SUNLINE

WEALTH MANAGEMENT

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2024: Government Elections and Monetary Pivots

As we commented one year ago, amongst other things, 2024 was going to be the year of national elections - with 40% of the world's population, representing slightly less than 60% of the world's GDP, heading to the polls. But we also had some surprises. In general, 70 to 80% of incumbents were defeated by populist movements.

In the UK, the governing Conservative party suffered an historic defeat, whilst, at the same time, the rightwing party Reform UK gained an unprecedented number of seats.

France's president Macron's surprise gamble to dissolve parliament at the beginning of the summer surprised more than one. The gamble failed: we now have a French president who is stuck, and there is still no budget.

The most anticipated election of all was, obviously, the US one. One year ago, we anticipated that candidate Trump would likely win, as we perceived President Biden as being too weak.

Another reason, that we have been citing since 2023, was the constant frustration by lower income consumers with the perceived elevated inflation in essential items. The incumbent President made the mistake of continually focusing on delivering the message that the war on inflation was being won. He was looking at the "economists'" inflation. For example, the price of a pound of beef steak has gone up by 38% since pre-pandemic, and remained steady throughout 2024, (thus the "steak economists'" inflation was close to zero), however salaries haven't kept up.

Our assumptions were that many disgruntled voters, independently from their political ideology or race, would likely vote for Trump and their own purse, hoping to see their personal purchasing power improve, after 4 years of Biden. We obviously didn't expect that Biden would pass the baton to Kamala Harris just a few weeks before the vote. What is also clear, is that Trump doesn't have much time to improve the livelihood of these voters: if there is no tangible change, these unlikely GOP voters might quickly return to voting Democrat come the mid-term elections in 2026, returning the senate and maybe the house to the Democratic party.

In Germany, the governing coalition collapsed: this, per se, is not really a surprise. Germans will go to the polls at the end of February. A new coalition is likely to govern, which will exclude left and right wing extremists. Germans are very pragmatic, and when they are hard-pressed, they know how to take tough decisions. Germany has had two back-to-back years of negative growth: we are convinced that this year they will abandon, or at least render more flexible, their constitutional limit to deficits, ('Schuldenbremse'), allowing a fiscally induced recovery that will benefit Europe at large.

2024 was also the year, with inflation more or less gradually coming under control, when most of the major central banks were expected to pivot towards monetary easing. We were skeptical back then that the US Federal Reserve (The Fed) would cut as much as the market implied back one year ago: about 1.8% to 3.75% by 2024 year-end. In fact, over the year the Fed cut rates by 100 bps to 4.5%. While inflation in the US seems to be more stubborn than in other countries, what comes next will depend on a large range of factors, not least Trump's policies.

The latest round of rate cutting was initiated in March by the Swiss National Bank, which, as a result of the strong Swiss Franc, is facing imported deflation while the economy is doing reasonably well.

The European Central Bank waited until June to do the same. In view of the economic weakness of core Europe, the periphery is doing reasonably well, we feel it is now behind the curve, so would expect quicker rate cuts in the early part of 2025.

The Bank of England cut rates in July; however it is now facing stubborn inflation, which might worsen by April, when the Price Cap for energy will likely rise. Further complicating the task for the BoE, is the budget announced last year, which could be inflationary in nature, in view of the increased taxes on labor. Recent moves higher in 30-year Gilt yields - which, at 5.4%, hit the highest level since 1998 - will be a drag on growth this year, virtually eliminated the headroom the government had after its Autumn Budget. A continued sell-off in Gilt yields might force corrective fiscal action before the autumn. Investors, reminiscent of 1992 and 1976, will watch the currency for any guidance.

The Bank of Japan is the only major central bank looking at hiking rates. After 30 years of policy rates between 0.5% and minus 0.1%, it will be careful when and how to 'normalize' rates higher after the market meltdown it created back in early August. Every month it is tentatively communicating to the public that it could soon increase rates. The bond market meanwhile is already doing the job for them: the 30-year bond rate at 2.3% is at its highest since 2010, and perhaps more importantly in a regional context, it is now higher than China's, which lies at an all-time low at 1.8%.

China

China's investment landscape, which has endured a difficult year, is showing signs of improvement, shaped by ongoing structural shifts.

Following a prolonged period of structural adjustment and challenges in the real estate sector, China's economy could rebound in 2025, despite the government's policy of multiple small steps. The government has worked to rebuild economic confidence through targeted policy measures, including real estate stabilization, reforms to its capital markets and, most recently, a pledge to loosen monetary policy. Household savings are estimated at close to 7 trillion dollars. So, if the government manages to convince consumers to spend, and businesses to invest, there is plenty of potential to drive GDP growth beyond the official 5% annual target. While obviously tariffs are a threat, China has increased its trading ties globally, including with neighbors Indonesia and Vietnam, or Brazil. It has also shown leadership in manufacturing sectors such as batteries and electric vehicles, and, despite US sanctions, it looks like it is making significant advances in being autonomous in semiconductor manufacturing.

Financial Markets in 2024

Artificial Intelligence (AI) clearly was still the buzzword in 2024. The first part of the year was dominated by flows towards infrastructure, read Nvidia. However, during the second part of the year AI investment flows moved more towards infrastructure software solution companies involved in AI. Nvidia and the 'hyperscalers', Amazon, Alphabet, Meta and Microsoft accounted for 41% of the S&P 500 25% total return for the year. Nvidia's market cap alone rose by 2 trillion over the year, that was concentrated in the first part of the year.

In the second half of the year, Nvidia's stock 'only' rose by 8%, in line with the S&P 500, and thus wasn't a significant 'pull' for the index anymore. Clearly, in the second half, the market's rally broadened out beyond the Magnificent 7, and the incredible 62% rally experienced by Tesla after Trump's win: until the election, the 2024 performance for the stock had been close to zero.

For the first time since 1998-1999, the S&P 500 produced back-to back years of over 20%. How likely is it that is going to be repeated in 2025? The result of the overall S&P outperformance has been a geographical and stock overconcentration in the benchmark MSCI World index: the US is now over 72% of the index, and the tenth stock in the index, JPMorgan Chase, has a market capitalization of over 700 billion dollars, well over the 300 billion dollars of Europe's largest stock, ASML.

In Europe, there is this wide misconception that Eurozone equities, (not the Stoxx 600, which includes the UK, Switzerland and Scandinavia), are constantly underperforming US peers, and hence our overweight stance has been continually challenged over the last two years. We obviously do not have the statistical firepower of the large investment banks, however, here is one statistic that was published just recently by the Financial Times: since the AI buzz started in October 2022, if you strip out Nvidia from the S&P500, the performance of Eurozone equities has been on par, or even slightly higher.

While looking at the overall performance of portfolios for the year, one might think that 2024 had been relatively calm. However, we can't forget:

- the inflation pinch of April, which triggered a sell-off in technology stocks
- the 'Sahm rule*' triggered in July, whereby the Nasdaq fell 15% in one month
- the 20% Bank of Japan change-of-policy-induced Japanese stock crash in early August over just 3 days
- which in turn pushed up, in a matter of days, the volatility index VIX to 65 to only come back down to 15 within two weeks,
- the 14% selloff in Nvidia in early September.

** According to the Sahm Rule, the early stage of a recession is signaled when the three-month moving average of the U.S. unemployment rate is half a percentage point or more above the lowest three-month moving average unemployment rate over the previous 12 months.*

The election of Trump temporarily boosted small cap expectations: those post-election gains were fully reversed by the end of December, and small caps lagged large caps once again. As we highlighted in the past, to outperform, US small companies need to have a benign economic and monetary environment: in fact, 42% of the companies in the Russell 2000 are unprofitable and have an average of 4.4 times net debt/ebitda. Debt is mostly in variable interest. That compares to 10% of unprofitable companies in the small cap space in Europe, and 1.6 times net debt/ebitda for the S&P 500. The current environment might be positive for domestically sensitive stocks such as small caps in view of Trump's policies, however the outlook for rates and inflation is highly uncertain, we therefore tend to avoid them in the current environment. We might of course revisit this stance if/when we have more clarity on the economy and rates.

In Asia, despite all the bad 'tape' (or news flow) on Chinese equities, the first part of the year saw Japanese equities outperform, whilst, in the second half, Chinese equities were in the lead, in the end delivering a decent 18% for the year, (CSI 300 index). The clear laggard has been Korea at -10%, (-20% in dollar terms).

In fixed income, credit greatly outperformed duration, and, in general, yield curves steepened. Currency hedged Global Aggregate benchmarks returned between 2 to 4%, depending on the currency. In domestic terms Swiss investment grade domestic bonds performed the best at close to 6%, while Sterling bonds performed the worst, at -1.6%.

As mentioned above credit outperformed: amongst others European investment grade was up over 5%, Asian hard currency bonds were up over 8%, subordinated financials we up over 9%, European hybrids were up over 8% and European high yield was up close to 7%.

Despite the late year correction, induced by higher dollar rates after Trump's election, Gold had a stellar year and finished up 27%. Absent any big and long-standing rate shock, Gold should continue to shine. While it is now a known fact that central banks of emerging countries' central banks are diversifying their reserves into it, more portfolio and asset managers are seeing the advantages of owning the precious metal as a diversifier in view of the changed geopolitical landscape.

Crypto: Bitcoin rallied again - 120% this year, after 155% in 2023. While it is clearly liquidity driven, and the target of flows of easy money, we would argue that each year that passes adds credibility to the asset class and makes it difficult to ignore. It is starting to look no different than investing in momentum stocks. The issue, is to master its volatility. The longer this performance continues, the more difficult will be for institutional investors to look away. As usual, should we have another market crash such as in 2018, 2021 or 2022, we would be hearing 'I told you so', once again.

Outlook 2025

Economy

We expect slower but solid US growth. Tax cuts and deregulation may further boost the US economy.

Growth of core Europe will largely depend on Germany's fiscal flexibility, as peripheral Europe should continue to outperform. We expect growth, in general, to improve on lower interest rates, while tariff threats are a headwind. As with China, the European consumer, who has been saving post - pandemic, (current saving rate being double the US - the numbers need some adjustment to make them comparable, courtesy JPM), needs to be convinced to spend. An eventual halt to hostilities in Ukraine, or, even better, a truce, could be the spark for renewed optimism and spending.

China's recent messages seem to show the willingness to address market and consumer confidence weakness, and the structural issues of its real estate sector. At the same time, the country is readying measures to counter the likely increased US tariffs.

Risks to the US economic outlook are its unsustainable fiscal policy, with budget deficits already in excess of 6%; blanket tariffs and further limits to immigration and mass deportation of illegal workers could cause inflation to creep up and limit GDP growth. The central bank might stop its rate cutting cycle towards the end of 2025 and revert to rate hikes.

Here in Europe, unsustainable deficit dynamics also apply to France and the UK.

Central Banks

ECB: is likely to accelerate rate cuts as it is behind the curve, with an eventual terminal rate of 1% by early 2026.

The SNB is likely to cut rates to zero by the summer of 2025.

The US Federal Reserve should cut rates by a further 1% in 2025, however its path will be highly dependent upon the potential changes in policies in trade, fiscal and energy from the incoming US administration.

Financial markets

US Equity markets should rise more modestly in 2025, as high valuations and positioning will limit the upside. Some of the Magnificent 7 could start to be a drag on the index. Positive factors are a Trump pro-business administration, easing from the central bank and the Fed ending its Quantitative Tightening (reduction of balance sheet) by the end of Q1 2025. A major risk could be fading AI spending by corporates. while we expect the stocks associated with AI infrastructure to continue to rise in 2025, we believe investor focus will increasingly turn to the companies with AI-enabled revenues, while the magnitude of infrastructure spending surprises could diminish, leading to a (lower) rerating of the companies involved, such as Nvidia. Key challenges ahead include fending off increasing competition and justifying its high valuation.

European equities will continue to see high dispersions within the different indices, as all of them have a different sectorial bias, (luxury, software, banks for example for respectively France, Germany and Italy). Globally European equities are highly dependent on world growth, which in turn will be dependent on US and China, which face risks highlighted above. A positive catalyst could be a rerating, as European equities trade at a historical discount compared to US equities even ex the technology mega caps. A move towards AI applications for industrial companies would also clearly benefit European companies and thus European indices, that have a much larger exposure to the sector.

Commodities

Gold should continue to see buying from central banks and asset managers diversifying their portfolios.

Crude oil should continue to be under pressure on the back of weak supply-demand fundamentals, while geopolitical uncertainties, sanctions and tariffs should increase its volatility and cap the downside.

Prices will be heavily influenced by the rate of production in non-OPEC countries: oil producers have high spare capacity, which may limit an increase in prices. Meanwhile shale supply, which can be increased and decreased to counteract swings in energy prices is expected to limit the risk of a significant drop in the oil price.

The key risks in Europe are a further softening of the economy, driven by a combination of high funding costs, negative net investment, political uncertainty and US tariffs.

The key risk in the US is immigration and tariff policies leading to a very tight job market and creating supply issues, in turn creating plenty of inflationary risk in the economy.

Changes to immigration, trade, and fiscal policy under the second Trump administration will likely be meaningful but stop short of some of the more dramatic proposals. We expect net immigration to slow but not as significantly as Trump campaigned for. We expect tariffs on imports from China and autos, but not a universal tariff, which would carry economic and political risks that we think the White House will prefer to avoid. We also expect full extension of the 2017 tax cuts and some additional personal tax cuts, but we are skeptical that the DOGE led by Musk and Ramaswamy will come up with proposals for huge spending cuts that will be enough to meaningfully reduce the deficit.

Strategy

In terms of asset allocation, and as discussed last month, we proceeded to move some of our equity allocation from the Eurozone to the 'rest' of the US, (i.e. ex the mega caps). The overall exposure to equities did not change. The likely next move will probably be to move underweight the US mega caps in favor once again of the wider US market: we doubt they will grow once again by close to 50% as a group in 2025. At the same time, this would allow us to diversify the portfolios away from the risk of having such a large exposure to a restricted number of stocks, even if that is what the 'benchmark' would dictate us to do. And memory is short after two stellar years: in 2022 the group dropped by 40%, much worse than the 20% drop in the MSCI World and the S&P 500. And that year the European 'GRANOLAS*', lost only 5%.

*GRANOLAS: The acronym derives from the first letters of the 11: GSK, Roche, ASML, Nestle, Novartis, Novo Nordisk, L'Oreal, LVMH, AstraZeneca, SAP, and Sanofi. The group is largely consumer-oriented, with a bit of tech thrown in for flavor. They are listed on equity markets across Europe but are all international businesses with exposure to the global economy.

Equity

We keep an overweight in Eurozone equities versus the US broader market, while being neutral the technology sector.

Fixed income

We continue to favor exposure to credit versus duration. We have exposure to investment grade credit, European high yield, hybrids, financials' subordinated debt, US municipal infrastructure and Asian hard currency debt.

Foreign Exchange

The Japanese YEN exposure is mostly hedged and we keep a 5% exposure to the US Dollar. We have a carry trade in the Turkish Lira versus the Euro.

Gold

We continue to keep our allocation to Gold at about 5%: while it doesn't provide any yield, it continues to be a good diversifier in a multi-asset portfolio.

Conclusion

The perspective of lower rates going forward and continuing disinflationary trends are supportive for equity markets, fixed income, gold and thus a balanced portfolio. The profiles proposed to our clients, all other things being equal, might differ depending on the currency: for example, a Swiss based investor might potentially face zero or even negative rates in 2025. Thus, the risk associated in being invested in fixed income might comparatively be higher than a USD based investor.

Positioning

Overall Exposure

We are now Neutral Equities, and Neutral Fixed Income, with a Gold position, partially USD and JPY hedged.

Equity: Neutral

We have an Overweight to the Eurozone and an Underweight in US equities, Slight Underweight US technology, Overweight Nasdaq 100 equal weight, Neutral UK, Neutral Japan, Overweight Asia ex Japan.

Thematic Equities

European Family Holdings, Asian Technology, Health Improving Technologies and Services, European Champions.

Fixed Income: Neutral

Long 1 to 3 years US Treasury Notes. Long 20+ years US Treasuries, Underweight Sovereigns. Overweight Investment Grade EUR and USD Bonds. Overweight High Yield in EUR and Underweight in USD.

Thematic Fixed Income

Long US Municipal Infrastructure Bonds, Long Hybrids, Long Subordinated Financial Credit & Long Asian Bonds in hard currency.

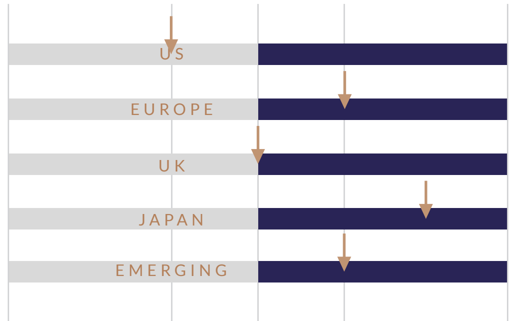
Currencies: Portfolios have a 5 % USD exposure. Long Turkish Lira against Euro.

Commodities: Overweight

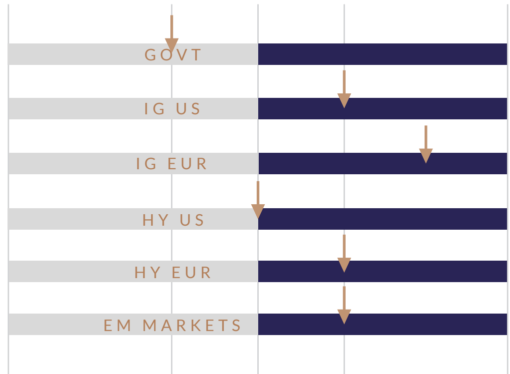
Long Gold.

Conviction thermometer

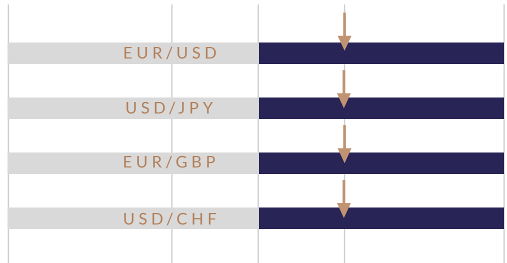
Equities



Bonds



Currencies



Commodities

Negative view

Positive view

Market overview as of 31st December 2024

Equities (local ccies)	Level	5D	MTD	YTD
MSCI WORLD	3 707,84	-1,82%	-2,57%	19,22%
US S&P500	5 881,63	-2,60%	-2,39%	25,00%
NASDAQ 100	21 012,17	-3,60%	0,46%	25,88%
RUSSELL 2000	2 230,16	-1,25%	-8,26%	11,53%
EUROPE EURO STOXX 50	4 895,98	0,78%	1,95%	11,90%
GERMANY DAX	19 909,14	0,30%	1,44%	18,85%
FRANCE CAC40	7 380,74	1,35%	2,14%	0,92%
BELGIUM BEL20	4 264,53	0,44%	1,09%	18,46%
SWISS MARKET INDEX	11 600,90	0,98%	-1,39%	7,54%
UK FTSE100	8 173,02	0,44%	-1,29%	9,59%
JAPAN TOPIX	2 784,92	2,24%	4,01%	20,41%
MSCI EMERGING	1 075,48	-0,83%	-0,12%	7,97%
BRAZIL IBOVESPA	120 283	-0,40%	-4,28%	-10,36%
CHINA CSI 300	3 934,91	-1,21%	0,59%	18,24%
HS TECH	4 468,11	-0,88%	2,63%	19,90%
INDIA SENSEX	78 139,01	-0,43%	-2,08%	9,57%
KOREA KOSPI	2 399,49	-1,63%	-2,24%	-8,42%
HONG KONG HANG SENG	20 059,95	-0,19%	3,29%	22,90%
AUSTRALIA ALL-SHARE	4 467,80	0,41%	-1,16%	9,41%
SAUDI ARABIA TADAWUL	11679.50	1,03%	3,44%	3,32%

US: Sectors	Level	5D	MTD	YTD
COMMUNICATION SVCS	341,66	-3,12%	3,58%	40,23%
CONSUMER DISCRETIONARY	1 831,16	-5,01%	2,39%	30,14%
CONSUMER STAPLES	853,65	-1,46%	-4,97%	14,87%
ENERGY	654,85	1,15%	-9,47%	5,72%
FINANCIALS	804,44	-1,44%	-5,46%	30,50%
HEALTH CARE	1 604,75	-1,30%	-6,21%	2,58%
INDUSTRIALS	1 115,65	-1,82%	-7,98%	17,30%
INFORMATION TECHNOLOGY	4 609,52	-3,51%	1,16%	36,61%
MATERIALS	529,77	-1,71%	-10,72%	-0,04%
REAL ESTATE	255,92	-0,38%	-8,60%	5,23%
UTILITIES	384,95	-1,06%	-7,93%	23,43%

EUROPE: Sectors	Level	5D	MTD	YTD
BASIC MATERIALS	2 733,06	0,77%	-2,18%	-6,16%
CONSUMER GOODS	3 762,11	0,64%	-1,26%	-0,68%
CONSUMER SERVICES	1 540,44	0,84%	3,88%	4,67%
FINANCIALS	1 091,72	1,29%	1,67%	27,89%
HEALTH CARE	3 635,33	0,77%	-4,31%	5,69%
INDUSTRIALS	4 165,05	0,29%	-1,38%	15,32%
OIL & GAS	1 410,05	2,23%	-1,75%	-2,77%
TECHNOLOGY	1 926,93	-0,64%	3,81%	13,90%
TELECOMS	610,11	0,60%	-3,09%	21,96%
UTILITIES	2 001,69	0,95%	-3,60%	2,35%

Market overview as of 31st December 2024

Fixed Income	Level	5D	MTD	YTD
Pan-Euro 3-5 yrs IG	212,98	0,09%	-0,27%	3,60%
Euro Aggregate	243,76	-0,07%	-1,04%	2,63%
Pan-Euro HY Hedged Eur	453,50	0,08%	0,65%	8,38%
Global Inflation hedged EUR	233,03	0,02%	-2,20%	-2,01%
US Corp High Yield	2 264,90	0,16%	-0,43%	8,19%
EM USD Aggregate TR	1 260,87	0,05%	-1,19%	6,58%
EM Aggregate TR Local Ccy	148,79	-0,10%	-0,63%	1,68%
EUR Banks CoCo Tier 1	159,93	0,03%	0,73%	11,22%
EU GOVT HEDGED EUR	213,60	-0,03%	-1,61%	0,55%
Global Aggregate	2 554,99	0,00%	-2,15%	-1,69%

Commodities	Level	5D	MTD	YTD
GOLD	2 624,50	0,29%	-0,71%	27,22%
COPPER	402,65	-0,57%	-1,32%	3,50%
OIL WTI	71,72	2,31%	5,47%	0,10%
OIL BRENT	74,64	1,44%	2,33%	-3,12%

Currencies	Rate	5D	MTD	YTD
EURUSD	1,0354	-0,43%	-2,11%	-6,21%
GBPUSD	1,2516	-0,18%	-1,72%	-1,69%
USDJPY	157,2000	0,01%	4,96%	11,46%
USDCHF	0,9074	0,80%	3,00%	7,84%
AUDUSD	0,6188	-0,79%	-4,98%	-9,16%
EURCHF	0,9401	0,42%	0,86%	1,21%
USDCNY	7,2993	0,05%	0,73%	2,81%
USDKRW	1 471,95	1,64%	5,35%	14,27%
USDINR	85,6087	0,48%	1,32%	2,88%
USDIDR	16 102,00	-0,57%	1,62%	4,58%
USDBRL	6,1774	1,76%	3,45%	-7,55%
USDTRY	35,3547	0,76%	1,88%	19,73%
BITCOIN	93 714,04	-4,69%	-3,84%	123,47%

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