Multi-Asset Perspectives

January 2025

1. Macroeconomic Overview

- **Manufacturing indicators ticked up slightly**
  - **a.** Our global manufacturing PMI[1] index recovered to 49.8 as U.S. improved to 50.9 from 49.3, and European Union to 47.2 from 46.2. China, however, went the other way, at 49.1 from 50.1.
  - **b.** Our leading regime indicator ticked up further, implying improving manufacturing growth prospects. The threat of tariffs under the Trump administration is providing a near-term boost.
  - **c.** Economic surprises were positive in U.S. and Japan, but marginally negative in China and Europe.
- **Global financial conditions** were marginally easier due to lower interest rates, tighter credit spreads and better equity momentum. U.S. financial conditions eased the most.
- **Global inflation** was stable at 2.8% year-over-year in December 2024 (3.4% in December 2023), with thirteen countries recording higher readings, and thirteen lower. Inflation was 2.5% (+0.2%) in developed economies and 3.5% (-0.1%) in emerging. Potential tariffs could spike inflation in coming months, albeit the effect should wear out after a few months.

2. Bottom-up view

- **Expected earnings growth** for 2025 for MSCI AC World[2] was steady at 12% with S&P 500 at 14% relative to 7% and 9% respectively for 2024. IT (22%↓), Health Care (18%) and Materials (16%) are expected to drive earnings growth with Financials (7%), Energy (6%↑), Staples (6%) & Utilities (5%) being the laggards. It will require both topline growth and solid margin expansion for expectations to be met.
- **Global credit rating upgrades to total changes** were at 50% at the end of 2024 which was a significant improvement relative to 43% at the start of the year. Global Investment Grade finished at 66% with Global High-Yield at 40%. We will see how 2025 pans out, but it is hard for ratings momentum to get better from these levels outside of recoveries from recessions.

3. Valuations

- The **U.S. 10-year treasury** yield, at 4.5%, was right in the middle of our model implied fair value range of 4-4.8%.
- **U.S. IG[3] Index** spread finished at 15th percentile in history and HY index[4] spread at 3rd percentile. The picture was broadly similar for ultra-long spreads (30-years), where A-rated finished at 14th percentile and BBB-rated at the 4th percentile.
- **Global equity valuations remained expensive.** MSCI ACWI was cheaper than current levels 96% of the time in history, driven by expensive **U.S. stocks that remain almost as expensive as they have ever been relative to ex-U.S. stocks.** Latin America and Asia ex-India remained cheap. Large Caps remained very expensive relative to small caps.

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1 Purchasing Managers' Index (PMI)
2 MSCI All Country World Index
3 U.S. investment-grade (IG) corporate bonds
4 High-yield (HY) or junk bonds

4. Markets during the month

- **Global Equities** resumed their uptrend, riding improving growth (aided by preponement of manufacturing orders to beat potential tariffs), rate cuts (particularly in Europe where the interest rate outlook has turned distinctly dovish) and belief that despite headlines, the new U.S. administration will not push its mercantilist agenda deep enough to dent markets. The surprising winners were European equities (Germany's DAX was up 9%) where growth sentiment remains weak, but markets are pricing deeper cuts (cumulative 115 basis points (bps) in the next twelve months). Besides, a weaker Euro would help the export-oriented economies like Germany. Within U.S., Nasdaq (2%) lagged both the Dow (5%) and S&P 500 (3%) as the rally showed signs of broadening beyond the technology heavyweights. Large Caps were ahead of small caps. There was not much differentiation between returns based on style. U.S. REITs (1%) lagged equities though Industrial REITs (10%) jumped. Office REITs (-1%) were weak for a second straight month, though there are signs that the bottoming out process for the office sector is under way.

- **Fixed income**

  - **Policy Rates:** Bank of Japan hiked 25bps to 0.50% and Brazil hiked another +100bps to 13.25% to bring inflation expectations back under control. Eight other banks including European Central Bank cut rates, taking our global policy rate indicator to 4.6%. The U.S. Federal Reserve expectedly kept its policy rate unchanged but set the bar higher for rate cuts to resume, given growth (strong) and inflation (stalled progress towards 2% goal). Markets are pricing an 80% chance of 50bps of cuts in 2025.

  - **Bond Yields:** Our Global Sovereign 10-year yield indicator softened -6bps to 4.5%, with yields lower in 15 out of the 27 countries we track. U.S. yield was -3bps lower at 4.54%. The 2-10 U.S. treasury spread ended unchanged at 34bps.

  - **Credit Spreads:** Credit spreads were almost unchanged for U.S. Investment Grade at 79bps but narrowed -26bps for High Yield to 261bps.

    - **Returns:** Returns were positive across most categories with spreads tighter and yields lower.

- **Currencies:** US$ weakened against two-thirds of the currencies after large gains in the prior three months on expectations of a hawkish trade agenda by the new administration. The broad trade weighted dollar eased -1% after gaining 7% in the prior three months.

- **Commodities:** The GS[5] commodity index gained 2%, boosted by strong near-term growth prospects and the threat of potential tariffs. Precious metals were the best performers, rising 8%.

5. U.S. Property Indicators

- U.S. housing affordability remains well below its historical average due to high mortgage rates and higher home prices. Offsets through low U.S. mortgage debt/GDP (46% vs 70% pre-GFC), high home equity (~75%), and low interest rates on outstanding mortgages (4% compared to new 30-year mortgages at 7%) are helping the housing sector. While supply of existing homes remains very low (1 million vs long-term median of 2.2 million), supply of new homes has increased to approximately 500,000 (median 325), which could keep new home price increases muted during 2025.

- The commercial property sector remains challenged but there are continuing signs of a bottoming-out process. While rising interest rates could provide fresh headwinds, Public REITs markets which tend to lead private markets by 12-18 months, have started recovering. Real Capital Analytics' (RCA) indices showed that commercial property prices have been stable since 1Q'24 for offices (slightly higher for suburban, slightly lower for Central Business Districts, CBD). Multi-family oversupply should work itself out this year as new construction remains low. On the other hand, industrials, which have seen consistent price increases, could see a more subdued price increase.

[5] Goldman Sachs Commodity Index, which tracks the performance of a broad range of commodities.

6. Summary

a. Growth

Neutral but trending positive in short term

Global manufacturing PMIs are recovering from 2024 lows, boosted by the threat of tariffs and continued consumer strength in the U.S. U.S. employment growth remains positive but is ebbing (growth eased from ~1.6% in 1Q'24 to ~1.3% in 4Q'24). Real wage growth has held steady around 2.5%, supporting consumption. While 1Q'25 GDP growth is likely to be boosted by inventory effects, we expect it to taper towards 2% in coming quarters. European growth remains lackluster. While 2025 growth is forecasted to improve three-tenths to 1%, trade tensions with the U.S. could dampen it. In China, we expect the Govt. to keep injecting monetary and fiscal stimulus to sustain GDP growth around 5% but structural challenges (adverse demographics, a more hostile trade environment in the developed world) would keep pressurizing their medium-term growth outlook.

b. Inflation

Neutral

After making solid progress towards the 2% goal in developed economies, the last mile is proving more challenging, with demand staying strong and services/housing prices staying resilient. The threat of tariffs is adding to the uncertainty. From a longer- term perspective, "greenification" costs, peaking of China's working age population, rejigging of global supply chains and expansionary fiscal policies point towards higher potential inflation.

c. Global financial conditions

Neutral

With credit spreads very tight, equity momentum extended, and the projected path for U.S. policy rates shallower than before, we keep this factor at neutral.

d. Valuations

Negative

- **Risk-free rates** continue to present positive yielding anti-fragile alternatives.
- **Equity Valuations** remain super expensive in the U.S. but remain reasonable in most emerging markets.
- **Corporate spreads** remain at multi-year tights.

e. Asset allocation orientation

Neutral

Very tight risk premia keep our stance defensive. U.S. large cap equities and global corporate credit are priced for perfection. On the other hand, the U.S. growth remains solid which is preventing us from going underweight risk assets. Key sources of frustration for risk assets could come from:

- The new U.S. administration fails to strike deals with trading counterparties and resorts to high tariffs which hurt growth adversely.
- Credit card delinquencies tick up as lower income households exhaust excess savings. Our models suggest U.S. consumers have used up $1.8bn out of the $2.3bn of accumulated excess savings following the pandemic.
- Floating rate borrowers see weaker earnings growth relative to the cost of borrowings.
- Tax rates rise globally as governments try to flatten the income curve to fund expanded budget deficits.

Risk considerations
Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed.

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