UBP House View

January 2025

MARKETING COMMUNICATION

Union Bancaire Privée

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Editorial

Momentum slows on rate cuts

The policies of the incoming US administration are beginning to challenge the fixed income market. Trump's agenda on higher tariffs, tax cuts, and stricter immigration measures could spur inflationary pressures if implemented. These uncertainties increase the likelihood of just one Federal Reserve rate cut – or none at all –, while our scenario forecasts two reductions in 2025. In this environment, the current tight spread levels offer insufficient protection against interest rate volatility, creating a precarious risk-return balance, with the potential for yield overshoots as they near elevated levels.

With this in mind, our tactical view on fixed income has turned bearish. Upside risks to US inflation in a robust economy are likely to limit capital gains, while narrow spreads offer little protection against rising yields. To navigate these challenges, hedge fund strategies may serve as a haven until interest rate risks normalise later in the year. Despite this short-term caution, our long-term outlook on fixed income remains unchanged: the sustained high level of carry is still attractive for those investors with an extended time horizon, and who are willing to weather transient interest rate volatility.

On the equity front, our outlook for US equities remains positive, underpinned by solid earnings growth. Although rising yields may present challenges in the near future, robust fundamentals continue to support valuations across both technology and non-technology sectors. This market stands out as a resilient option, particularly in a fragmented global economic landscape.

Contents

Key investment themes & risks
page 3

Macroeconomics
page 5

Strategy
page 8

Directional views
page 10

Asset allocation
page 12

Market monitor
page 15

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Key investment themes & risks

Investment themes

1 Hedge funds provide a better risk/reward profile than fixed income assets in a 'higher-for-longer' inflationary environment.

2 Despite the rising yield environment, the outlook on equities is moderately positive, as earnings will accelerate across most sectors in 2025.

3 Gold remains a strong conviction for 2025 given a sustained inflation backdrop.

4 The US technology sector and domestic US mid-caps remain our preferred segments in global equities at the start of the year.

The US economy ended 2024 on a strong note (for the second year in a row), with real GDP growth probably closing at 2.8%, well above the initial 1.0% projection expected at the start of the year. This fuelled gains in risk assets, as the S&P 500 finished the year with a performance of 23.31%, while fixed income lagged behind and delivered returns of 3.40%, putting the sector behind cash. We expect these trends to continue in 2025.

The end of the disinflationary trend is set to have significant impacts at asset allocation level. In this context, sustained inflation in the 2–3% range is a consequence of resilient economic growth and provides an optimal environment for long-term equity returns. Conversely, this scenario is less favourable for bonds, where capital gains are likely to remain muted in 2025. The 'higher-for-longer' interest rate narrative leads us to favour hedge funds over fixed income, given their higher expected returns. Precious metals will also continue to play a central role in our asset allocation strategy for 2025.

In equities, we maintain our current allocation with a strong preference for US technology companies. These firms are expected to deliver earnings growth superior to the broader market, with valuations remaining largely in line with historical averages. We are also exploring opportunities in the US mid-cap segment, which appears attractively valued relative to earnings growth expectations.

Risks

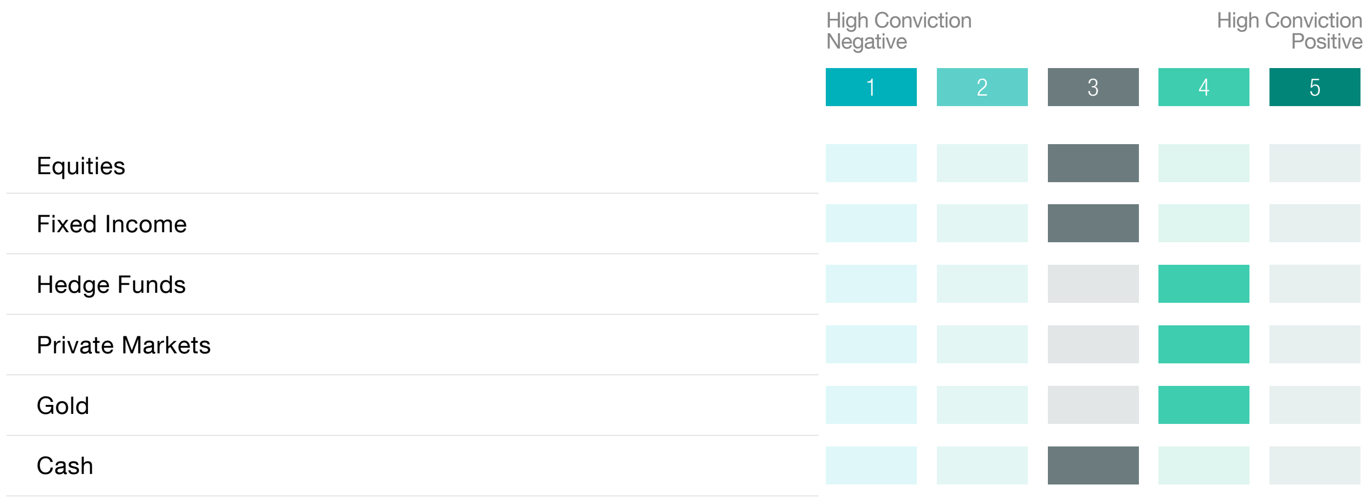
The risks and supportive factors for financial markets are well balanced at the start of the year. The 'higher-for-longer' interest rate environment and inflationary backdrop pose clear risks to the bond market, particularly given the elevated debt burden and ongoing fiscal uncertainties.

Rising bond yields, driven by upside risks in US inflation, represent the primary risk for portfolios, as both bonds and equities could face pressure due to tight valuations across asset classes. Given the significance of this risk, we maintain our recommendations to avoid long-duration bonds and to refrain from overweighting equities at the start of the year.

A second risk lies on the earnings front, with US earnings projected to accelerate from 10% in 2024 to 15% in 2025. Should major US technology companies scale back spending on artificial intelligence infrastructure due to limited monetisation visibility, it could weigh on technology sector earnings and, in turn, the broader market. However, we believe this risk is unlikely to materialise in 2025 and we remain confident about the sector's prospects for the year ahead.

As long as the US economy maintains its growth trajectory and global earnings meet expectations, any market shocks are likely to be short-lived and should be viewed as opportunities to rebalance portfolios strategically.

Asset allocation: strategic views as at January 2025



High Conviction Negative 1 2 | Baseline Allocation 3 | High Conviction Positive 4 5

Previous view ● (no dot means no change)

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Macroeconomics

Global monetary easing cycle likely to end swiftly

We remain optimistic about global growth, which we project to come in at approximately 3.2% for 2025, bolstered by reflationary policies emerging in the US following Trump's re-election. The extension of tax cuts from Trump's first term, along with reduced corporate taxes, is expected to stimulate investment and job creation in the industrial sector, keeping US growth at approximately 2.7% in 2025. Both business and consumer confidence have continued to improve, which suggests that economic activity should stay strong in the coming months, with consumer spending remaining robust and a progressive recovery in the manufacturing sector.

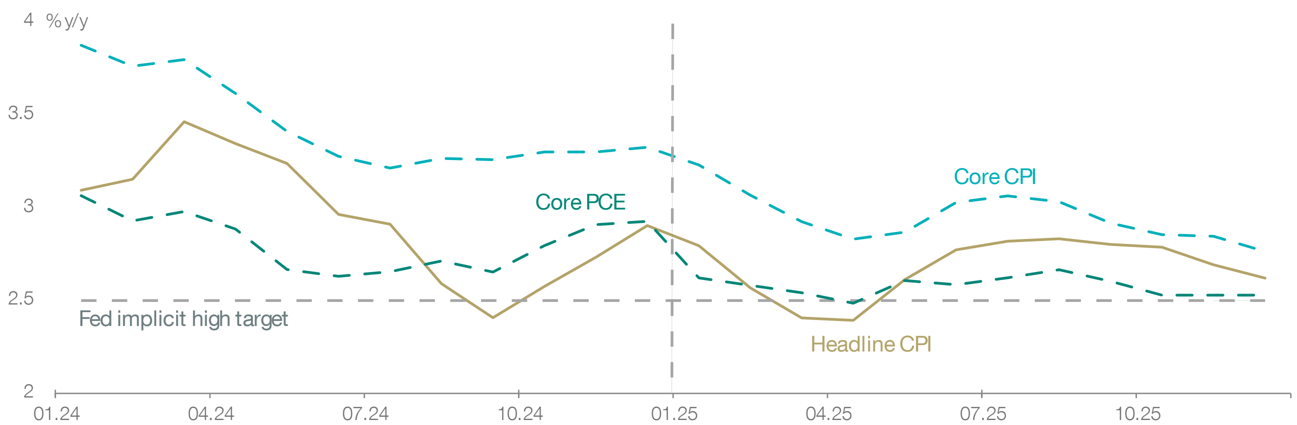
In contrast, we expect economic growth in the eurozone to remain fragile, with projections not exceeding 1% in 2025, characterised by significant disparities between member states. Southern nations, such as Spain, are poised for robust growth of around 2%, while their counterparts to the north, including France and Germany, face vulnerabilities, with forecasts of just 0.5% and 0.7%, respectively. Both countries are mired in persistent political instability and will continue to struggle with limited fiscal flexibility, exacerbated by rising debt burdens and increased defence expenditures.

In China, additional support measures could facilitate a gradual recovery in private investment and broader domestic consumption in 2025. Activity stabilised at the end of the year, but remains fragile. More support is needed for the real estate sector crisis to stabilise. In contrast, India and ASEAN countries offer a relatively constructive outlook despite uncertainties related to China and the future US trade policy.

Inflation: rebuilding upside risks

Inflation in developed countries remained resilient at the end of 2024 due to persistently high service prices. Global inflation is expected to ease slightly at the start of 2025, driven primarily by favourable base effects, but it is likely to pick up again in the course of the year. According to our scenario, US inflation could reach 2.5–3.0%, while in the eurozone it should range between 2.1–2.3% by the end of the year.

US INFLATION SCENARIO



Sources: BLS, Refinitiv and UBP

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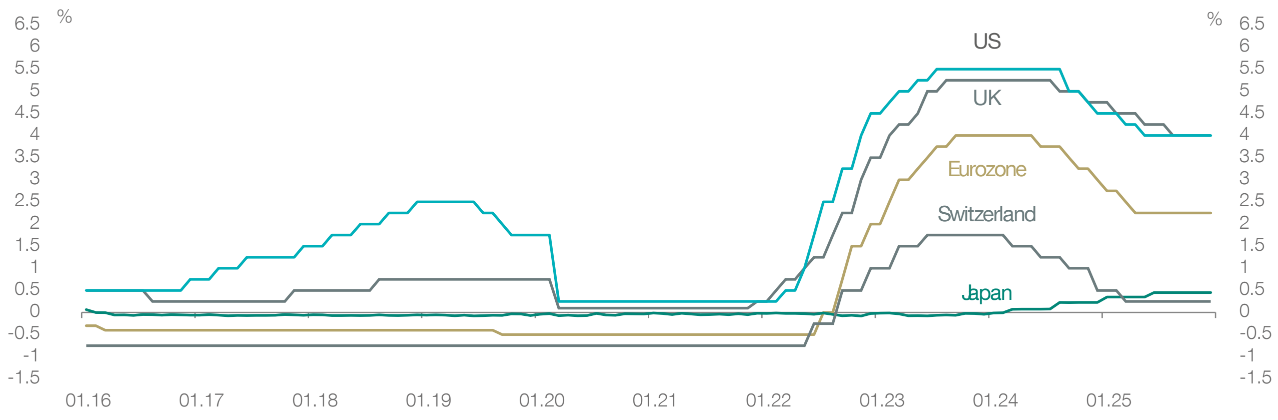
In the United States, several measures announced by Donald Trump could lead to rising inflation, either due to a decline in supply – exacerbated by labour shortages stemming from immigration restrictions – or through excessive demand fuelled by tax cuts and rising tariffs on foreign products. If all the promised measures were adopted, US inflation could rise significantly above 3%.

US growth to remain robust in 2025, maintaining its position as a leader among developed economies.

Early end to the US monetary easing cycle

The Federal Reserve will be constrained by the reflation policies of the Trump administration, limiting its ability to further reduce its policy rates. While the Fed is very likely to skip a rate cut in January, it may still lower policy rates to 4% during 2025, which would entail two rate cuts. Nevertheless, the risk of seeing only one rate cut, or even no rate cut at all in 2025, has recently increased due to uncertainties on the future US economic policy.

MONETARY POLICY PROJECTION OF MAJOR KEY RATES



Sources: Bloomberg Financial L.P., central banks and UBP
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Amid weak growth, lower inflation, and the threat of tariffs from the new US administration, the European Central Bank (ECB) will continue to ease its monetary policies in the first half of 2025, with a rate cut already likely in January; however, as seen in the US, resilient inflation in services will prevent the ECB from aggressively cutting its rates over the next few months. In the UK, the scope for rate cuts is limited, as inflation in services and wage increases remain above the Bank of England's expectations.

The 'higher-for-longer' interest rate environment favours hedge funds over fixed income assets given their higher expected returns.

Strategy

New year starts with interest rate risk

As 2025 begins, US 10-year Treasury yields have broken above 4.5% for the third time in the post-pandemic era. During the episodes in autumn 2023 and in spring 2024, the stability of the US Treasury markets was challenged with meaningful volatility, enough so that US policymakers pivoted in an effort to restore order to markets.

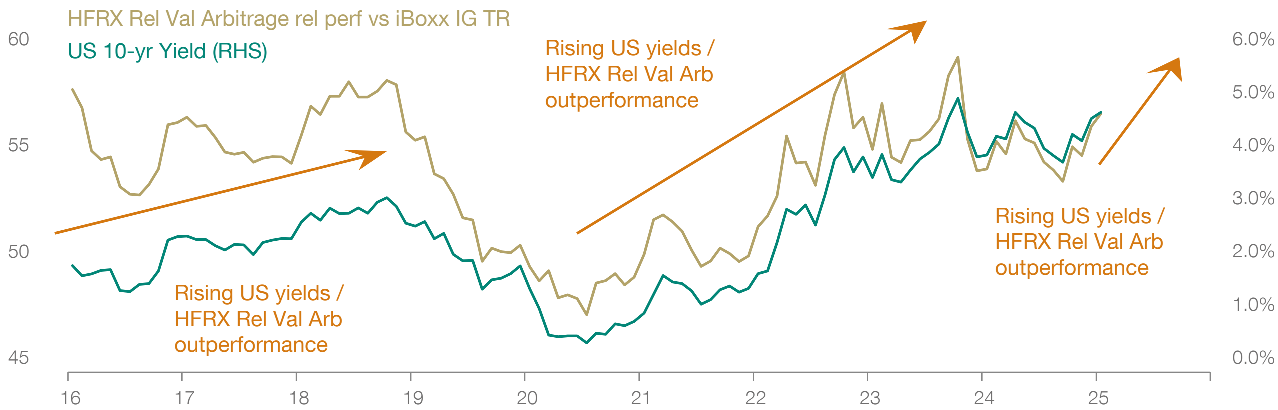
This third episode in 2025 poses a different test for policymakers than the previous two. During 2023 and 2024, US authorities could rely on the tailwind of falling inflation to aid in their efforts, as this provided a backdrop against which US policy communications and then actual policy rates could pivot in an attempt to re-anchor longer-term yields to a lower level.

This time, however, US inflation, as well as recent inflation prints in the UK, Germany, and Japan, have surprised on the upside and have concerned markets over the stickiness of prices following their declines through much of 2023/24, likely bringing the Fed to pause its rate-cutting cycle at least temporarily in early 2025.

Indeed, amidst this inflation ambiguity, the Fed's own December dot plot has already removed the expectation that the Fed would cut rates to 3% by the end of 2025 and instead suggests a terminal rate closer to 4%, i.e. only slightly below current levels, by year-end.

For US dollar bond investors in particular, this suggests that the normalisation of the American yield curve under way since 2023 should continue. With 2-year yields likely floored at near 4% according to both the Fed's guidance and UBP's forecast, a return to the pre-pandemic 1989–2019 average of 110 bps would mean US 10-year Treasury yields of just above our 2025 target of 5%, as outlined in our 2025 Investment Outlook*.

US 10-YEAR YIELDS VERSUS HEDGE FUNDS PERFORMANCE



Sources: HFRX, Bloomberg Financial L.P. and UBP

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Despite the compensation investors earn for buying longer-dated bonds becoming positive once again, it would still take a move towards 5.5% for this 10-year ‘term premium’ to normalise to its 1989–2019 average.

This normalisation process which has been unfolding since the Fed rate-hiking cycle ended in 2023 – across not only USD, but also GBP, EUR and JPY bond markets – is coming under further pressure from the leadership transition taking place in late January as Donald Trump takes office.

With he and his transition team remaining tight-lipped about details surrounding tax, immigration, and tariff policies, the risk exists that a fiscal shock may emerge – not unlike that seen in the UK under the short-lived Truss government in 2022 or even in the US in 1980 under Ronald Reagan.

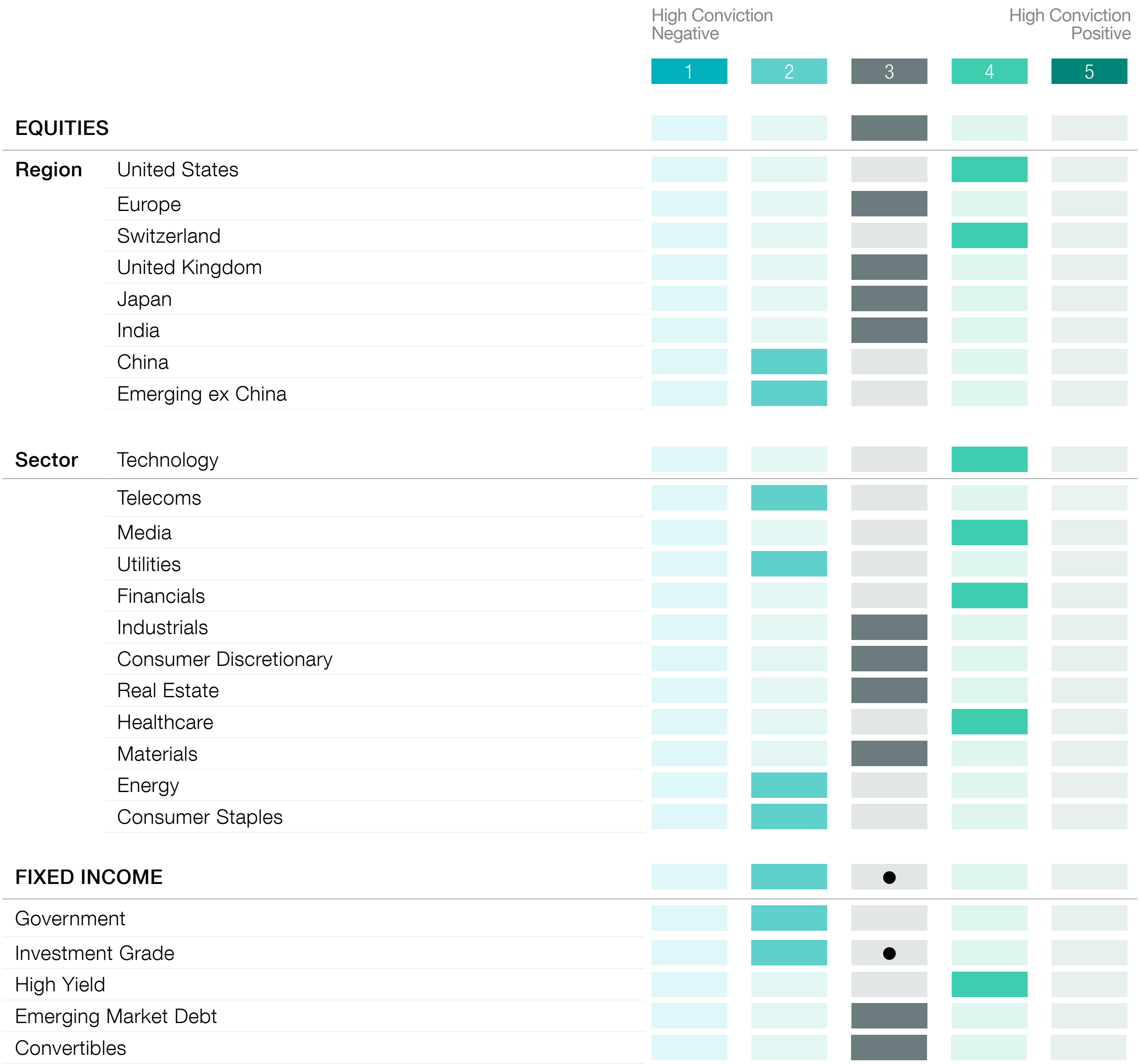
This, combined with the fiscal position left by the outgoing Biden administration, where the US budget deficit in October/November has already reached USD 650 billion (up 67% year-on-year), suggests that tail risks exist for even higher yields than our 5% target for 2025 captures.

As a result, for fixed income-focused investors, we continue to prefer low-to-no-duration credit strategies. For bond-heavy, multi-asset investors, however, we continue to believe select fixed income alternative hedge fund strategies offer a valuable refuge until the interest rate risk fully normalises over the course of the year.

*_Fragmented Resilience_ published in November 2024.

Directional views

Asset allocation: tactical views as at January 2025



High Conviction Negative 1 2 | Baseline Allocation 3 | High Conviction Positive 4 5

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Directional views

Asset allocation: tactical views as at January 2025

	1 (High Conviction Negative)	2	3	4	5 (High Conviction Positive)
HEDGE FUNDS				■	
Equity long/short			■		
Global Macro				■	
Credit				■	
Relative Value				■	
PRIVATE MARKETS				■	
Private Equity			■		
Private Credit					■
Infrastructure				■	
Real Estate			●	■	
GOLD				■	
COMMODITIES			■		
Oil			■		
Silver				■	
CASH			■		
USD				■	
EUR			■		
GBP			■		
CHF		■			
CURRENCIES					
EUR/USD			■		
USD/JPY				■	
GBP/USD				■	
USD/CHF				■	
USD/CNY				■	

High Conviction Negative 1 2 | Baseline Allocation 3 | High Conviction Positive 4 5

Previous view ● (no dot means no change)

Asset allocation

Equities

In 2024, global equities mirrored the trends seen in 2023, with US equities and the technology sector once again leading global returns. A supportive economic backdrop, coupled with secular growth in the technology sector, translated into a rebound in earnings. US earnings grew by approximately 10% in 2024, significantly outperforming their European and Chinese counterparts, which experienced declines of -1% and -4%, respectively.

Looking ahead to 2025, the balance of risks and positive drivers appears evenly matched, supporting our neutral allocation to the asset class. The rising yield environment, driven by a robust economic outlook and fiscal uncertainties (including an increasing term premium), should be manageable as long as no overshoot is observed.

Earnings growth is expected to accelerate to 15% this year, propelled by the technology sector (+20%) and contributions from other areas such as healthcare, materials, and industrials. We maintain a strong preference for US technology names and US mid-caps, which should be supported by favourable policies under the Trump administration, even if the near term yield environment could be seen as a headwind.

Although the S&P 500's absolute valuation may appear elevated, we see no significant excesses, either in large-cap technology names (with the 'Magnificent 7' trading near their 10-year averages) or in non-technology sectors.

Regionally, we continue to strategically favour US equities. However, tactical opportunities may arise in Europe, driven by the upcoming German federal elections and the potential resolution of the conflict in Ukraine.

Fixed income

In 2024, fixed income markets experienced a mixed bag of outcomes. On the one hand, spread tightening was evident across various segments, as the US economy proved resilient: investment-grade (IG) saw a 25 bps reduction, high-yield (HY) compressed by 40 bps, emerging markets (EM) by 65 bps, and AT1 CoCos by an impressive 100 bps. However, this was overshadowed by a steepening in the curve, with US 5-year and 10-year yields increasing by 55 bps and 70 bps, respectively, causing sub-segments to underperform their starting carry, with the notable exception of AT1s. The year closed with IG up by 4.6%, HY by 7.6%, EM by 6.5%, and AT1s chalking up a 10.8% return. In this sense, our decision to keep a relatively low duration position, while putting a greater emphasis on high yield and away from government debt, proved correct.

To start the year, we are taking a more cautious approach to fixed income. This is justified by UBP's 5% target for 10-year US Treasuries (revised from 4.75–5.00%), with the important caveat that we see a risk of overshooting. On the other hand, both IG and HY spreads are unlikely to move lower from their current multi-decade tights. We arrive at a plausible scenario of returns from fixed income being constrained to 'coupon-minus' levels. We are thus revising our tactical view of the fixed income class and that of investment grade to 2/5.

As regards duration, we continue to maintain a relatively short stance (around 3 years), but stand ready to extend this if yields move towards our revised targets. It is worth noting that European bond yields might hit their peak sooner than US yields due to different economic dynamics, and so the adjustment is likely to start there.

Last, during the second half of the year, we strived to look beyond traditional segments for yield, shifting some IG exposure to agency MBS in a move that allowed for an improvement in both yield and credit quality. Similarly, we favour senior loans over regular high yield, given their relatively attractive spreads and the (now consensus) expectation the Fed will keep rates elevated.

Strategically, we maintain a 3/5 rating on fixed income, supported by the still-attractive carry for long-term investors, with IG bonds offering a yield of 5.3%. This level offers a cushion against potential rate or spread shocks, making a negative return for the year quite unlikely.

In summary, navigating 2025's fixed income landscape requires a strategic approach, focusing on carry, diversifying spread sources, and carefully managing duration risk.

	USD	EUR	GBP
Duration	3.0y	3.5y	3.5y

Hedge funds

In December, some equity long/short managers incurred losses, whereas both global macro and relative value managers continued to perform well, leading to greater dispersion in performance. As the year came to a close, 2024 proved to be another strong year for hedge funds, as most funds finished in positive territory. Despite a wide range of geopolitical events and sustained uncertainties on both central bank policies and inflationary trends, managers performed in line with expectations. Looking ahead, investors are facing a more complex investment landscape, as the global economy is expected to remain fragmented. Many fixed income investments have become particularly at risk after having seen their spreads tighten throughout 2024. In this context, we are particularly sanguine on active strategies available in credit-oriented hedge funds; such funds can provide attractive risk/return profiles by benefiting from an increased level of dispersion and volatility in a wide range of fixed income markets, be they cash or derivatives.

Private markets

Real estate investors are entering 2025 with glimmers of hope after several difficult quarters following the interest rate shock of 2022. US rates are set to stabilise at a higher level than anticipated, but the 'higher-for-longer' narrative is now behind us. In Europe, logistics and hospitality, especially in southern European countries, present compelling investment opportunities. On the other side of the Atlantic, investors could start looking at the conversion of office space into residential units, driven by the ongoing shift to remote and hybrid work models that have reduced demand for traditional offices.

Currencies

In December, the US dollar continued on its uptrend, despite the US Federal Reserve's 25-bps rate cut. The FOMC (Federal Open Market Committee) raised its 2025 projections for US GDP growth and inflation, and the Fed's dot plot showed an expectation of only two 25-bps rate cuts in 2025. US yields climbed across the curve and the USD Index rose to 108. The greenback will continue to trade with an elevated profile in the first quarter, reflecting trade- and tariff-related uncertainties, which will weigh on most other major currencies.

Conversely, the Swiss franc weakened modestly following the SNB's (Swiss National Bank) 50-bps rate cut, which took the deposit rate to 0.50%. We expect that the USD/CHF will trade at the upper end of its recent ranges in the short term, however, the EUR/CHF will struggle to appreciate above 0.94.

Commodities

Gold traded modestly lower to levels of around USD 2,600 per oz during December. This decline reflected the appreciation of the US dollar and the rise in US 10-year TIPS yields, which is our proxy for real rate expectations. Silver also dropped towards levels of around USD 30 per oz; in our opinion these declines are unlikely to last. We note that central bank gold purchases increased again in recent months, with China buying for a second consecutive month. The large rise in 30-year bond yields is also constructive for both gold and silver, as it reflects inflation and debt-sustainability concerns.

Oil and natural gas prices rose in early 2025, reflecting the cold weather in the northern hemisphere, although we do not believe that these price rises will be sustained. Global oil markets will remain oversupplied in 2025 due to significant non-OPEC supply growth and constrained demand, leading to a forecast surplus of around 1 million barrels/day.

Market monitor

As at 14 January 2025

Equities World	Last Price	4W Chng	YTD Chng
MSCI Word Index (ex EM)	3 682.46	-3.53%	-0.68%

Equities USA	Last Price	4W Chng	YTD Chng
S&P 500	5 842.91	-3.44%	-0.66%
Dow Jones	42 518.28	-2.99%	-0.06%
Nasdaq 100	20 757.41	-4.70%	-1.21%

Equities Europe	Last Price	4W Chng	YTD Chng
FTSE 100	8 201.54	-1.19%	0.35%
STOXX Europe 600	508.28	-1.58%	0.13%
Swiss Market Index	11 702.57	0.07%	0.88%

Equities Asia	Last Price	4W Chng	YTD Chng
Hang Seng	19 219.78	-3.76%	-4.19%
MSCI India	978.45	-9.69%	-4.46%
Nikkei 225	38 474.30	-2.52%	-3.56%
MSCI Emerging Markets	1 053.05	-4.87%	-2.08%

Credit	Last Price	4W Chng	YTD Chng
Global High Yield Bonds	492.31	-0.62%	-0.13%
US High Yield bonds	1 720.39	-0.59%	-0.02%
US Corporate bonds	3 289.76	-2.11%	-1.16%
US Aggregate Bonds	93.06	-2.02%	-1.33%
European Aggregate bonds	54.65	-2.05%	-1.36%
EM USD Aggregate Bonds	1 637.61	0.00%	0.00%

Sovereign	Last Price	4W Chng	YTD Chng
US 10-year Treasury	4.79	9.07%	4.82%
German 10-year Bund	2.62	16.71%	11.03%

Alternatives	Last Price	4W Chng	YTD Chng
S&P Commodities	22.84	5.99%	4.96%
Crude oil	78.10	9.86%	8.67%
HFRX Equity Hedge	1 226.40	0.00%	0.00%
Gold	2 677.29	1.08%	2.01%
Silver	29.90	-2.20%	3.45%

Currencies	Last Price	4W Chng	YTD Chng
Dollar Index	109.21	2.12%	0.66%
EUR/USD	1.0308	-1.85%	-0.44%
USD/CHF	0.9122	2.18%	0.54%

Volatility	Last Price	4W Chng	YTD Chng
S&P 500 VIX	18.71	35.48%	7.84%
NASDAQ VXN	21.45	29.14%	7.68%
VSTOXX	17.70	28.74%	4.12%
XDAX	15.69	19.45%	0.30%

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