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AZIMUT GLOBAL VIEW

16.12.24

Main Events

17.12	US RETAIL SALES	Retail sales are expected to record another strong reading for November
18.12	FOMC	The Fed is expected to cut 25 bps, but the key focus will be on the rate path for 2025
20.12	JAPAN CPI	Inflation is expected to pick up again in Japan, potentially triggering the need for further hikes by the BoJ
20.12	U.S. PCE	The Fed's preferred gauge of inflation, core PCE, is expected to rise by 0.1% to 2.9%

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Geneva
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

ASSET ALLOCATION 2025 OUTLOOK

At a first glance, 2025 seems to be shaping up as a year that could still deliver positive performance, albeit milder than in the recent past. However, several uncertainties persist, potentially leading to corrections that could represent mid-term buying opportunities. Among the uncertainties, the two main ones are the lack of clarity about what Trump's administration might actually implement when he returns to power, and the fact that the performance of the various asset classes have been highly polarized: what has benefited from investor favor in the year just ended has reached challenging valuations, from which rapid corrections are possible.

We will try to discern what factors are likely to have the greatest impact on the global economy and financial markets, and what is the best positioning based on the information available at the moment.

Trump Administration

Republicans winning both houses of Congress will make it easier for Trump to implement his electoral agenda.

Many of Trump's measures have inflationary potential: These include the imposition of universal tariffs of 20 percent and 60 percent on imports from China. The expulsion of millions of illegal immigrants, which would lead to a contraction of the labor supply and potentially restore conditions that caused wage pressures in recent years. The extension of tax cuts expiring in 2025, and the introduction of additional ones, which could increase disposable income for consumption and, in turn, a renewed imbalance between supply and demand for goods and services. Other measures are potentially deflationary. These include deregulation and cuts to government spending, increased U.S. oil production —which could reduce oil prices —and the push for large-scale adoption of artificial intelligence, which may increase unemployment. What will truly matter is how many of the electoral promises will be translated into concrete actions and to what extent. We can expect that only a limited part of Trump's electoral "threats" will be translated into concrete measures. The following analysis is based on this assumption.

(continued)

The impact for U.S. growth is expected to be positive regardless of the extent to which electoral pledges are implemented. However, for other countries, the effects will be almost unequivocally recessionary and deflationary: higher tariffs will reduce exports to the U.S., which will, in turn, adversely affect growth and employment.

Inflation and Central Banks

The consensus is that the Trump Administration's measures are more likely to have an inflationary impact than a deflationary one, although not to the extent that inflation spirals out of control. The most probable scenario is for U.S. inflation to remain near current levels or, at worst, rise modestly.

In this environment, the Federal Reserve would face challenges in cutting rates aggressively. The market has already revised its expectations for 2025 substantially downward, now forecasting only three additional cuts of 25 basis-points, bringing official rates to the 3.75%-4.00% range by year-end. We align with this projection.

Conversely, inflation in the rest of the world could fall faster than initially expected. Reduced output from falling exports is likely to result in higher unemployment and reduced consumption. This scenario appears particularly complicated for Europe, which is already suffering from anemic growth and political tensions in several member countries.

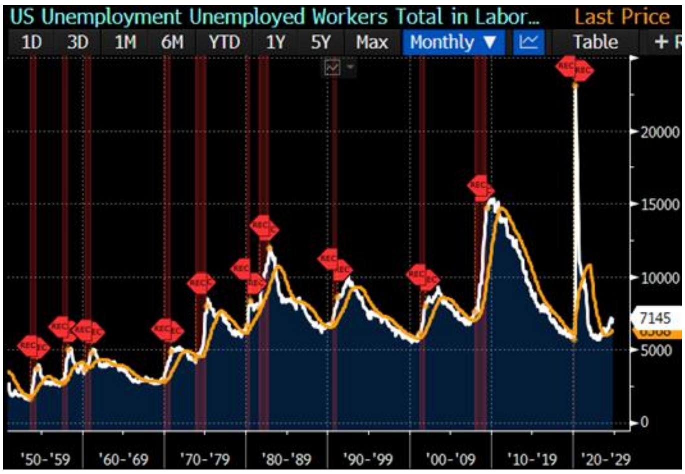
The most plausible consequence, therefore, is that central banks in the rest of the world will cut more aggressively than previously assumed to counteract both the recessionary effects of the Trump Administration's policies and to prevent inflation from falling too far below 2 percent.

US Labor Market

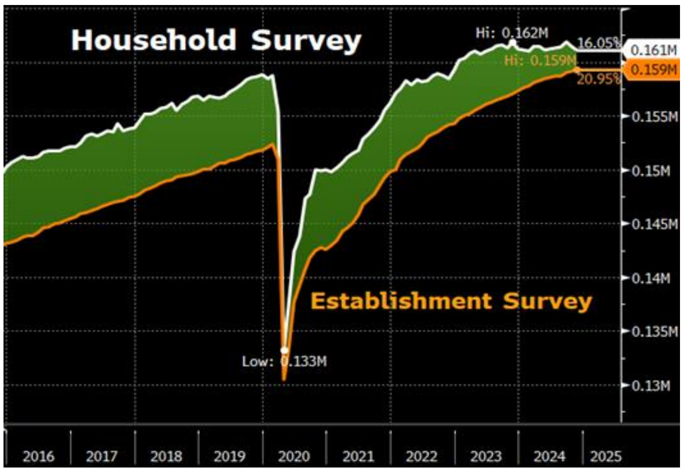
Another major question mark is the actual health of the U.S. labor market. The unemployment rate continues to rise, and historically, whenever the number of unemployed has exceeded its two-year average, a recession has followed.

In the current episode, however, it is difficult to foresee a recession in the short term. This could be explained by the abnormal use of fiscal stimulus (i.e. government deficit) in recent years, as discussed below.

Moreover, there are significant inconsistencies between the two main employment surveys. According to the nonfarm payroll or "establishment survey," employment appears to be steadily increasing. In contrast, the household survey—conducted by the same government agency but with a different methodology—shows no job creation over the past 18 months.



Source: Bloomberg



Source: Bloomberg

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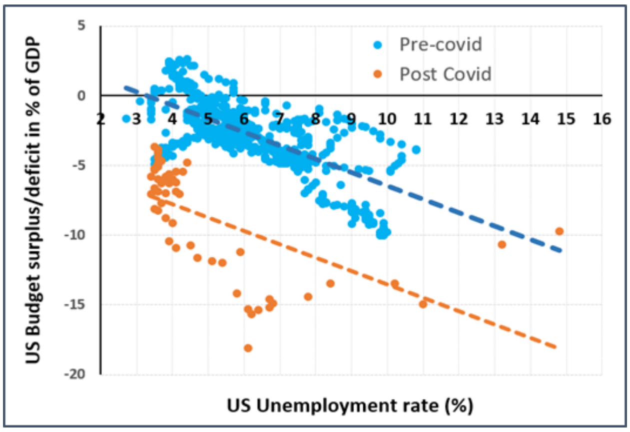
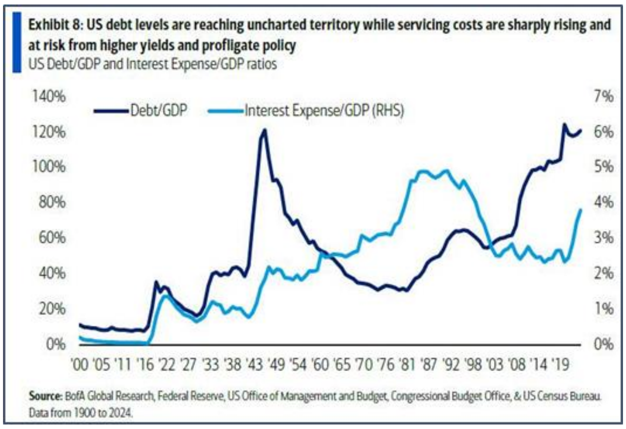
The health of the labor market is key to figuring out the resilience of consumption in the year ahead, considering that the pool of accumulated savings has been progressively drying up.

Public debt sustainability

Since the COVID crisis, all governments have resorted to deficit spending to a much greater extent than in the past. The United States has done so more than other countries, despite experiencing sustained growth and full employment. This surge in government debt, combined with rising interest rates, is driving a significant increase in the cost of debt.



Source: FRED, Bloomberg, Azimut elaboration



Source: BofA Global Research

This dynamic will likely become increasingly relevant to monetary policy choices. In order to avoid problems of public debt sustainability, it will be necessary to keep inflation slightly above the official 2 percent target, allowing for a real-term reduction in debt. At the same time, rates will likely would need to be lowered more rapidly than the economy otherwise require to avoid an unsustainable rise in interest expenditures.

A final, often overlooked consideration: a nation's GDP can be broken down into private sector GDP and public sector GDP. In recent years, the stronger growth in the United States compared to the rest of the world can be attributed not only to technological advances but also to higher government deficits. At the time of writing, U.S. government spending has increased 11 percent year-on-year to $7 trillion. Without this additional spending, U.S. growth would have been more modest: the strength of U.S. consumers also stems from massive government transfers. Therefore, the evolution of the deficit will be crucial: if it remains high, growth will likely continue. However, it's important to remember that historically, the excessive use of borrowing has rarely been accompanied by long-term prosperity.

Chinese Optionality

Since September, the Chinese government has openly acknowledged the need for substantial fiscal and monetary policy measures to revive domestic growth. It is unusual for the Chinese government to speak so candidly without then following through on its statements. The approval of substantial measures could enable the Chinese economy to jumpstart, with positive spillovers globally. This would at least partially offset the negative impacts on global growth of the tariffs that the Trump administration might impose.

In the event of concrete fiscal and monetary stimulus measures, Chinese assets could rebound sharply, supported by the current steep discount in valuations compared to most developed and emerging markets, a strong underweight in international portfolios, and extremely negative sentiment toward the country.

The Global Growth

As a result of factors mentioned above, global growth is expected to remain healthy - neither too strong nor too weak.

However, growth would be uneven. The United States is expected to grow a little above its potential owing to Trump's policies and the significant investment needed for the development of artificial intelligence. The rest of the world is expected to experience more anemic growth, primarily due to the effects of the possible imposition of large-scale tariffs. After years of disappointing results, China could be the exception, with a positive surprise if stimulus measures are approved. Should this happen, among foreign countries Europe could emerge as the biggest beneficiary.

Thus, the process of normalization of inflation, growth, and monetary policy can be expected to continue, returning the world to the moderate growth and inflation environment that fostered expansion in past decades.

Not all curves and segments of the credit market are equal…

We start with a basic assumption: current levels of interest rates will be the major driver of the performance (carry), with short-term maturities expected to decline across all Western countries during 2025. Therefore, in aggregate, the outlook for Fixed Income is generally positive. However, as mentioned earlier, it is plausible to expect that the behavior of the various interest rate curves may not align perfectly. The Federal Reserve may cut rates less than other major central banks. By the end of 2025, Fed Funds rates could hover around 4 percent, while the ECB could bring official rates below 2 percent, though not significantly. In light of these projections, nominal rates around 4 percent to 4.5 percent and real rates around 2 percent in the United States, or European government curves between 2 percent and 3.5 percent nominal, should be considered attractive.

However, some uncertainties remain. One such uncertainty common to all central banks, concerns the so-called "neutral rate." A consensus is forming that this is now at higher levels than in previous decades. Although the neutral rate is more of an abstract concept than an actually quantifiable measure, the fact that central banks are flagging that it is higher today than in the past suggests that the room to cut rates may be less than expected.

Another big question mark common to many countries is the sustainability of sovereign debts. In recent years, the market has reacted increasingly nervously when significant jumps in deficits have been announced (as seen with Liz Truss' British government). Recently, two major countries seem to have been added to the watch list: France and the United States. For France, the market will focus on how the political impasse following the fall of the Barnier's government will be resolved. As for the United States, it is difficult to expect serious problems in the short term, considering its status as a global superpower and reserve currency, but any fiscal slippage by the Trump administration could put stress on the long end of the U.S. curve.

Therefore, despite a generally positive view on duration, it seems wiser to overweight duration outside the United States. Only the short end of the U.S. curve can be considered safe, while caution is needed on the long end, which could be vulnerable not only if government deficits rise, but also if inflation remains too high. Only a significant deterioration in the U.S. labor market and/or growth would make the long end of the U.S. curve attractive again. In the credit space, our preference remains for subordinated bonds, corporate hybrids and CoCos in particular, as well as emerging market debt. In contrast, we are increasingly cautious on high yields, particularly U.S. high yields, where spreads are about to reach historic lows. Moreover, as long as there are no risks to growth, any widening of spreads that occurs is worth buying. Likewise, any sudden and substantial rise in sovereign bond yields should be viewed as an opportunity to accumulate.

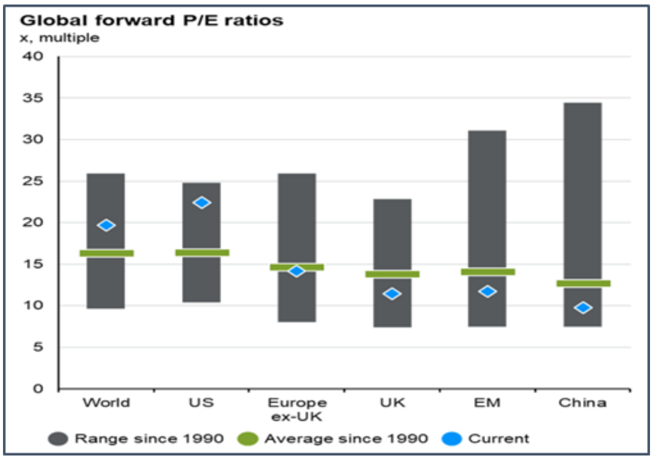
More details in the Fixed Income Outlook

…nor are countries and sectors for equities

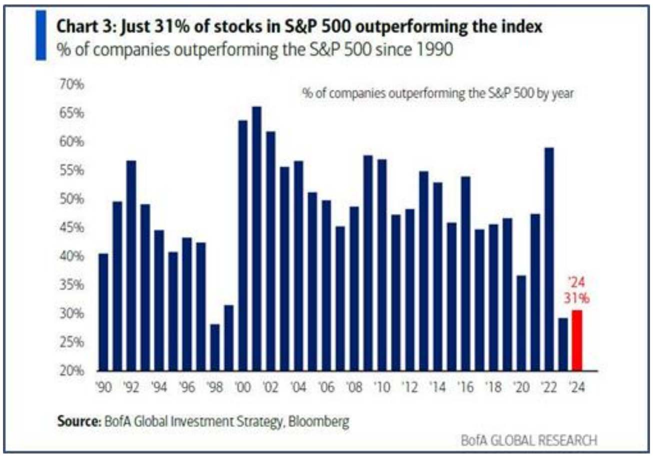
For the second consecutive year, global stocks achieved a positive performance of more than 20 percent. New technologies and the United States again led the charge, while other countries and sectors lagged behind. After two such strong years, - returns in the third year were positive again in most cases. The committee expects returns in 2025 to remain positive, although they are likely to be more modest than in recent years.

The U.S. market and technology will likely continue to thrive due to massive investments related to the development of artificial intelligence. Deregulation, pro-growth policies and tariffs on imports that the Trump administration may implement could further support the U.S. economy. However, given the remarkably high valuations, the possibility of rapid and deep corrections such as those already experienced in 2024 cannot be ruled out.

That said, more than half of the increase over the past two years has been due to multiple expansions, with stocks becoming increasingly expensive based on fundamentals. In other words, stock markets have grown more than earnings. This represents a vulnerability, as there is an established inverse correlation between starting valuations and the long-term returns. Furthermore, the concentration of returns in a small number of companies is another element of vulnerability. In the past two years, a very small percentage of companies outperformed the S&P 500, resembling the conditions of 1998 and 1999.



Source: J.P. Morgan AM



Source: BofA Global Investment Strategy

In contrast, the rest of the world trades at much more attractive valuations, but struggles to keep pace with the United States due to more moderate EPS growth and the absence of companies operating in AI and/or other leading technologies. Despite deeply discounted valuations, we struggle to see positive catalysts for Europe, especially given the political uncertainties in France and Germany. Japan could reap the benefits of some structural reforms, but its growth remains largely dependent on global growth and exports. The only region with a chance to outperform global stocks is China, but this would depend on the Chinese government effectively approving substantial stimulus measures to revive the economy

Volatility spikes

Given that valuations are stretched on both equities and fixed income, corrections are possible in 2025.

However, with the baseline expectation for positive performance in both asset classes over the medium term, we recommend staying calm. On the contrary, corrections should be viewed as opportunities to accumulate equities, duration and/or credit, while moving away from more conservative investments.

RECOMMENDED PORTFOLIO

Based on the above, we can expect moderately positive returns for both stocks and bonds in 2025, with performance fairly aligned with each other. Given the correlation between the two asset classes has returned to being consistently negative, a well-balanced portfolio aligned with the client's risk profile is the best way to navigate any potential spikes in volatility that might eventually materialize.

In public markets, it is therefore advisable to maintain a neutral portfolio in terms of equity/bond allocations, ensuring broad diversification across investment styles and managers. The aggregate portfolio should also have substantial exposure to products that invest in private markets, since they are expected to continue outperforming public markets. Moreover, adding exposure to private markets can increase decorrelation and significantly reduce overall portfolio volatility.

Asset Allocation View

	−	=	+
Equity			
Developed Markets		■	
Emerging Markets		■	
Fixed Income			
Developed Markets Sovereign		■	
Developed Markets Corporate			■
Emerging Markets		■	
Commodities		■	
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

Developed Markets

UNDER OVER
NEUTRAL

We have kept our **Neutral** recommendation on Developed Market Equities. No change from the prior indication. The "Trump" trade (buy U.S. stocks and sell everything else) still has room to extend until the end of the year, also in light of the political troubles in Europe. Short-term retracements are possible considering the size of the gap in performance between the U.S. and the rest of the world since the election, but they seem more likely in early 2025.

US	=	**Europe**	=	**Japan**	−

Emerging Markets

UNDER OVER
NEUTRAL

We have maintained our **Neutral** recommendation on Emerging Markets Equities. After significant underperformance following the U.S. elections, emerging market equities appear poised for at least a short-term rebound, likely materializing in early 2025. Among these markets, China retains a key advantage with the potential to leverage fiscal policy to counteract the negative effects of the Trump administration's tariffs, but unfortunately the Chinese government just missed another opportunity to announce concrete measures.

Asia ex-Japan	+	**EEMEA**	−	**LATAM**	=

Fixed Income

Developed Markets Sovereign

We have maintained our **Neutral** recommendation on Developed Markets Sovereign Bonds. We continue to prefer the short end of the US curve, while maintaining caution on the long end waiting for more clarity about the policies effectively enacted by Trump. In the EU, the ECB sounded a less dovish tone than expected, triggering a rebound in rates that should be seen as an opportunity to accumulate.

EU Core	=	EU Periphery	=	US Treasury	=	Japanese JGB	=

Developed Markets Corporate

We have kept our **Slightly Overweight** recommendation on Developed Markets Corporates. The search for yield in the fixed income market will continue to favor corporate bonds. Within corporates, we maintain a preference for investment-grade bonds over high-yield bonds that are approaching all-time lows.

IG Europe	+	IG US	+	HY Europe	−	HY US	−

Emerging Markets

We have kept our **Neutral** recommendation for Emerging Market Bonds. The potential risks posed by tariff impositions from the Trump administration are mitigated by the recent widening of spreads on emerging market bonds compared to similarly rated corporate bonds in developed markets.

Local Currency	=	Hard Currency IG	=	Hard Currency HY	=

Commodities

We maintained our **Neutral** recommendation on Commodities. Precious metals continue to be seen the best place to be within commodities, notwithstanding the recent dollar strength and the subsiding inflation, considering that bullion typically outperforms during periods of monetary policy easing and serves as a portfolio hedge against unexpected geopolitical tensions.

Precious	+	Energy	−	Industrial	=	Agricultural	=

Currencies

The Committee kept the **Neutral** stance on the US Dollar. The rate differential between the United States and the rest of the world is likely to continue supporting a strong dollar, especially if the new dots plot shows less than the three rate cuts expected by the market in 2025.

The view on the Euro remains **Neutral** as well. The political uncertainties surrounding Germany and particularly France are in the short term counterbalanced by the less dovish attitude of the ECB at the last meeting.

The view on the **Chinese Renminbi** remains **Neutral with a bearish bias**. The Chinese currency will continue to remain under pressure due to tariff threats from the U.S. and the lack of details on fiscal measures to support the domestic economy.

The outlook for other **emerging market currencies** remains **Neutral with a bearish bias** in view of protectionist measures that Trump may implement.

Euro	=	USD	=	CNY	=	Other EM	=