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Balancing Act
Monthly Insights: Global Multi-Asset (January 2025)

Overweight to growth assets maintained, position on defensives increased

By the Multi-Asset Team
29 January 2025

Snapshot

December was a negative month for most asset classes, with both bonds and equities dipping after a strong showing in the previous month. Global equities reached an all-time high in December before correcting, with the MSCI World Index declining by 2.3% during the month. The Bloomberg Global Aggregate Bond Index also fell by 2.2% in US dollar (USD) terms. Given the strong performance for the year, it is not surprising if investors took the opportunity to lock in the profits before the end of 2024, especially after the US elections. US equities were the best performers, largely due to a Republican election sweep. Both the S&P 500 and Nasdaq indices reached all-time highs during the month before giving up some of the gains at the end of the year. Performance outside of the US equity market was mixed. Latin America was the hardest hit as their currencies depreciated against the US dollar, while Europe faced the possibility of tariffs from the Trump administration. China bucked the decline as its markets remained resilient on the back of government stimulus measures aimed at propping up the economy. Taiwan continued to rally on the back of positive artificial intelligence (AI) sentiments.

In the bond market, the sell-off of US 10-year Treasuries continued and their yields settled the month at 4.57%, with new concerns that inflationary policies proposed by Donald Trump and the Republicans would lead to a rise in the terminal rate. Stronger-than-expected US economic data, which could lead to less interest rate cuts in 2025, reinforced the higher for longer rhetoric, which resulted in the sell-off in bonds. The US Federal Reserve (Fed) also delivered a hawkish rate cut in December and indicated a slower pace of cuts in 2025, due to more persistent inflation. The Fed's stance spooked the markets; the US currency rallied in response and the dollar index reached a recent high of 108.5 while the euro weakened and ended the month at 1.035 against the dollar. The easier path of policy in Europe and potential for higher-for-longer rates in the US are expected to keep the euro under pressure in the near term.

Cross-asset[1]

For the month of December, we maintained our overweight growth position and increased our position on defensives. With respect to growth assets, the Republican election sweep is viewed as positive for risk markets, as Trump's policies, which tout potential tax cuts and deregulation, are seen as pro-market. US data continue to indicate that the economy is performing strongly, and markets are expecting robust earnings growth for 2025. Meantime, the Fed delivered a rate cut, albeit with a hawkish guide, which resulted in some market weakness.

On the defensive side, we have increased our position to reflect the better value in the bond market following the sell-off in yields. In addition, with the fall in cash rates, the hedging costs of owning offshore bonds have improved and portfolios are looking to take advantage of this as bond yield curves steepen.

Within the cross-asset scores for growth, we retained our overweight in developed market (DM) equities and remained neutral on emerging market (EM) equities given our view of a stronger dollar, which could be negative for EMs. The Republican sweep could revive concerns of more import tariffs, which could be inflationary and hence result in a higher-for-longer interest rate environment. This means EM central bankers would have less leeway to cut interest rates to stimulate their economies while needing to maintain local currency strength.

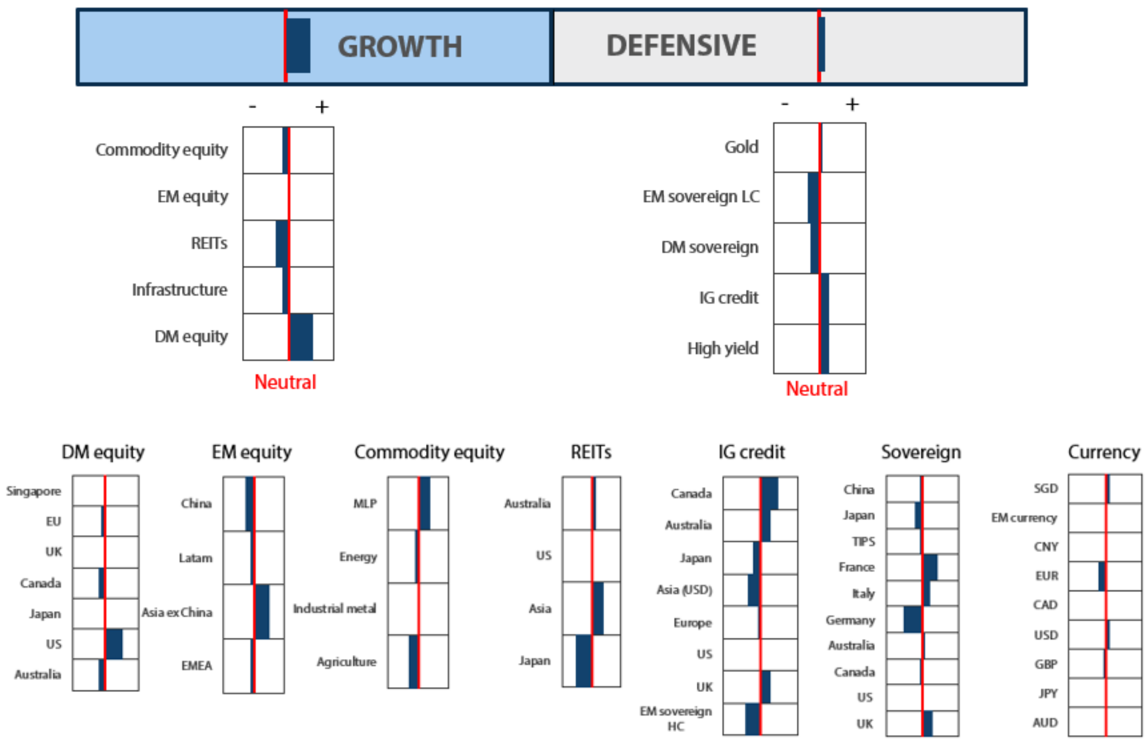
We retain our positive view on growth on resilient economic data and dovish monetary policies globally as inflation is now closer to central bank targets worldwide. Within DM, we maintained our overweight in US on the back of better visibility driven by secular growth themes, and we retained our neutral position for Japan. We are underweight in Europe as we think import tariffs and China's economic weakness could create headwinds for the region. We continue to like Japan for its long-term structural story of improving corporate governance and earnings growth momentum, but we maintain our neutral position due to yen volatility.

We maintained our underweight in energy, given the ongoing oversupply and slowing demand. Within infrastructure, we retained our preference for US utilities to reflect our positive view on increasing energy demand with the secular growth of data centres. Within EM, we continue to favour selective countries like India, which is seen benefitting from domestically-driven economies and structural long-term growth stories. Likewise, we retained our overweight position in Taiwan, which is a beneficiary of the current global tech upcycle.

Our view of defensives improved as higher yields now make the asset class marginally more attractive. We maintained our overweights in Investment Grade (IG) credit and High Yield as we still expect the spread environment to be positive given the strength of the US economy. Although we did not increase our score for DM sovereign bonds, increasing the score for the broader defensive sector led to a marginal reduction in our underweight allocation to DM sovereigns. Because of the sell-off in US Treasuries (USTs) the hedged yield is now relatively attractive, and the steepening in the bond curve makes the market more palatable to own. Additionally, we continue to favour DM sovereigns where additional spreads can be obtained, such as France and Italy, and this may provide a buffer against the poor carry of global sovereign markets. Finally, for EM Local Currencies, we remain underweight even as we selectively favour certain countries such as India and Indonesia. Broadly speaking, the rising dollar puts pressure on the sector.

[1] The Multi Asset team's cross-asset views are expressed at three different levels: (1) growth versus defensive, (2) cross asset within growth and defensive assets, and (3) relative asset views within each asset class. These levels describe our research and intuition that asset classes behave similarly or disparately in predictable ways, such that cross-asset scoring makes sense and ultimately leads to more deliberate and robust portfolio construction.

Asset Class Hierarchy (Team View[2])



[2]The asset classes or sectors mentioned herein are a reflection of the portfolio manager's current view of the investment strategies taken on behalf of the portfolio managed. The research framework is divided into 3 levels of analysis. The scores presented reflect the team's view of each asset relative to others in its asset class. Scores within each asset class will average to neutral, with the exception of Commodity. These comments should not be constituted as an investment research or recommendation advice. Any prediction, projection or forecast on sectors, the economy and/or the market trends is not necessarily indicative of their future state or likely performances.

Research views

Growth assets

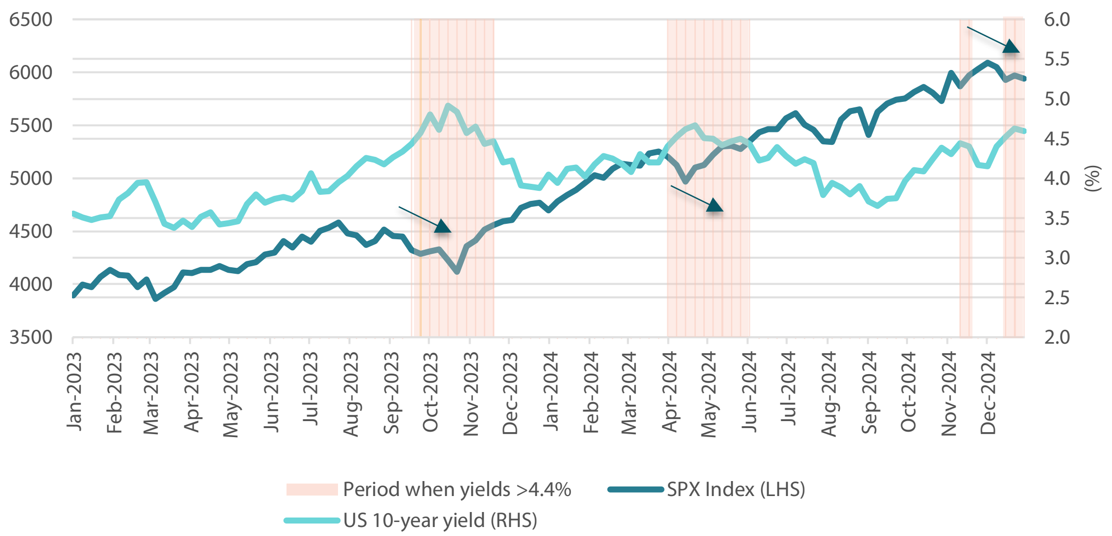
Growth assets are attractive as economic data remain resilient amid falling inflation and as global central banks lower interest rates after pivoting away from restrictive monetary policies. The Republican sweep could lead to increased US fiscal spending and higher import tariffs, potentially reigniting inflationary pressures. This could mean a higher-for-longer rates outlook and a stronger dollar. However, expectations of the Trump administration implementing corporate tax cuts, along with the current rate-cutting cycle and deregulation, remain powerful drivers of returns. Earnings so far have been resilient, and the current reporting season should confirm the continued upward trajectory of earnings growth. This is supportive of growth assets, although the hurdle is now higher.

Peeking into the crystal ball as we look ahead to 2025

Markets declined recently on the back of stronger-than-expected US payroll numbers. Investor concerns centred around stronger-than-expected economic data and expectations of higher-for-longer interest rates due to stickier inflation. Higher yields do present risks to equities by increasing the borrowing costs of companies. Likewise, given that equities are long duration risk assets, the higher yields would imply a higher discount rate for future cash flows, leading to a lower intrinsic value. In addition, when comparing the two asset classes, the equity risk premium would look less attractive than the bond yields at these levels.

If we look in the past years when markets became concerned with higher yields, we see that the S&P index tends to struggle when the yields exceeds 4.4% (Chart 1). Yields at current levels could therefore generate headwinds for equities. Based on our internal view of higher yields for 2025, together with the stretched valuation of equities, we foresee a more arduous path to higher equity prices. Despite this, we continue to be positive on the companies delivering earnings growth in 2025. Moreover, market-friendly Trump policies such as tax cuts and deregulation, if implemented, should be supportive.

Chart 1: Higher yields provide headwinds to equities

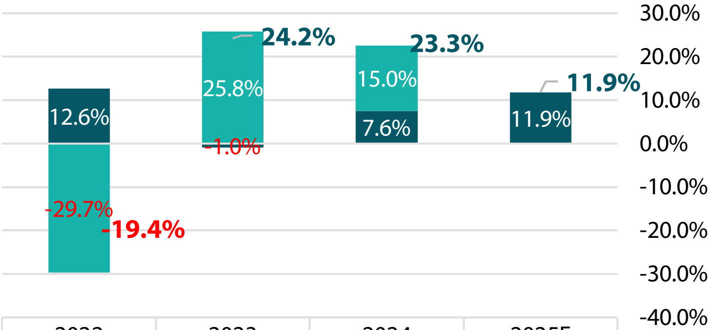


Source: Bloomberg, January 2025

It is important to look at the drivers of returns in the past few years and understand what may propel equity prices higher in 2025. In 2022, despite a 12.6% growth in earnings, the US market de-rated with price-earnings ratio (P/E) contracting by 29.7% on fears of recession. Conversely, the market rallied 24.2% in 2023 as recession fears subsided, despite earnings declining by 1.0%. The P/E ratio expansion in 2023 drove all of the market returns as it rose 25.8% on the back of slowing inflation and a pause by the Fed. Moving on to 2024 when the Fed finally initiated the rate cutting cycle and inflation rolled over, the market again rallied, surging 23.3%. During this period, the P/E ratio expanding by 15.0%, and earnings grew by 7.6%.

Moving into 2025, the earnings outlook remains positive with a projected increase of 11.9% as corporations are seen benefitting from the stronger-than-expected economy and rate cuts. In addition, the Trump administration could potentially implement tax cuts and deregulation and provide a boost for risk assets. However, although not impossible, further P/E multiple expansions from current levels are highly unlikely. Hence, earnings growth is expected to drive most of the US market's returns in 2025 (Chart 2).

Chart 2: Breakdown of market returns, 2022-2025E



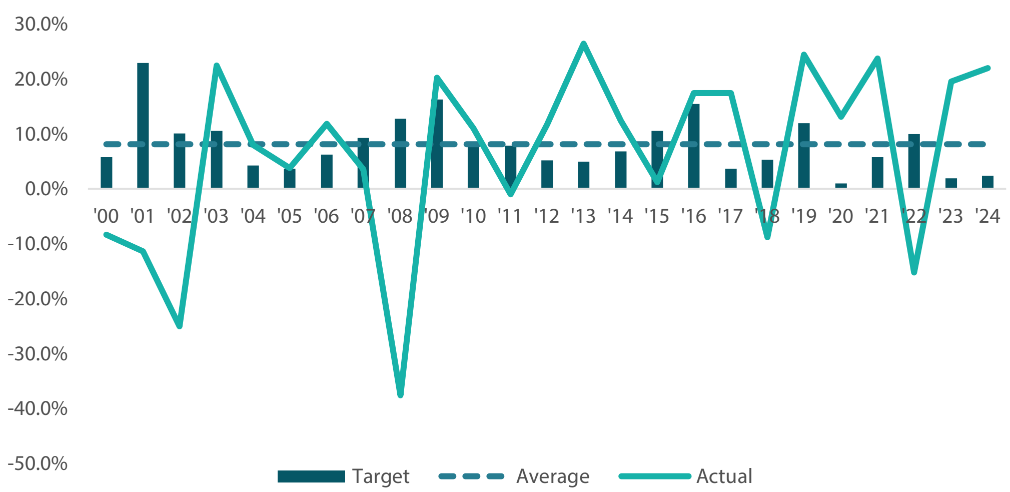
	2022	2023	2024	2025E
Multiple PE Change	-29.7%	25.8%	15.0%	0.0%
EPS Change	12.6%	-1.0%	7.6%	11.9%
Returns %	-19.4%	24.2%	23.3%	11.9%

EPS Change   Multiple PE Change   Returns %

Source: Bloomberg, January 2025

It is interesting to observe the targets set by global strategists at the start of each year. For the past two years bears probably outnumbered bulls, with projected target returns of +1.9% and +2.4% for 2023 and 2024, respectively. From a top-down perspective, strategists were also widely divided on their positioning for the various regions. Since then, the bears have largely capitulated, and for the first time, there is an almost unanimous call to overweight the US and underweight the rest of the world. This is despite the US having the richest valuation relative to the rest of the world. It appears that, after getting it wrong for two years, the fear of missing out (better known as FOMO) has caught up with the strategists. Historically, global strategists do seem to be more wrong than right (Chart 3). Perhaps at some point, it might be prudent to look beyond the US for other risk assets to deploy capital for a more diversified risk reward profile.

Chart 3: Strategists more likely to be wrong than right—S&P 500 return forecasts vs actual outcomes



Source: Bloomberg, January 2025

Conviction views on growth assets

— Maintain exposure to US secular growth: We continue to like US tech-related stocks despite market concerns regarding the returns expected on investments made on AI and data centres. Corporate earnings have been holding out well and the secular long-term growth story for the sector remains intact. Within the US, we are also starting to see the rally widening beyond the "Magnificent 7", which is positive for the overall market. As inflation comes under control amidst a more dovish monetary policy, risk assets are expected to do well in the US. Likewise, the Republican sweep is positive for equity markets as we expect to see continued strong fiscal spending and protectionism from the US to support its economy.

— Reduce exposure to EMs: We maintained our neutral position in EMs on the back of the Republican sweep. While we maintain our view that interest rate cuts will continue into 2025, the pace will likely slow, resulting in a stronger-than-expected dollar. A strong dollar historically would present headwinds for EM performance as central banks in the region will have less leeway to cut rates to stimulate their domestic economies. Within EMs, we still like selective markets, notably India, which benefits from a domestically-driven economy and structural long-term growth story. Likewise, we like Taiwan for its exposure to the global technology upcycle.

— Maintain Japan equities: We retained a neutral position in Japan equities in lieu of our view on the weaker yen amidst a stronger dollar. We still like Japan's structural reform story where we expect companies to increase their capital and dividend returns to shareholders. However, the volatility of the yen and a hawkish Bank of Japan juxtaposed against dovish central banks globally also presents headwinds to sentiments. We will adopt a more positive stance on the country once we see its currency stabilising at a higher level.

— Remain underweight on commodity-linked equities: Given the slowing economic data and energy oversupply, we retained our underweight exposure in the asset class. We rebalanced the weights from materials equities given weak sentiments and remained overweight MLPs on strong defensive yields and a good structural story. We continue to believe that commodity-linked equities will continue to provide good diversification against inflation in the longer term. The fundamentals of commodity-linked equities remain compelling due to both cyclical and secular fundamentals.

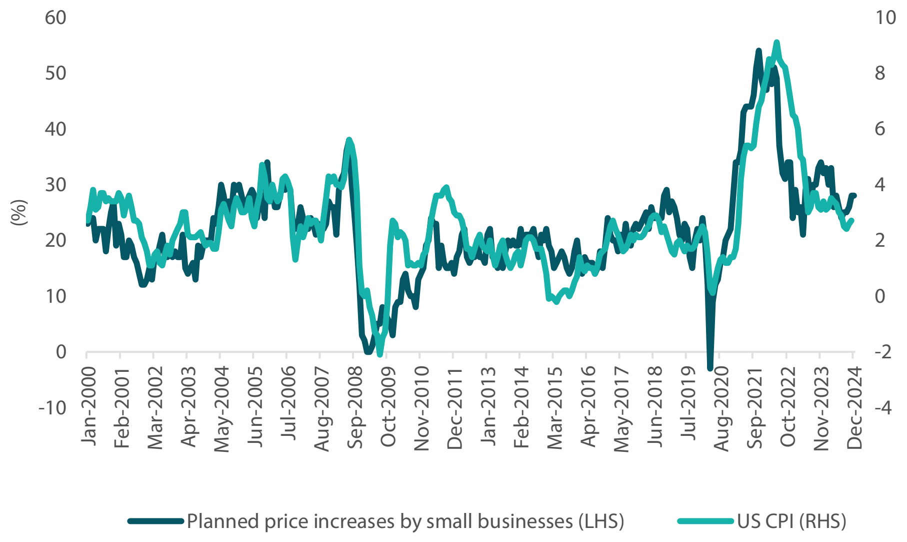
Defensive assets

With the Fed having cut interest rates by 100 basis points (bps) since September 2024, bond curves are now steepening to reflect the easier financial conditions. While markets had been excited for an extended easing cycle, the strong economic data is now leading to the thought that this may be a slower rate cutting cycle than previously expected. This month's Balancing Act looks at the strength of the key US data to help determine just where fair value for bonds may lie in 2025. Despite the potentially more hawkish outlook for the US policy rate, overall, we think USTs are becoming increasingly attractive following their sell-off as yields approach 5%. After maintaining a cautious view on USTs for the past 12 months, we are now looking to close those underweights.

Fed: a changed policy path already?

With inflation moving back towards its target and the unemployment rate drifting marginally higher, the Fed eased by 100 bps to move the economy out of a restrictive rate policy. When the Fed initiated its easing cycle, markets forecasted a policy rate as low as 2.5% in two years, expecting a drawn-out easing cycle. However, as we move into 2025, this narrative has shifted dramatically, as inflation appears stickier than expected and unemployment remains low. Following a string of positive data, the market now anticipates a policy rate of 4.13% in 12 months, barely pricing in one more rate cut before this easing cycle ends. While this is slightly ahead of what we previously forecasted—we expected a policy rate between 3.50% and 4.0%—lead indicators for inflation do show some signs that the fight against inflation is not over. For example, more small business are planning price increases, and ISM's survey of prices paid by manufacturers are points to higher prices once again.

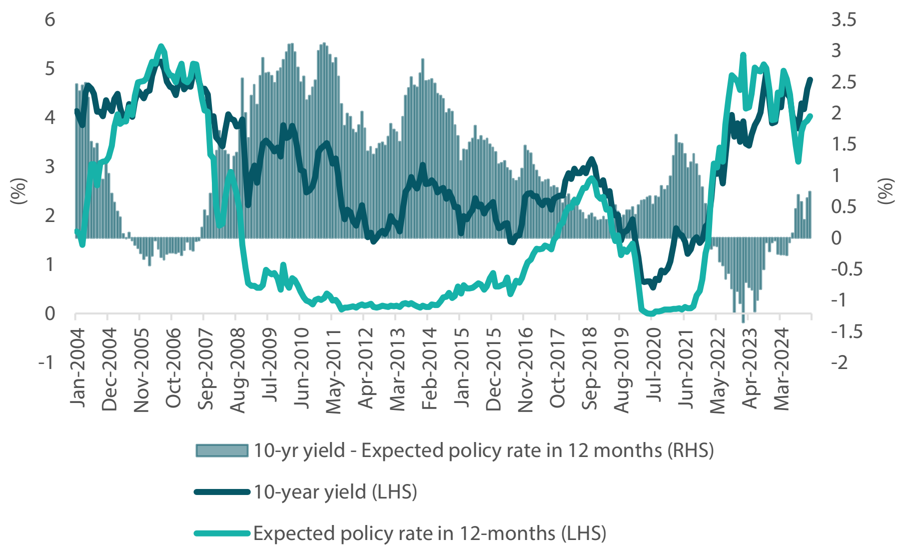
Chart 4: Planned price increases by small businesses and US CPI



Source: Blomberg, January 2025

In addition to this, strong payroll figures have led the market to question its prior narrative that the labour market was beginning to soften. US payrolls expanded by over 250,000 jobs in December 2024, strong enough to keep the unemployment rate at a robust 4.1% and maintain payroll growth at a three-month average of 170,000. Given inflation remains at 2.9% and unemployment in the low single digits, it is difficult to dispute the market's expectation that the Fed should be actively considering ending their easing cycle soon. From a bond valuation perspective, this raises the question of just how far bond yields could rise if the higher for longer environment is truly upon us. From our perspective, we see 10-year bonds as representing a decent valuation when their yields are 100 bps above the market's expectation for policy rates in 12 months. Accordingly, we currently see the 10-year bond's 5% yield mark, a level which is now only about 25 bps away as of this writing, as an attractive entry point.

Chart 5: US 10-year yield vs. policy rate forecasts



Source: Bloomberg, January 2025

From a positioning perspective, the rise in yields has led portfolios to begin reducing their underweights to US debt, adding back both sovereign bonds and US IG Credit. Just last month, we made a case for Australian bonds; however, since that market's spread versus USTs has since contracted from +20 bps to -15 bps, we have revived our favourable view of the US. In terms of forecasting how far the Fed might move rates, we currently expect that at least a 1% real rate is required in order to tackle the last mile of inflation. Unfortunately for those who wanted easier policy rates, inflation is persisting in the 2.5% to 3.0% range and this may mean that a 4% policy rate could become the norm in the near term.

Conviction views on defensive assets

— IG credit and high yield: Credit spreads remain at fair levels, and as central banks ease, global growth should improve. With steeper bond curves and stronger levels of hedged yield, we look to use credit to add yield across all portfolios.

— Gold remains an attractive hedge: Gold has been resilient in the face of rising real yields and a strong dollar, while proving to be an effective hedge against geopolitical risks and persistent inflation pressures. Falling real yields should benefit the asset class and we use this allocation to supplement our long bond positioning.

— Adding duration: Although central bank easing cycles might end more quickly than expected, the global curve steepening makes bonds look more attractive. Our portfolios have begun to close underweights to USTs and are seeking a 10-year yield of around 5% to add additional duration.

Process

In-house research to understand the key drivers of return:

Valuation	Momentum	Macro
Quant models to assess relative value	Quant models to measure asset momentum over the medium term	Analyse macro cycles with tested correlation to asset
Example for equity use 5Y CAPE, P/B & ROE	Used to inform valuation model	Monetary policy, fiscal policy, consumer, earnings & liquidity cycles
Example		
+	N	N
Final Score +		