are well-poised to help clients navigate the increasingly complex environment. Our experts have their eyes on the board, ready to **adapt** our tactical allocation as necessary to seize opportunities and avoid, or at worst, limit the length of any snakes that the market might present. As always, **performance** for our clients is the overarching aim of the game.



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