# Global Asset Allocation: The View From Europe

January 2025

## 1 Market Perspective

- While global growth remains broadly resilient, with inflation trending lower, paths forward will vary as uncertain policy impacts create divergence.
- US growth expectations are higher on the back of pro-growth policies, despite concerns they could be inflationary and disrupt recent trends lower. European, UK and Japanese growth remain soft. Chinese policymakers pledge additional stimulus and reforms to support the economy in the new year.
- The US Fed delivered a hawkish cut, pivoting back to inflation concerns, while the European Central Bank is likely to act faster amid the economy facing weaker growth and lower inflation. The Bank of England (BoE) is likely to cut rates quarterly, but recent volatility in the gilt market may impact its decisions. The Bank of Japan (BoJ) is expected to remain on its divergent path, with incoming inflation data supporting further hikes.
- Key risks to global markets include elevated uncertainty around policy changes, central bank missteps, geopolitical tensions and a reacceleration in inflation.

## 2 Portfolio Positioning

As of 31 December 2024

- We maintain a modest overweight to equities versus bonds given a favorable fundamental outlook, although constrained by valuation considerations and potential policy crosscurrents.
- Despite broadly elevated equity valuations, we find opportunities beyond large-cap growth attractive, while bonds remain vulnerable to higher rates.
- Within equities, we favour more cyclical, value-oriented areas of the market supported by easing monetary policy and resilient growth, notably in the US, that could see further support through policy changes.
- We maintain an overweight to cash relative to bonds. Cash yields remain attractive, but should be monitored as the ECB eases its policy rate.
- Within fixed income, we continue to see value in higher yielding sectors, such as global high yield and emerging market debt. Despite rich valuations, all-in yield levels remain compelling and provide a buffer should spreads widen. Fundamentals remain attractive, with still modest default expectations.

## 3 Market Themes

### Finding middle ground

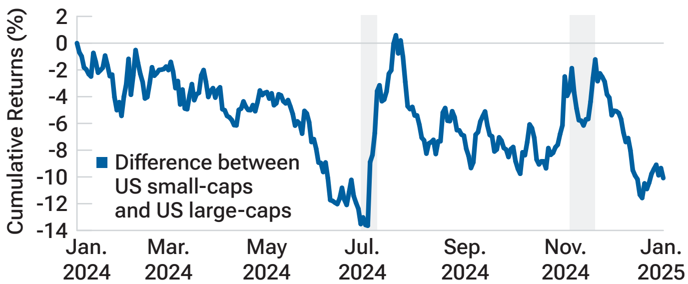
Entering the new year with US large-caps continuing their dominance, led by a narrow set of names, has investors once again asking when, if ever, a broadening in participation will take hold. We certainly had fits and starts last year with smaller companies outperforming in July when markets were expecting a very dovish Fed, only to quickly unwind. They again came to life post-election in hopes for supportive policies, including deregulation and lower corporate taxes, only to fade once again as large-caps dominated into year-end. As we face heightened uncertainty around policy changes, inflation, rates and the Fed's reaction to each, mid-cap equities stand out. Mid-cap relative valuations remain attractive versus large-caps, and relative to small-caps, they are less vulnerable to higher rates, deliver more profitability and have less exposure to concentrated sectors. As we continue to anticipate a broadening in the market, the 'middle ground' should be well-positioned to participate.

### Flip-flop

Just a few months ago, the Fed's narrative around easing policy began to shift towards stabilising the labour market as it showed comfort with the decelerating path of inflation. The Fed seemed to flip-flop on that at their December meeting, taking a more hawkish tone on inflation, even as they lowered rates. The seemingly abrupt shift in tone caught markets a bit by surprise as they expected the 'data-dependent' Fed to need a more notable reversal in trends for such an abrupt change. What was notable before they met was the outcome of the US election, which markets quickly reacted to, speculating on the future impacts of policy changes. It seems like the Fed is now taking these risks into consideration as they make their policy decisions, which could further increase uncertainty on the path for rates.

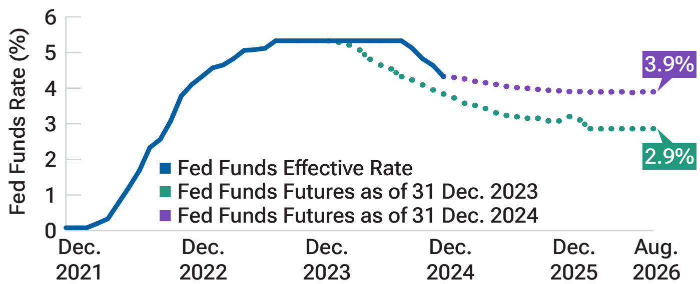
### False starts[1]

As of 8 January 2025




### Not so 'easy' anymore

As of 31 December 2024




**Performance data quoted represent past performance which is not a guarantee or a reliable indicator of future results.**

Source: Bloomberg Finance L.P., S&P and Russell. Please see Additional Disclosures for more information.

[1] Shaded areas represent periods of outperformance of small-caps. US small-caps and US large-caps are represented by the Russell 2000 and S&P 500 indices, respectively.

## REGIONAL BACKDROP

| | | Positives | Negatives |
|---|---|---|---|
| **Europe** | U | – Monetary policy is expected to ease further<br>– Unemployment remains low<br>– Valuations are reasonable | – Economic growth remains weak<br>– Geopolitical uncertainty is heightened<br>– Earnings growth is structurally weak |
| **United Kingdom** | N | – Monetary policy is expected to ease further<br>– Labour market has been resilient<br>– Valuations are reasonable | – Inflation expectations are rising again<br>– Fiscal consolidation may need to be accelerated<br>– Earnings growth is structurally weak |
| **United States** | O | – Corporate earnings are resilient<br>– The Fed is still on a rate-cutting path<br>– There is potential for deregulation and lower corporate taxes | – Stock valuations have become challenging<br>– Credit trends are weakening<br>– Political uncertainty is heightened |
| **Japan** | O | – The reflationary environment continues<br>– Corporate governance continues to improve<br>– Valuations are supportive | – Political instability is impacting foreign investment flows<br>– The BoJ will maintain a hawkish bias due to strong wage growth<br>– Manufacturing indicators are weak due to a drop in global demand |
| **Asia Pacific ex-Japan** | N | – More stimulus announcements are expected in China, further boosting the equity market<br>– An evident policy shift in China may support domestic sentiment<br>– Australia may also continue to reap benefits from China stimulus measures in the form of increased resources demand | – China's housing sector faces structural challenges that have yet to be addressed<br>– China earnings prospects could undermine the equity rally as policy measures will take time to feed through to the economy<br>– In Australia, government support is positive, but elevated valuations and weak earnings forecasts are not encouraging for the domestic market |
| **Emerging Markets** | N | – Further stimulus efforts from China are likely<br>– Monetary policy is loosening in many emerging markets<br>– Valuations are attractive | – US tariffs could provide an additional headwind to global trade<br>– Chinese property deleveraging continues to weigh on activity<br>– Geopolitical risks are rising |

U Underweight N Neutral O Overweight

Views are informed by the Asset Allocation Committee and regional investment committees (United Kingdom, Europe, Australia, Japan and Asia) and reflect the equity market.

## EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 December 2024

▼ or ▲ Month-Over-Month Change

**These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.**

| | | Change | Underweight | | Neutral | Overweight | | |
|---|---|---|---|---|---|---|---|---|
| ASSET CLASSES | Equities | | | | | ■ | | We see potential for earnings growth broadening as the impact of central bank cuts flows through to the global economy, although earnings expectations are already lofty and valuations are stretched. |
| | Fixed Income | | | ■ | | | | Yields could remain elevated on resilient growth, potential for higher inflation and a shallower rate-cutting cycle going forward. Credit fundamentals remain supportive; however, spreads remain tight. |
| | Cash | | | | | ■ | | Cash yields remain attractive, especially with fewer rate cuts expected, and cash offers liquidity should market opportunities arise. |
| | | *Region* | | | | | | |
| EQUITIES | US | | | | | ■ | | Pro-growth policies, including trends towards greater deregulation and extension of tax cuts, are expected to stimulate broader economic activity. Innovation remains a key differentiator, although valuations are elevated. |
| | Europe ex-UK | | | ■ | | | | Valuations remain attractive. Core inflation (excluding food and energy) is easing, but risks of a rebound remain. Economic activity is likely to stay weak, with risks to growth from Trump tariffs and competition from China. |
| | UK | | | | ■ | | | Valuations are appealing. While domestic inflation is beginning to ease, it remains volatile. Surveys indicate a slowdown in near-term growth, but it may pick up again this year. Fiscal vulnerabilities are increasing with rising gilt yields and a weakening pound. |
| | Japan | | | | ■ | | | Economic indicators are reaching new highs in this cycle. Corporate governance improvements continue to support Japanese company fundamentals. |
| | Developed Asia ex-Japan[1] | | | ■ | | | | In Australia, government support is positive. Consumer activity has rebounded thanks to a resilient job market. The Reserve Bank of Australia could pivot to more hawkish tone. |
| | Emerging Markets | | | | ■ | | | Emerging markets (EM) stock and currency valuations are attractive. China's government policy is supportive. However, geopolitical tensions with the US could rise. |
| | | *Style and Market Capitalisation* | | | | | | |
| | Global Growth vs. Value[2] | | | ■ | | | | Deregulation and steeper yield curve are likely to support rate and cyclically sensitive sectors and could lead to a broadening of earnings. Meanwhile, growth could be challenged by decelerating earnings. |
| | Global Small-Cap vs. Large-Cap[2] | | | | ■ | | | Small-caps could benefit from deregulation, stronger merger and acquisition activity and accelerating domestic economic growth. However, a higher-for-longer rate environment will be a challenge. |

**Past performance is not a reliable indicator of future performance.**

[1] Includes Australia.

[2] For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

The asset classes across the equity and fixed income markets shown are represented in our multi-asset portfolios. Certain style and market capitalisation asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.

## EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 December 2024

*Underweight* — *Neutral* — *Overweight*

▼ or ▲ Month-Over-Month Change

| | | Change | Underweight | | Neutral | | Overweight | **These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.** |
|---|---|---|---|---|---|---|---|---|
| FIXED INCOME | Euro Government Bonds | | | ■ | | | | Euro area economic activity is weaker; however, inflation risks remain. Trade policy uncertainty, Trump tariffs and a weaker China all support euro government bonds. |
| | Euro Inflation Linked | | | | | ■ | | Inflation is expected to ease further as the economy slows down. The labour market, however, remains tight, creating ongoing inflation risk. |
| | Euro Investment-Grade (IG) Corporates | | | | ■ | | | Euro IG credit is looking less attractive in terms of valuations, given the tight nature of spreads. |
| | US IG Aggregate | | | ■ | | | | Stubborn inflation and a resilient economy could see the Fed cutting rates fewer times than the market expects. Meanwhile, IG spreads remain tight. |
| | Global High Yield | | | | ■ | | | Despite historically tight spreads, fundamentals remain supportive, and default expectations are expected to remain contained. |
| | EM Dollar Sovereigns | | | | ■ | | | EM sovereign valuations are relatively attractive, with compelling yield levels. However, trade policy and the path of the US dollar add uncertainty. |
| | EM Local Currency | | | | | ■ | | Attractive yield levels, while US dollar strength poses a headwind. |
| | EM Corporates | | | | ■ | | | We currently prefer to overweight EM sovereigns rather than corporates, as credit spreads may widen as the global economy slows. |
| CURRENCIES | EUR vs. USD | | | | ■ | | | Inflation is receding more quickly in Europe. The US dollar is expensive, but interest rate differentials and stronger US economic growth support it. |
| | EUR vs. JPY | | | | ■ | | | The yen is a safe-haven currency, and current valuation levels are attractive. However, given the recent volatility in the yen and uncertainty about the policy of the BoJ, we prefer to remain neutral. |

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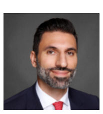
The specific securities identified and described are for informational purposes only and do not represent recommendations.

## EUROPEAN INVESTMENT COMMITTEE



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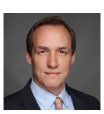

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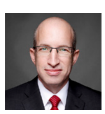

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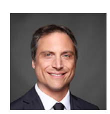

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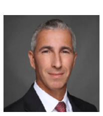

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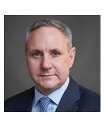

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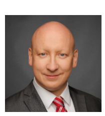

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