# Multi-Asset Perspectives

*February 2025*

## 1. Macroeconomic Overview

- **Manufacturing indicators were mixed.**
  - **a.** Our global Manufacturing PMI index was stable at 49.9 as China improved to 50.2 from 49.1, and EU to 47.8 from 47.2. U.S., however, went the other way, at 50.3 from 50.9.
  - **b.** Our leading regime Indicator ticked up marginally, staying in mildly expansionary zone. The threat of tariffs under the Trump administration has been providing a short-term boost.
  - **c.** Economic Surprises were positive in China and Europe, but negative in Japan and U.S.
- **Global financial conditions** (FCIs) were easier primarily due to lower interest rates. The spread component was flat while momentum/volatility implied tighter conditions.
- **Global inflation** was stable at 2.9%yoy in Jan'25, with fifteen countries recording higher readings, and ten lower. Inflation was at 2.5% in developed economies and 3.5% in emerging. Potential tariffs could spike inflation in coming months, albeit the effect should wear out over time.

## 2. Bottom-up view

- **Expected earnings growth** for 2025 for MSCI AC World was 11% (-1%) with S&P 500 at 12% (-2%). However, 2024 numbers were revised up 2% for S&P 500. IT (20%↓), Materials (18%↑) and Health Care (17%) and are expected to drive earnings growth with Financials (6%), Energy (7%), Staples (4%↓) & Utilities (5%) being the laggards. It will require both topline growth and solid margin expansion for expectations to be met at the index level.
- **Global credit rating upgrades to total changes** were at 45% versus 50% at the end of 2024. Global IG was unchanged at 66% but Global HY weakened a tad to 34% (41%). Early days yet as rating actions have been limited thus far this year, but if the this does become a trend through 2025, it would start widening high yield spreads.

## 3. Valuations

- The **U.S. 10-yr treasury** yield, at 4.2%, moved towards the lower end of our model implied fair value range of 4-4.8%.
- **A modest widening in spreads caused the U.S. IG Index** spread to finish at 21$^{st}$ percentile in history vs. 15$^{th}$ the month prior and HY index spread at 6$^{th}$ percentile (3$^{rd}$). The picture was broadly similar for ultra-long spreads (30-yrs), where A-rated finished at 31$^{st}$ percentile (14$^{th}$) and BBB-rated at 13$^{th}$ percentile (4$^{th}$).
- **Global equity valuations remained expensive, though a little less so than the month prior.** MSCI ACWI was cheaper than current levels 93% (96% prior month) of the time in history, driven by expensive **U.S. stocks that remain extremely expensive relative to ex-U.S. stocks (96$^{th}$ percentile).** Latin America and Asia remained cheap. Large Caps remained expensive relative to small caps.

## 4. Markets during the month

- **Global Equities** paused as tariff worries dented U.S. market sentiment. U.S. equities underperformed the rest of the world, with S&P 500 down -1.4% relative to a gain of 1.4% in ex-U.S. equities (58% of the global markets we track gained, and the median local currency return was 1.4%). European equities (Germany's DAX +4% to take YTD'25 return to 13%) continued their surge, powered by recovering Chinese growth (strong trade links), potential for higher defense spending, and a dovish ECB. The cake, however, was taken by offshore Chinese equities (H-shares +15%) which saw continued retail inflows, propped by Chinese leadership adopting a pro-growth stance by welcoming large technology giants like Alibaba. The success of DeepSeek, the Chinese AI company that develops large language models showed Chinese advancement in new technologies despite U.S. curbs. Within U.S., Nasdaq (-4%) lagged as Value and low volatility stocks made a comeback. U.S. small caps (-5%) suffered due to concerns on margins from higher tariffs. U.S. Reits (4%) outperformed though Office Reits (-4%) had a weak month despite signs that the bottoming out process for the sector is under way.

- **Fixed income**
  - **Policy Rates:** Eight rate cuts lowered our global policy rate indicator -5bps to 4.56% as focus of central banks shifted to growth in economies like India, Mexico, New Zealand, Australia and even U.K. We do not expect the U.S. Federal Reserve to cut rates in March though markets are pricing almost three rate cuts this year versus two a month ago.
  - **Bond Yields:** Our Global Sovereign 10-yr yield indicator softened -8bps to 4.4%, with yields lower in eighteen out of the 27 countries we track. U.S. yield was -33bps lower at 4.2%. The 2-10 U.S. treasury spread compressed -12bps to 22bps as long end yields dropped faster than the shorter end.
  - **Credit Spreads:** Credit spreads were slightly wider. U.S. IG was +8bps to 87bps, and HY +19bps to 280bps but both remained extremely tight relative to history.
  - **Returns:** Returns were strong with U.S. sovereign duration outperforming all other categories.
- **Currencies:** US$ weakened against half the currencies we track it against, with Bloomberg's $ Spot index easing -70bps. The broad trade weighted dollar eased -20bps. U.S. $ remained overvalued based on real effective exchange rates.
- **Commodities:** The GS commodity index eased -2%, wiping out the Jan'25 gain. Energy and agriculture were weaker, base metals were stronger (tariff threats boosted prices). Precious metals took a breather, ending flat but were up 8% YTD'25.

## 5. U.S. Property Indicators

- U.S. housing affordability remains weak but seems to be bottoming out. 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% vs new 30-yr mortgages at 7%) are helping the sector. Muted supply of existing homes (1.2 million vs long-term median of 2.2 million) is helping too. However, supply of new homes has increased to ~500k (median 325k), and new housing starts were at 1.37m units in 2024, which could keep new home price increases muted during 2025. Based on the Case-Schiller 20-City Price Index, home prices grew 4.5% in 2024.
- The commercial property sector remains challenged but there are continuing signs of a bottoming-out process. Public Reits markets which tend to lead private markets by 12-18 months, have started recovering. Real Capital Analytics' (RCA) indices show commercial property prices to be stabilizing. As of Jan,25, the YoY change in prices was -5% for offices (-1% for suburban, -10% for Central Business Districts, CBD), -2% for apartments (oversupply is working itself out), and 3% for industrials.

## 6. Summary

### a. Growth

**Neutral**

Global manufacturing PMIs have recovered from 2024 lows, helped by continued consumer strength in the U.S. and the threat of tariffs which boosted output. U.S. employment growth remains positive but is ebbing (growth eased from ~1.6% in 1Q'24 to ~1.3% in 4Q'24; annual revisions are likely to push that growth down further). Real wage growth has held steady around 2%, which should support consumption growth around 2.5%, with help from withdrawal of excess savings built during the pandemic era (our estimates peg excess savings at $500bn from a peak of $2.3bn, with about $50bn being drawn monthly). That leads us to believe that U.S. GDP will grow in the 2-2.5% range in 2025 compared to 2.8% in 2024. European growth is likely to get a boost from higher defense spending in the latter part of the year and 2026 though trade related drags could provide offsets. In China, the Govt. is targeting its highest ever budget deficit of 4% in 2025 to achieve the growth target of 5% while dealing with uncertainty posed by U.S. tariffs.

### b. Inflation

**Neutral**

Progress towards U.S. policymakers 2% inflation goal has stalled in recent weeks due to strong consumer demand and resilient services/housing prices. The threat of tariffs has also added 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**

While financial conditions got a boost from lower rates in February, the scope for them to ease further is limited due to already tight credit spreads, extended equity momentum, and a shallower U.S. policy rate cut path. However, disinflation could cause the U.S. Fed to ease at a faster pace, which would ease financial conditions more than in our base case.

### d. Valuations

**Negative**

- **Risk-free rates** continue to present positive yielding anti-fragile alternatives.
- **Equity Valuations** remain extremely expensive in the U.S. but 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 Trump administration fails to strike deals with trading counterparties leading to high mutual tariffs which hurts growth adversely while causing inflation.

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