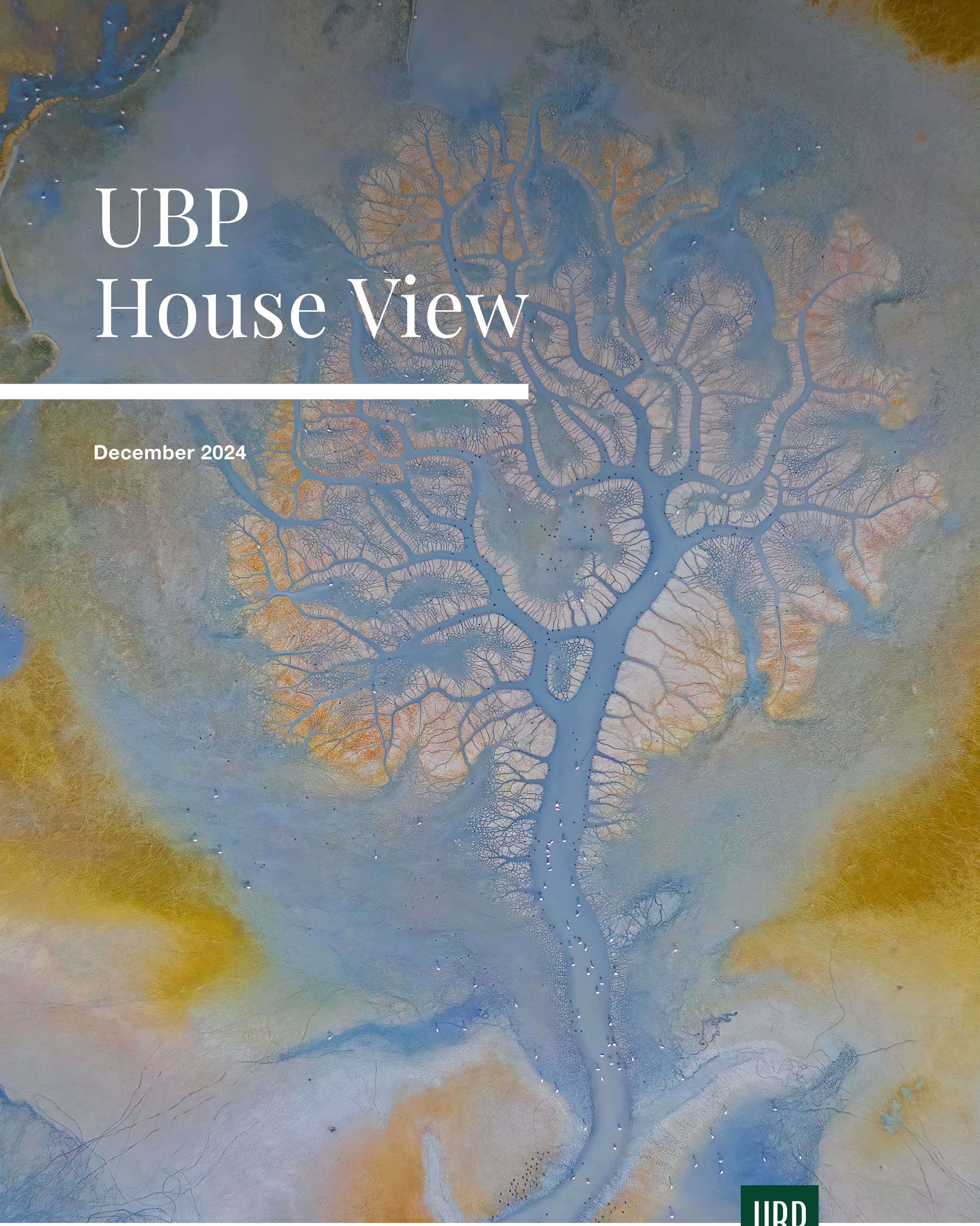
UBP House View

December 2024



MARKETING COMMUNICATION

Union Bancaire Privée

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Asset Management

New dynamics in 2025

The S&P 500 ended November with its strongest gain of the year, buoyed by the re-election of Donald Trump. As he nominates his cabinet members, it has become clear that his second term would take a different path from his first; rather than a mere replication, his choice of governing team signals the beginning of a new chapter in the transformation of the US economy, and perhaps even beyond.

Trump's pledges of tax cuts and pro-business regulations should continue to support US equities which remain one of our main convictions. This backdrop is particularly advantageous for US-based companies engaged in artificial intelligence, as well as for US mid-cap stocks currently trading at attractive valuations.

However, this new political era is likely to spark uncertainty. Trump's unpredictability might exacerbate volatility across all asset classes. Moreover, his ambition to 'make America great again' through pro-US policies might drive a resurgence in inflation, push bond yields higher, and elevate terminal federal fund rates. Should these scenarios materialise, we are well-positioned to manage any resulting convexity.

Beyond the US, the global economic landscape in 2025 will continue to be increasingly fragmented. In Asia, India is poised to maintain its strong momentum, contrasting with China which continues to be an unpredictable market. Key appointments in the Trump administration indicate a firmer stance on China, suggesting that the tariff-driven policy of Trump's second term may become even more assertive, necessitating a broader response from Chinese authorities. Similarly, the eurozone is displaying signs of increasing divergence, highlighting the appeal of more stable and resilient markets such as Switzerland and Scandinavia.

Key Takeaways

1 MACROECONOMICS

The outlook for global growth in 2025 remains positive at around 3.2%, supported by reflationary policies taking shape in the US following Trump's victory.

2 ASSET ALLOCATION

Aligned with our long-term global macroeconomic outlook, we remain confident that global equities, hedge funds, and precious metals will be key drivers of performance in the years ahead.

3 EQUITIES

For 2025, we expect global equities to deliver moderate positive returns following valuation adjustments. US equities remain our strategic preference, driven by solid growth prospects in the technology sector, particularly in AI infrastructure. In Europe, we favour a selective, bottom-up approach, and we have downgraded UK equities due to political and economic headwinds.

4 FIXED INCOME

We have reduced the exposure to fixed income, where we focused on short-duration and high-carry opportunities; we have added agency mortgage-backed securities as a diversification tool.

The opinions expressed in this document are as at 2 December 2024 and are subject to change without notice.

Macroeconomic environment

US quarterly growth expected to be on a strong trend in 2025

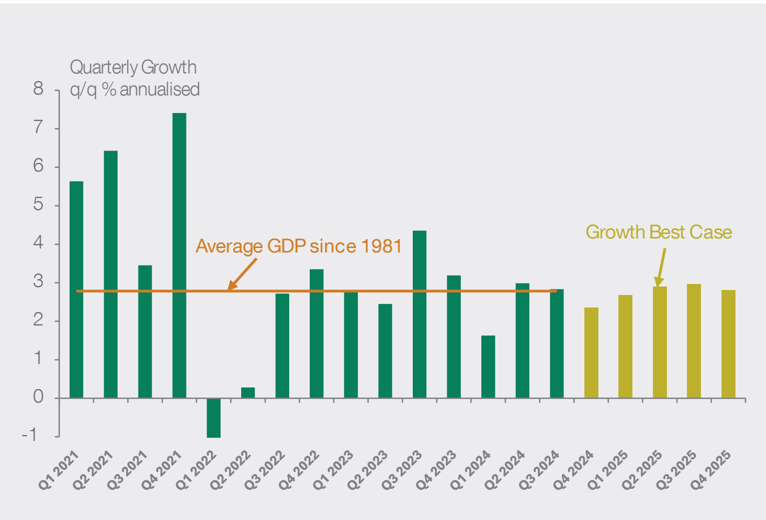
GLOBAL GROWTH SUPPORTED BY US EXCEPTIONALISM AND RATE CUTS

The outlook for global growth remains positive, at around 3.2% in 2025, given reflationary policies taking shape in the US following Trump's election victory.

We expect US growth to rebound to around 2.5% in 2025. Indeed, the extension of the tax cuts adopted during Trump's first term and the reduction in corporate taxes should boost investment and employment in industry. Consumption should remain buoyant, driven by high income contributions and wealth effects. In the wake of the elections, both business and consumer confidence rebounded, pointing to a rapid pick-up in activity.

A Goldilocks scenario is taking shape in the United States, and US exceptionalism is back in full force, supported by Donald Trump's policies, namely nominal growth boosted by fiscal support for domestic demand and by opening up external markets through negotiations. US trade policy seeks concessions from the rest of the world in the interest of US businesses and agriculture.

US GROSS DOMESTIC PRODUCT (GDP)



Sources: BEA, UBP ETR

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The rest of the world is watching for signs of a trade war. President-elect Trump's first tariff hikes have already been announced: up to 25% on products from Canada and Mexico, and 10% on Chinese imports. Negotiations with Mexico have already begun, with immigration trumping tariffs as the central issue. Concessions on controlling immigration from Mexico and on the inclusion of US content in products exported to the United States should allow Mexico to limit or even avoid a tariff increase.

China is at the centre of US policy concerns that go well beyond the trade and economic framework. The timetable for raising tariffs and the list of products affected have not yet been specified, leaving the way open for negotiations in the first half of 2025. For its part, China, whose economy seems to be stabilising at the end of the year, still has room to manoeuvre to lower its key interest rates and consolidate the recovery in consumption, even if its exports are under attack from both the United States and the European Union.

Europe remains dependent on US decisions. Clearly, Europe does not have the economic or political strength to refuse US demands for greater access to its domestic market, including agriculture. Imported automobiles, especially German ones, are likely to be the first sector to see tariffs rise significantly, but other sectors could also be affected. The eurozone is weakened by growth that is unlikely to exceed 1% in 2025. In addition, the region is blighted by political instability in France and Germany, and is constrained by the lack of fiscal headroom and the burdens rising of debt and defence spending.

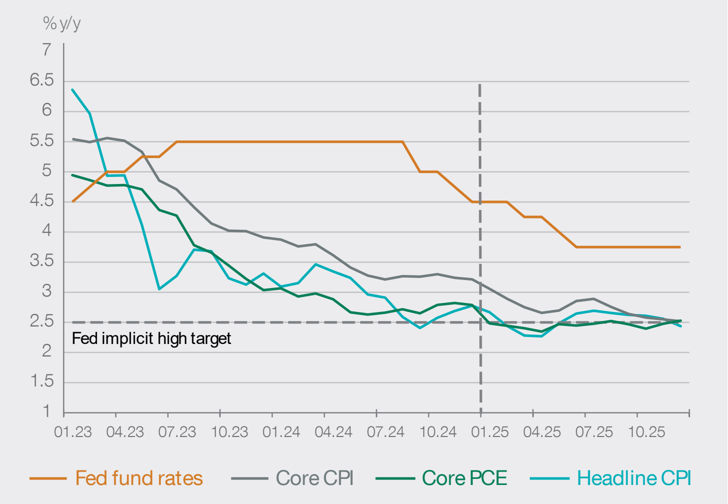
KEY RATE CUTS TO SUPPORT GROWTH

Rate cuts still on the Fed's agenda

In the eurozone, the only room to manoeuvre is the prospect of substantial rate cuts by the European Central Bank (ECB). Weak growth would argue for a more aggressive cut, but there does not seem to be a consensus among governors for a 50-bps cut in December. There exists the possibility of a rate cut at the January meeting, when disinflation, weak growth and trade attacks will increase risks and justify a more aggressive stance on the part of the ECB.

The Fed will certainly not need to cut its key rates below neutral given the expected recovery. The Fed may skip the cut in January after an expected 25-bps cut in December. The Fed could cut rates in line with the expected easing of inflation over the next few quarters but should stabilise rates at around 4% in 2025 and keep real rates in positive territory.

US INFLATION AND FED FUNDS SCENARIO



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Strategy

TRUMP 2.0: MOVE FAST AND BREAK THINGS

With US President-elect Donald Trump having nominated his cabinet for his second term, it is evident that Trump 2.0 will not replicate his first term; rather, it marks the next chapter in the reshaping of the US economy and world order that began in 2017.

Overlooking former US Trade Representative Robert Lighthizer – the architect of tariff policies during Trump's first term – was one of the most surprising decisions. Coupled with the inclusion of Scott Bessent, who views tariffs primarily as a 'negotiating tool', this reduces the likelihood of broad global tariffs early on in Trump's second term. Instead, tariff policy is likely to focus on pressuring Mexico and Canada for concessions ahead of the 2026 renegotiations of the United States-Mexico-Canada Agreement.

However, tariffs on China fall into a different category. The nomination of so-called China 'hawks' as Secretaries of State and Defense as well as the National Security Advisor, highlight that the tariff focus might be more wide-ranging under Trump 2.0, likely requiring a multi-pronged response from Chinese authorities in 2025.

Robert Kennedy Jr.'s nomination to lead the Trump health agenda could disrupt 'big food' and 'big pharma' as he shifts the regulatory landscape in both arenas. However, slim majorities in Congress and other more pressing Trump legislative priorities will likely limit the timing of large-scale changes to beyond 2025.

In contrast, Thomas Homan, Trump's nominee to lead Immigration and Customs Enforcement, looks set to disrupt the flow of illegal immigrants into the US, the numbers of which have swollen the labour force and kept wage growth in check in recent years. This may create a comparatively less recognised catalyst to inflationary pressure should deportation programmes take shape under the new Trump administration in the new year.

Elon Musk and Vivek Ramaswamy, advisors to Trump's Department of Government Efficiency (DoGE), have outlined a target to find USD 500 billion in federal budget savings annually. While a substantial sum, if achieved, this represents only 25% of the estimated 2024 budget deficit and only 7% of overall federal spending. Indeed, reaching half a trillion dollars in savings would itself be impressive, given that the bulk of these reductions would likely have to come from 'discretionary' government spending, which totalled just USD 1.7 trillion in 2023.

Combined with Treasury Secretary nominee Bessent's focus on fiscal sustainability, the prospect of an aggressive and creative reallocation of US government spending looks to be on the agenda in Trump's second term.

Anchors like gold and hedge funds provide stability amidst the rapid pace of change

Although less than two months remains before President-elect Trump is sworn in and the prioritisation and detail of the Trump 2.0 agenda remains unclear, what is unambiguous is that the nominees to the new Trump administration are being tasked with changing the American status quo within the historical operating framework of the world largest economy, along with how the world's superpower interacts – financially, commercially as well as from a national security perspective – with allies and adversaries alike.

With only four years in Trump's final term as President and only two years of assured Congressional majorities, America's 47th President looks set to mimic Silicon Valley's famous 'move fast and break things' mantra as the new administration seeks to attempt to reshape the US and world order.

For investors, the likely potentially rapid pace of change should bring not only opportunities but also risks, favouring active rather than passive investment strategies, resilient corporates which can weather such rapid transformation, as well as increased exposure to anchors – such as gold and hedge funds – to contain what is likely to be frequent bouts of volatility as these changes are rolled out.

Asset allocation

1

Fixed-income assets face constrained inflation-adjusted returns unless a significant 'growth shock' occurs in the US

2

Exposure to US mid-caps balances risks from technology sector concentration

3

The defence sector could benefit from a forced increase in defence budgets

ADJUSTING PORTFOLIOS FOR 2025

In line with our long-term global macroeconomic outlook, we maintain our conviction that global equities, hedge funds, and precious metals will drive performance in the coming years. While fixed-income assets will continue to play a role in portfolio diversification, their inflation-adjusted return potential appears increasingly constrained in the absence of a significant 'growth shock' in the US.

Following two years of substantial gains and a valuation re-rating, global equities are expected to deliver positive but more moderate returns in 2025 (barring a move into unsustainable valuation levels). Hedge funds and gold remain our preferred diversification tools, as they offer resilience in uncertain environments.

Despite the broad market consensus, we are keeping a strategic preference for US equities following the election result and are continuing to prioritise them within global equity allocations for 2025. The technology sector is expected to sustain solid earnings growth, driven by ongoing investments in artificial intelligence infrastructure – a trend we do not anticipate slowing in the near term. However, we remain vigilant, as any signs of reduced capital expenditures (capex) by large-cap technology companies could pose risks to equity markets more generally due to the sector's elevated concentration. To balance this risk, we maintain exposure to domestic US mid-cap stocks, which are trading at more reasonable valuations and stand to benefit from the pro-growth policies of the Trump administration.

Navigating complexity inside the European investment landscape is becoming increasingly challenging, necessitating a more selective, bottom-up approach. We have downgraded UK equities from 4/5 to 3/5, reflecting concerns about political uncertainty and the economic headwinds from higher corporate and household taxes. Within Europe, we have identified opportunities in the defence sector (representing a modest 2% weighting in the MSCI Europe) which could benefit from a forced increase in defence budgets. Furthermore, a favourable outcome to Germany's February elections could spark a tactical rebound in European equities, a scenario we will monitor closely given the negative investor sentiment on the region.

We are keeping a balanced view on emerging markets and are holding on to our cautious stance on Chinese equities as the ongoing threat of US tariffs continues to weigh on the outlook. Instead, we favour Indian equities for 2025, where the expected 18% earnings growth for 2025 justifies the rich 22x earnings valuation.

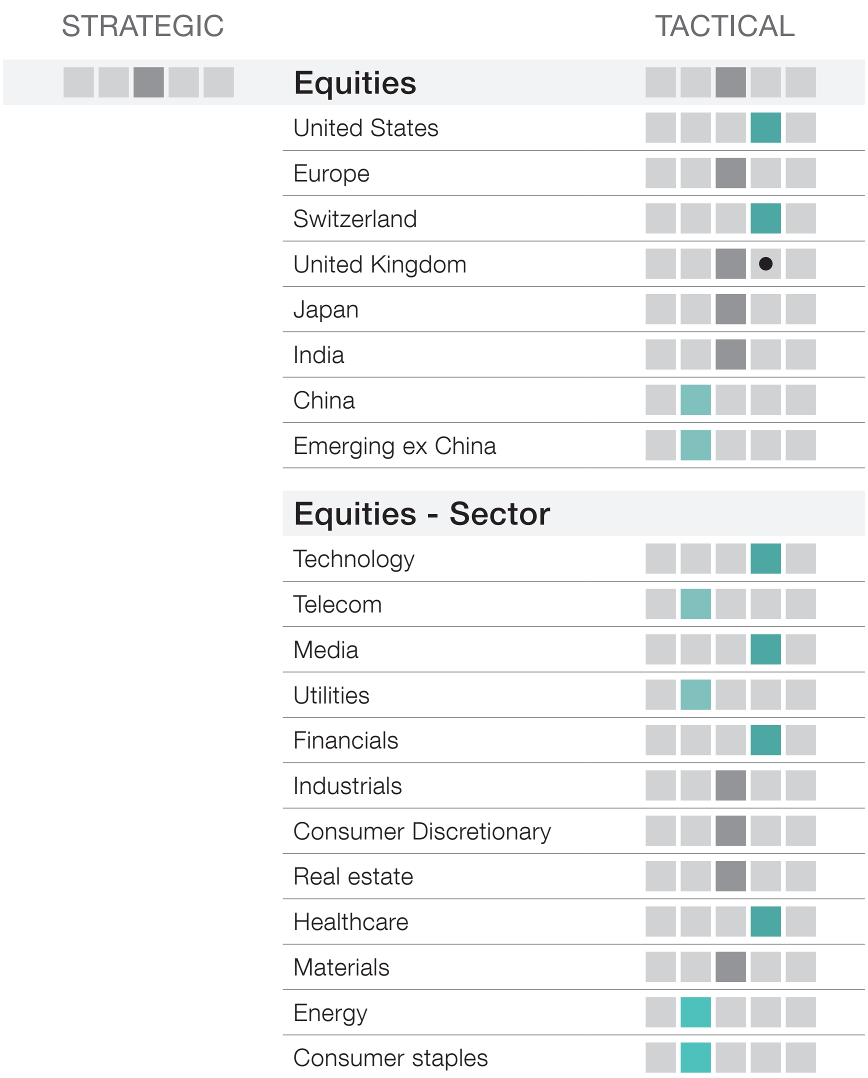
In response to the US election outcome, we have reduced fixed-income exposures and have maintained a short-duration strategy focused on high-carry opportunities. Agency mortgage-backed securities (MBS) have been added to portfolios as a diversification tool, offering attractive carry in a tight spread environment.

Directional views

LOW CONVICTION | BASE LINE ALLOCATION | HIGH CONVICTION

PREVIOUS VIEW ● (no dot means no change)

Strategic (long-term view) and tactical (1–6 month) on broad asset classes, December 2024



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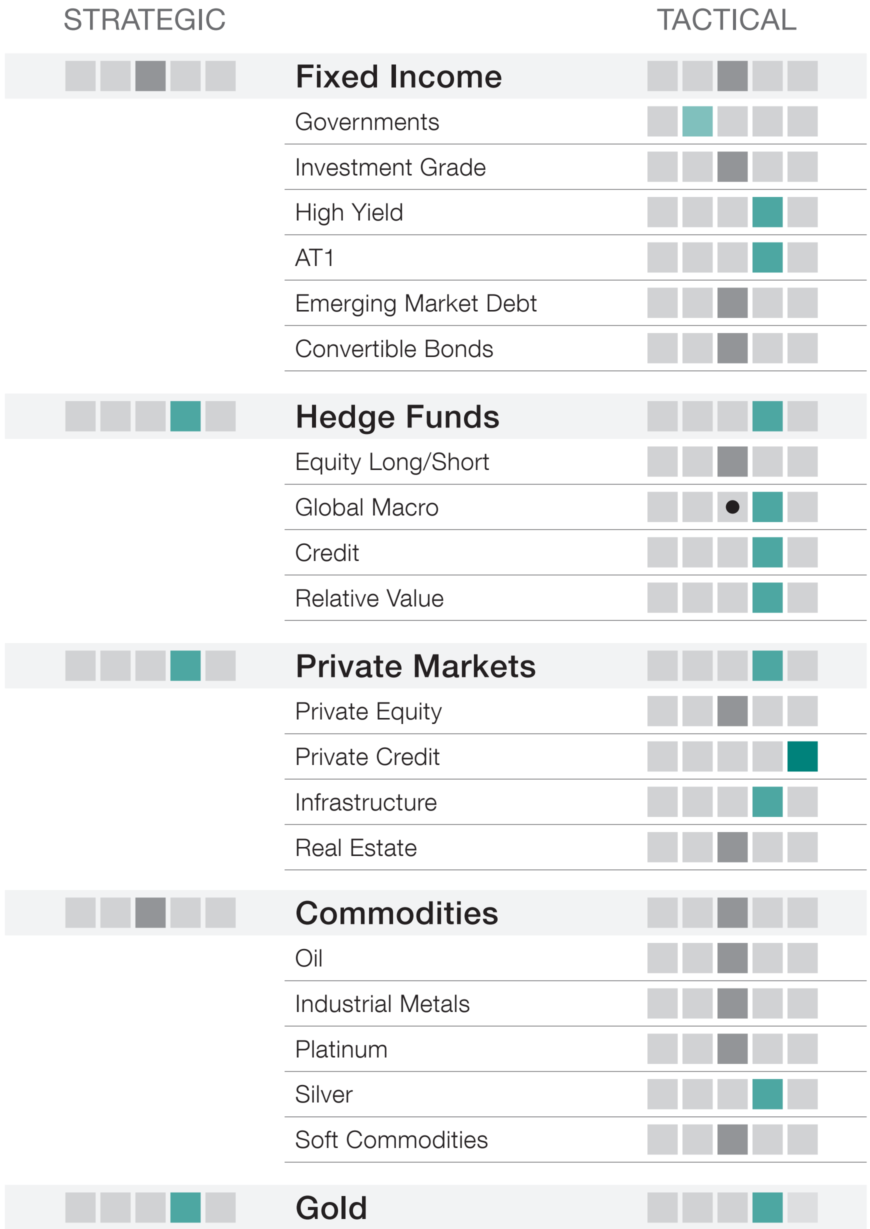

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Asset classes

EQUITIES

FRAGMENTED PERFORMANCE

Global equities experienced notable divergences in November, driven by the US elections. The MSCI USA Index gained 6.22% during the month, outperforming the broader MSCI World Index (3.74%). In contrast, European and emerging markets equities were hardest hit, declining by 1.68% and 3.59%, respectively.

The now widely held view that US equities are the most attractive market is difficult to contest. We continue to hold a high level of conviction on the region, maintaining a rating of 4/5. Earnings visibility for 2025 remains strong, especially when compared with other regions of the world.

Meanwhile, we have downgraded UK equities from 4/5 to 3/5 and have reduced exposure in portfolios. Our initial investment thesis – a domestic economic recovery fuelled by normalising inflation and aggressive rate cuts from the Bank of England – has been undermined by the country's strained fiscal situation. The new government's decision to raise taxes on households and corporations has further dampened the outlook.

In Europe, we acknowledge the potential for intermediate rebounds in equities, particularly ahead of Germany's February elections and possible announcements of fiscal support for, and/or a resolution to, the Russia-Ukraine conflict. However, we have adopted a more selective, bottom-up approach, focusing on sector opportunities. In this regard, the European defence sector stands out as a candidate for outperformance on the back of a forced increase in defence budgets. As a result, the sector is entering a new long-term growth cycle and is trading at 17x forward earnings – slightly cheaper than its US peers – while offering a compelling 13.6% compound annual growth rate (CAGR) in earnings over the next three years.

Looking ahead to 2025, we maintain a positive outlook on global equities. However, after two years of substantial returns and a valuation re-rating in the US, periods of heightened volatility appear increasingly likely.

FIXED INCOME

REDUCING INVESTMENT GRADE EXPOSURE

November saw ongoing volatility in interest rates, with US 10-year yields peaking mid-month at 4.5% following market fluctuations in the wake of Donald Trump's re-election. To put this in context, 10-year yields began the year below 4%, rose to 4.7% by April, dipped to 3.6% by September, and then climbed back to 4.5% before settling at 4.2%. The MOVE index, a measure of bond market volatility (akin to the VIX for equities), has remained above the 100 level for most of the past three years – a level rarely seen since the global financial crisis (GFC).

Despite this volatility, fixed income's performance has been robust, year-to-date. Investment-grade (IG) bonds have returned 4.6%, outperforming Treasuries by over 2% due to spread compression. High-yield (HY) and emerging market (EM) debt both gained more than 8%, driven by significant spread tightening. Spreads across IG and HY are tighter than at any time since the GFC, with low dispersion and between rating classes.

During the month we shifted a portion of our IG exposure to agency mortgage-backed securities (MBS): while IG spreads offer no room for compression, high-coupon agency MBS – backed by the US government and carrying no credit risk – are offering some of the highest spreads seen in thirty years. This is due to unique market conditions, including increased rate volatility, the Federal Reserve's quantitative tightening, and reduced demand from banks. This move enhances portfolio yield while improving credit quality and diversifying spread risk, as agency MBS spreads often move independently of corporate credit spreads. While no immediate catalyst exists for agency MBS spreads to tighten, we are content to enjoy the current carry. It is important to highlight that we continue to have IG as the core of our portfolio: despite tight spreads, an elevated rate environment means the class offers a 5% carry.

Following Trump's victory, we chose to reduce the exposure to EM local currency debt. Trump's win introduces potential challenges for EM currencies due to trade tariff threats, the likelihood of increased US-China tensions, and possible geopolitical risks in Europe. His expansionary fiscal policies could pressure EM central banks to maintain high interest rates to protect their currencies, limiting their ability to stimulate growth. Consequently, EM local debt may underperform EM hard currency debt. Nonetheless, we find EM hard currency bonds appealing. Following a series of post-Covid defaults, EM indices are relatively clean, and spreads significantly above recent lows.

Given the persistent interest rate volatility and our cautious outlook on long-term rates, we maintain a conservative duration strategy, favouring a position close to three years versus the neutral four years.

CONVERTIBLES

A FAVOURABLE LANDSCAPE

Global convertible bonds benefited from an eventful November to deliver a performance in line with global equities (+4.8%) despite an equity sensitivity of 40% at the start of the month. This was made possible by various elements. First, the lower yield/lower spreads environment had a favourable impact on the fixed income bucket of the asset class. However, most importantly, global convertible bonds benefited from the outperformance of their equity engine. The alpha came mainly from the US, where the underlying equities of convertible bond issuers gained +12.4% this month vs. +5.3% for the S&P, factoring in Trump's election and the Fed's 25-bps rate cut. The positive bias came from the overall small/mid-cap composition of the US universe (the Russell 2000 progressed by 11% in November), but also from idiosyncratic specificities. The one having the greatest impact – for the second month in a row – was the crypto exposure to Coinbase and MicroStrategy, the two largest exposures to this theme in our asset class, contributing 1.6% to November's performance.

HEDGE FUNDS

STRONG PERFORMANCES ACROSS STRATEGIES

While most funds had reduced exposure going into the US election, they were quick to re-engage when the Trump victory impacted financial markets. The consequences were widespread, and it benefited all strategies.

In terms of conviction, we are sanguine on the global macro strategy. As a result, we have raised our rating from 3/5 to 4/5. This adjustment reflects an increasing set of opportunities derived from the 'fragmented growth view' described by UBP's Investment Committee. Global macro funds are particularly well placed to capture various future imbalances in rates and currencies. As volatility is set to remain structurally higher, we also have a positive stance on managers dedicated to fixed income arbitrage strategies.

PRIVATE MARKETS

PRIVATE MARKETS UNDER A TRUMP PRESIDENCY

The implications for private markets during a second Trump mandate could be significant but are yet to be shown. For example, one can anticipate that the regulatory environment will change, which could potentially be more positive for M&A. The first Trump mandate was friendly towards financial services, and it is likely the second will follow the same path, boosting fintech. The flipside is that some cross-border deals may become more complex on the back of an 'America First' doctrine, adding scrutiny to some investments.

CURRENCIES

DOLLAR IN POLE POSITION COMING INTO DECEMBER

Reflecting higher yields across the US curve, the USD appreciated across the board in November in the wake of the US elections, notably against the EUR and GBP. The former underperformed on the back of publication of worse-than-expected eurozone PMI data, and the news that Germany would hold federal elections in late February. Meanwhile, the latter weakened following the UK budget. Looking ahead, December is traditionally a weak month for the USD, though we expect it to trade at robust levels coming into the new year.

Emerging market currencies broadly disappointed, with both the Mexican peso and the Brazilian real showing losses against the greenback. The CNY fell to its lowest level against the USD since July (around 7.25).

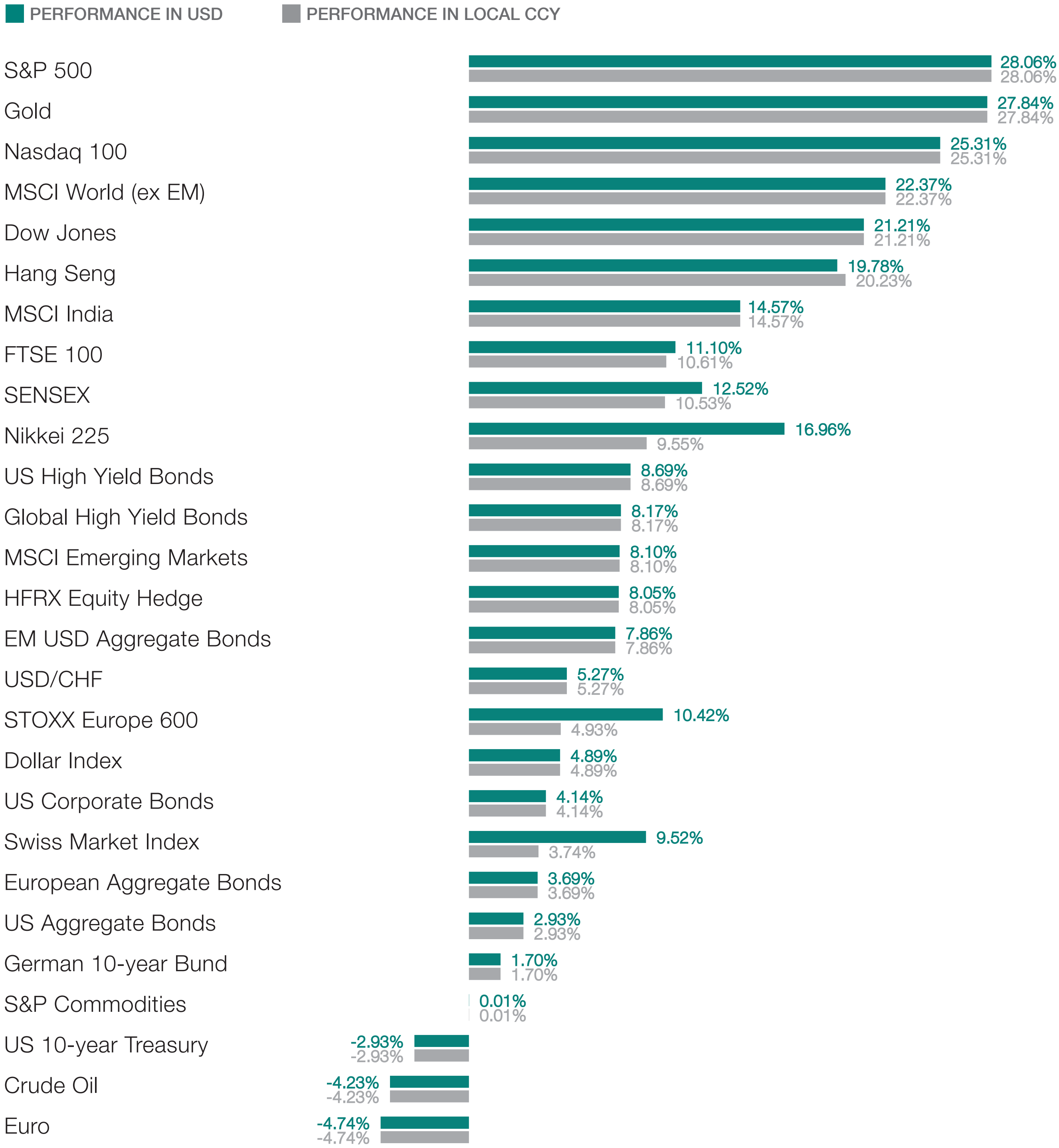
COMMODITIES

PULLBACK FOR PRECIOUS METALS IN NOVEMBER

Both gold and silver fell following the US elections. The yellow metal dropped from around USD 2,800 per oz to lows of just under USD 2,600 per oz. Investor positioning was heavily long on gold ahead of the elections, and the result led to profit-taking from CTAs and hedge funds. However, the fundamental outlook on gold remains supportive, and the rise in long-term bond yields is not a game changer. Since 2022, gold has decorrelated from long-term yield rises, suggesting that gold remains in a secular bull market. We view levels of around USD 2,600 per oz as a strong buying opportunity.

Market performances

2024 YEAR-TO-DATE RETURNS (%), DATA AS AT 2 DECEMBER 2024



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