PERSPECTIVE
PRIVATE WEALTH

Q4 2024 Market Update

The 4th quarter was mixed for the Perspective strategies, with cautious strategies suffering from the bond market sell off. Our balanced and growth strategies performed well on an absolute basis. On a relative basis the strategies performed either in line or outperformed their benchmarks.

Overall, a disappointing December in financial markets generally took a bit of shine off of what otherwise was a relatively strong year for the strategies. However, I'm pleased to report that, at the time of writing, January has seen a strong rebound in performance of the strategies.

Asset Class Returns (GBP)

EQUITIES	Performance
MSCI World (ACWI)	6.30%
FTSE 100	-1.29%
S&P 500	10.25%
Eurostoxx 50	-1.83%
Nikkei 225	0.28%
MSCI Emerging Markets	-2.00%

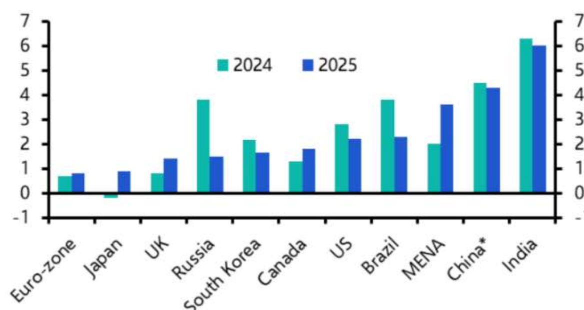
BONDS	Performance
UK Gilts	-3.38%
UK Index Linked Gilts	-7.77%
UK Corporate Bonds	-1.29%
Emerging Market Debt	7.69%

PROPERTY/ COMMODITIES	Performance
Global Property	-3.11%
GOLD	-1.33%
OIL	0.20%

US equities are set to fare better than other major asset classes in 2025 as the AI bubble inflates further. Equity markets elsewhere are generally expected to lag those in the US and provide lower returns than safe sovereign bonds. The outlook appears worst for industrial metals and energy commodities, given the prospect of waning global demand.

Equities delivered mixed returns in Q4. The best performing equity market in GBP terms

Chart 1: Real GDP (% y/y)



was the S&P 500 (up 10.25% on the quarter) and the poorest performing equity market was the MSCI Emerging Markets (down 2.00% on the quarter).

UK Bond markets performed poorly in Q4, reversing the gains from the previous three months. Returns were weighed down by UK index linked government bonds, which have fared poorly for two reasons. First, inflation cooled during Q4. Second, yields rose reflecting that investors expected interest rates to stabilise at a higher level than before the Budget was announced.

Global property prices declined by 3.11% on the quarter after positive growth in Q3. Though property outperformed ordinary equities, the return has been weighed down by higher bond yields.

Brent crude oil prices increased slightly, ending the quarter up 0.2% at $74.74 per barrel. Global demand for oil continues to soften even as geopolitical risks grow.

Economic Outlook – Weathering geopolitical storms and tariff threats

Global – 2025 is expected to be another year of reasonably healthy global GDP growth and a continued normalisation of monetary policy. Tariffs may do some damage, but probably less than is typically assumed. And while geopolitics is likely to dominate headlines, the economic effects will be felt over years rather than limited to the 12 months of 2025.

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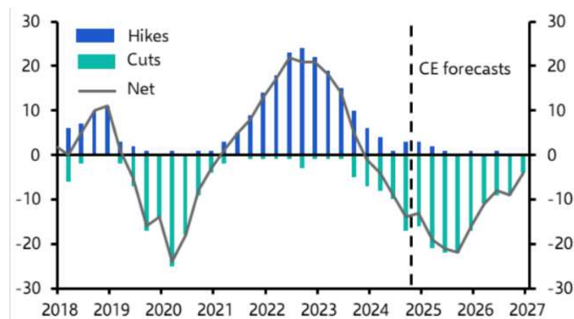
Economic developments during 2025 will be characterised by **five key themes**. First, the world's major economies will experience relatively **soft landings**. (See Chart 1.) We expect US GDP growth to slow next year, partly due to Donald Trump's proposed policies. But with private sector balance sheets still strong, the economy will continue to grow at a decent pace. GDP in the euro-zone will expand very slowly as a boost from lower inflation and policy rates is set against ongoing problems in the industrial sector and gradual fiscal policy tightening. Economic activity will slow in many emerging markets, but not in MENA where increased oil production will provide a boost.

Second, central banks will continue to **cut interest rates.** (See Chart 2.) With world GDP growing at close to its trend pace, demand conditions are not expected to provoke renewed inflationary pressures.

Chart 2: Number of Rate Cuts/Hikes by Major Central Banks

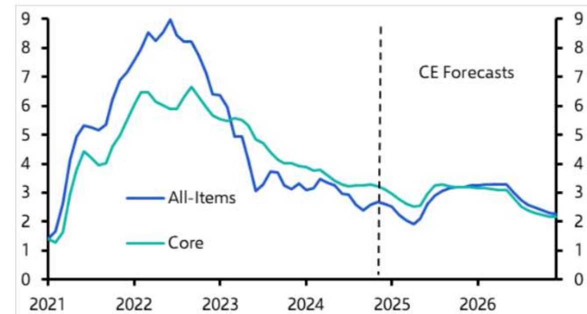


Third, **world trade will likely be fairly resilient in the face of tariff threats**, though the outlook for trade is not bright. Export orders are already weakening but most economies are less exposed to trade with the US than is generally believed. Furthermore, the actual level of tariffs may be curbed by negotiations and deals around other issues such as immigration so their impact may be reduced by an appreciation of the US dollar.

Fourth, **concerns about public finances** will grow as governments fail to implement austerity programmes and borrowing stays high. Although a fiscal crisis in one of the major developed markets is an outside possibility, fiscal vulnerabilities are likely to limit governments from enacting additional deficit-funded stimulus in the next several quarters.

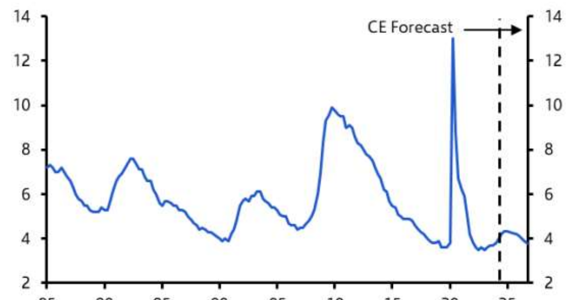
Finally, **geopolitics** will remain a factor in market sentiment. It is unlikely that either a US-brokered ceasefire in Ukraine or conflict with Iran would result in commodity price declines that are large enough to boost demand. After all, Russia will remain largely shut out of European energy markets and there is scope for Saudi Arabia and the US to increase their oil output if Iranian supply were reduced. The intense rivalry between the US and China will persist but its most significant economic effects will play out slowly through a long-run theme of global fracturing.

Chart 15: CPI Inflation (%)



US – The incoming Trump administration's policies are expected to have a mildly stagflationary impact on the economy. Assuming that Trump introduces tariffs and immigration curbs via executive action by the middle of 2025, GDP growth would be lower at 1.5% in 2025 versus a projected 2.8% pace in 2024. Inflation could temporarily rebound to around 3% from after registering 2.7% in November 2024.

Chart 12: Unemployment Rate (%)



If president-elect Donald Trump introduces further immigration curbs, labour force growth is expected to stall. This could lead to a decline in the unemployment rate (see Chart 12), with monthly job gains averaging 100,000. While reduced immigration would impact both aggregate demand and supply, the net impact is expected to be slightly inflationary – low-income unauthorised immigrants contribute minimally to aggregate consumption but their absence would significantly affect output in sectors like agriculture, construction, and food processing.

Trump is likely to introduce a 10% universal tariff through executive action in Q2 of this year,

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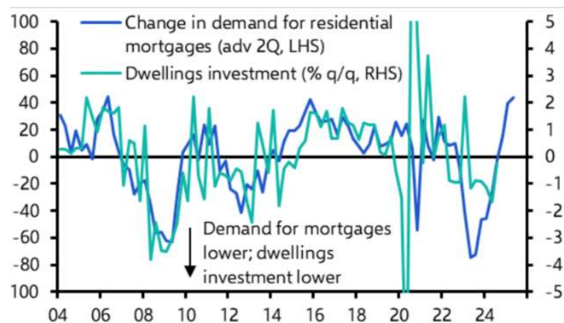
alongside a 60% tariff on Chinese imports. The universal tariff is expected to serve as a semi-permanent measure, primarily aimed at generating additional tax revenue. These tariffs are projected to temporarily drive up core goods inflation but, since the tariffs create a one-off increase in price levels, the inflation rate is expected to ease from mid-2026 onward. (See Chart 15.) It is likely that the Fed will cut interest rates twice more in the first half of 2025, lowering the fed funds range to between 3.75% and 4.00%.

Euro-zone – The euro-zone economy is growing again but the pace of expansion is quite feeble and surveys point to a renewed slowdown in Q4. This combination of weak growth and below-target inflation should prompt the ECB to cut interest rates by more than most anticipate in 2025.

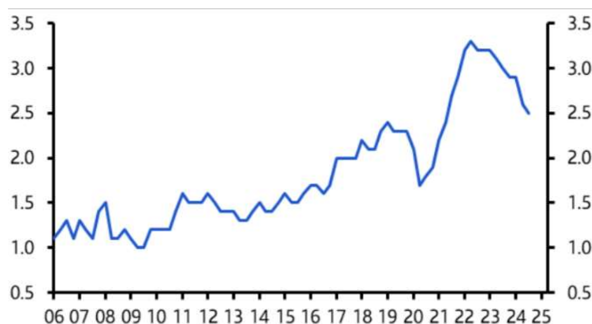
Investment outlays have been exceptionally weak. Even if looser monetary policy prompts a pick-up in the housing market and construction activity in 2025 (see Chart 18), the region's industrial sector remains uncompetitive due to low productivity growth which is likely to hinder investment in machinery and equipment.

Chart 18: Euro-zone Dwellings Investment & Change in Demand for Residential Mortgages



Although the unemployment rate is at a record low, declining vacancies indicate a further cooling in labour demand. (See Chart 21.) Wage growth is expected to slow signficiantly in 2025, allowing services inflation to ease.

Chart 21: Euro-zone Vacancy Rate (%)



Together with the impact of lower oil and gas prices, headline inflation will likely fall below the ECB's 2% target. The combination of low growth and subdued inflation increases the likelihood that the ECB will accelerate the pace of interest rate cuts in the near future.

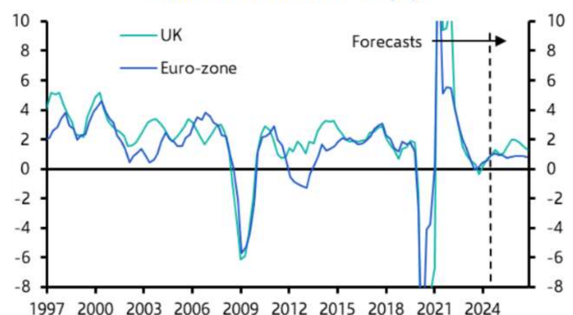
UK – Despite news of weakness in the domestic economy and the deterioration in the outlook for the UK's key trading partners, lower inflation and interest rates are expected to contribute to a stronger UK economy than consensus forecasts suggest.

Over the next two years, the economy will face several challenges. Trump's policies, combined with weak euro-zone growth, suggest that the external sector will provide only a modest drag on UK GDP growth. Although October's budget represents a net loosening compared to previous plans (see Chart 34), fiscal policy will still tighten over the next five years. This tightening, which is expected to amount to 0.8% of GDP, will weigh on growth in 2025/26. In addition, the impacts of higher interest rates and the recent hit to both consumer and business sentiment, triggered by the Budget, together have dampened economic activity.

Despite these headwinds, the UK appears well-positioned to withstand the challenges. Unlike many other economies, it is less exposed to Trump's proposed US import tariffs. With likely exemptions for services exports and a partially offsetting depreciation of the pound—potentially from $1.28 to $1.20 by the end of 2025—the impact of higher tariffs on UK GDP is expected to be minimal, likely no more than 0.1%. With inflation and interest rates now decreasing, the result is likely to be stronger

Chart 34: Cyclically Adjusted Primary Budget Balance (% of GDP)

Chart 39: Real GDP (%y/y)



GDP growth of 1.4% in 2025 and 1.6% in 2026, up from 0.9% in 2024. As a result, UK economic growth could match or outpace the euro-zone. (See Chart 39.)

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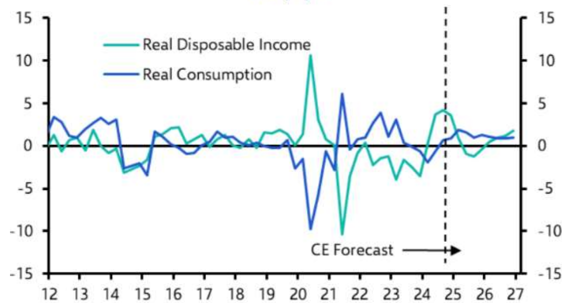
Japan - Inflation excluding fresh food and energy is expected to remain above the Bank of Japan's target for most of 2025 as the weaker yen persists and the upcoming spring wage negotiations result in another sizeable pay hike. Accordingly, the Bank of Japan is set to lift rates to 1.25% by mid-2026, up from 0.25% currently.

The recent rapid growth in real household incomes is partly due to a one-off boost from tax cuts that will reverse in 2026. But with the savings rate set to unwind at the start of this year, private consumption is expected to rise by a strong 1.5% in 2025, even as real incomes fall again. (See Chart 26.) As a result, GDP growth will rise to its trend level over the coming quarters.

Chart 26: Real Consumption & Disposable Income (% y/y)



Trump's expected universal tariff of 10% on imports starting in Q2 2025 could reduce Japan's GDP by around 0.2% and pressure the yen to weaken further against the US dollar. The yen's rally to ¥160 in mid-2024 has already partially reversed and is expected to end 2025 at ¥145 to the dollar.

A persistently weaker yen will prop up the profits of Japanese manufacturing firms since most of the goods they sell abroad are also produced abroad, rather than shipped from Japan. In addition, Japanese import prices will not fall as much as previously anticipated. As a result, "core" goods inflation is expected to only weaken from 3.1% now to 2% by end-2025.

Spring 2025 wage negotiations will probably result in a slightly smaller pay hike than in 2024. With firms increasingly willing to pass through higher labour costs to prices, it is likely that services inflation will pick up to 2% by end-2026, helping to keep inflation above the BoJ's 2% target for most of 2025. Given that environment, the BoJ will feel comfortable continuing with its tightening cycle, raising rates to 1% by end-2025 and to 1.25% in 2026.

China – The leadership has signalled that both monetary and fiscal policy will be loosened further, which will provide a near-term prop to activity. But China's growth is expected to slow in 2025, amid a more challenging external environment and a further decline in property prices and construction.

The China Activity Proxy (CAP) suggests that growth in the real economy has picked up recently (see Chart 57), and been broad-based with industry remaining the star performer and construction the laggard. Higher fiscal spending has also been a driver of the turnaround following stepped-up efforts to deploy unused funds from the existing budget. Officials have signalled that the deficit will be increased in 2025, with spending likely to be front-loaded at the start of the year.

Chart 57: Official GDP & CE China Activity Proxy (% y/y)

This boost to economic growth may be short-lived. Budget limits are unlikely to be relaxed to prevent the fiscal stance tightening this year and while the PBOC could accelerate rate cuts, the effect on credit growth will be muted as firms and households remain reluctant to borrow given weaker GDP growth prospects.

Trump appears set to follow through on his threat to impose a 60% tariff on Chinese imports. Though the PBOC is likely to allow the renminbi to weaken to 8.00/$ to mitigate the tariff impact, it will not be enough to prevent a slowdown in export growth. Reduced exports will likely feed through to weaker domestic demand causing core CPI to decline outright in 2025 for the first time since 2009. Many of these challenges are expected to persist beyond the next twelve months, leaving China's medium-term outlook for growth rather subdued.

Asset Allocation Views

Bonds - Having generally fared well in Q3 2024, DM bond total return indices have lost some ground in Q4, with negative returns in US dollar terms across the board. The widespread negative returns reflect the appreciation of the US dollar following Trump's re-election as well

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as the rises in sovereign bond yields across DMs. It is a similar story for EM dollar-denominated bonds, the spreads of which have fallen across regions, especially in Africa, despite capital outflows from EM assets.

Corporate bonds – Corporate bonds fared well in Q4 compared to sovereigns, especially those in ICE BofA's High Yield Index. Credit spreads fell across the board, both in the lead-up to and, in the wake of, Trump's victory. While data indicates that the US economy has been most resilient, there may be more scope for credit spreads in the euro-zone and the UK to narrow, as they are currently less compressed.

Equities – US equities rallied in the run-up to the US election as investors weighed prospects of corporate tax cuts and fiscal stimulus and have made further gains since Trump's victory. The valuations of US equities are already high compared to the rest of the world in terms of P/E ratios. If the AI bubble is still inflating, the most appropriate comparison may be the dotcom bubble of the late 1990s but, currently, valuations are generally less stretched than they were thirty years ago. For the US "big-tech" sectors, their excess earnings yield is still near levels seen after the dotcom bubble had nearly finished deflating, suggesting ample scope for valuations to rise further before the AI bubble bursts.

Emerging market equities – The prospects for EM equities have worsened since Trump's re-election, primarily because his administration is expected to impose a universal import tariff of 10%. Looking back to his first term, the trade war Trump started caused most stock markets to tumble in 2018. Given Mexico's strong economic ties to the US, its stock market could be quite vulnerable particularly if the USMCA agreement comes under attack. More generally, a trade war could turn investors away from risky assets, which could prove particularly harmful for EM equities.

Commodities – Energy commodities have performed well recently, but weak global demand is expected to cause commodities to lag most asset classes in 2025. Industrial metals will also face headwinds from the combination of subdued and ample supply. In contrast, precious metals are projected to perform relatively well, supported in part by central bank purchases. Even so, aggregate commodity indices are likely to underperform global equities, echoing trends seen during the latter stages of the dotcom bubble and the oil supply glut of the last decade. Looking ahead, commodities are anticipated to underperform both relative to other assets and their historical averages.

Industrial metals – Industrial metals generally fared less well in Q4 as demand waned and a lack of commodity-intensive measures in China's stimulus announcements disappointed investors. China's economy, particularly the weakness in its property sector, will likely continue to be a drag on demand for base metals. Consequently, the price gains expected to result from higher demand for metals related to the green transition, including copper, are expected to be offset by declines in other metals prices for a few years.

Precious metals – Precious metals prices slipped after Trump's election and traded roughly sideways in Q4. Nevertheless, for 2024 as a whole, prices in the class posted significant gains. Gold prices generally held their ground, on net, during Q4, despite both real US Treasury yields and the US dollar having risen (which might typically have weighed on gold prices). This has been a theme throughout 2024, with non-traditional factors – like demand from central banks and Chinese investors – lifting gold prices.

Final Word

In summary, 2025 should be another year of strong equity market returns – particularly in the US where the AI bubble will continue to inflate. The Trump administration's protectionist policies should support growth in smaller and mid-cap domestically focused US companies – ensuring diverse opportunities will exist for equity investors. In bond markets, corporate bonds are showing little value and we will focus on government bond exposures through our strategies.

I expect 2025 to be a challenging but ultimately fruitful year for investors given the economic backdrop and falling interest rate environment – which will support valuations in developed markets.

We look forward to capitalising on the opportunities the financial markets will offer this year and producing another year of competitive returns for you. Thank you for your support during 2024.

Scot Laing (Chartered FCSI)
Managing Director
Sources: Capital Economics; Bloomberg; FE Analytics
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