



The Way We See It

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2024 Highlights & 2025 Outlook

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A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Highlight of the Year 2024 to date

The surprises in 2024 do not reside in macroeconomic or geopolitical developments, but more in the performance of financial markets.

Macro Developments

In 2024, thanks to the massive fiscal stimulus spending by the U.S. government in 2024 and preceding years, combined with significant capital expenditures spent on U.S. Technology and, importantly, a resilient consumer and corporate sector, the U.S. economy shone. It is expected to show an annual GDP growth rate of about 3% in calendar 2024, higher than its commonly-assumed long-term equilibrium growth rate of 2.5%. European growth was flat while Japan and India showed better growth.

Inflation in the U.S. and elsewhere in the OECD bloc decelerated from the highs, as we, and many other economists, expected. Nonetheless, the overall cost of living everywhere in the world remains a significant political issue. The deceleration of inflationary pressures allowed the U.S. Federal Reserve, ECB and many other central banks in the OECD bloc to cut rates, since their real cash rates became prohibitively high.

China, on the other hand, found it difficult to grow sustainably and strongly. The weak and heavily indebted property sector, together with the sluggish private sector did not inspire confidence in local consumers and corporations. This poor economic backdrop forced a sudden change of direction of the government: the need to resurrect animal spirits in the economy via monetary and fiscal easing is urgent. But, given the substantial size of the problems, what was done to date was deemed inadequate. Investors are still waiting for the “bazooka” fiscal package and a more friendly attitude of the government towards the private sector.

Geopolitical global tensions, while still heated, appear to improve a little, as the 2024 year draws to an end.

Financial Markets' Performance

Following a strong year last year, the extraordinary 28% increase in the total return of the S&P 500 and Nasdaq indices in 2024 to date was a big surprise to all investors.

The strong U.S. equity market performance, similar to last year, was boosted by Technology. NVIDIA remains an incredible monopolistic powerhouse in the generative AI world, whereas the Magnificent 7 U.S. mega-caps in the social media and software sectors continued to deliver strong earnings, equipped with loads of cash and ideas to expand further in the future. In addition to Technology, U.S.

U.S. posted strong growth; China remained a laggard.

Strong U.S. equity market performance continued.



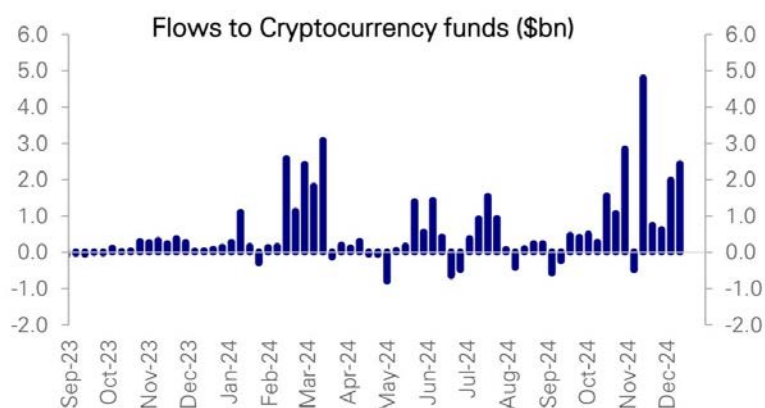
Source: Deutsche Bank Asset Allocation

banks and other consumer companies also delivered good results and showed confidence in their guidance of their future growth path, particularly following the victory of the pro-growth Republican Party.

Of course, monetary easing in the U.S. and elsewhere in the OECD bloc also supported the bull market in equities.

Unfortunately, not all global equity markets can match the U.S. equity market's stellar performance. So much so that historians and global investors alike call the U.S. the year and decade of "American Exceptionalism". China's (for reasons elaborated above) and other Emerging markets' performance lagged that of the U.S. substantially.

The Crypto universe burst into orbit as President-elect Trump, who won a landslide election, is in favour of promoting crypto assets as a store of value and a means of payments. However, some commentators offered the view that Bitcoin and other crypto assets are currently trading in a bubble. The intrinsic value of Bitcoin remains an enigma. Its value is all in the eyes of the beholder.



Source: EPFR, Deutsche Bank Asset Allocation

Bond markets experienced a more challenging year. Rates rose again after the first large rate cut of 50bps in September, as the core rental and services inflation components remain stubbornly high, and the U.S. employment trends remains solid. This, together with the threat of higher tariffs (hence inflation), on imported good and services in the U.S., kept bond investors less optimistic.

Stellar performance in U.S. equity - a year & decade of "American Exceptionalism"

Challenging year for bond market; inflation remain stubbornly high despite first large rate cut.

Outlook for 2025

Macroeconomic Outlook

Macroeconomic and geopolitical developments are likely to become less favourable for U.S. financial markets in 2025.

Our fundamental assessment of the major macro trends point to a base case scenario where inflationary pressure could return to haunt central banks and financial markets, particularly in countries which are expected to pursue a high-growth strategy. Let us elaborate on this theme below.

The two largest economies in the world, i.e. the U.S. and China, are likely to spend big fiscal sums to boost their domestic economies (including tax cuts and import-substituting or export-boosting measures).

Moreover, given that the U.S. economy is operating close to maximum capacity, it is not difficult to see inflationary pressures building up again in the goods, as well as continuing in the stretched services sector.

As far as the rest of the world is concerned, despite threats of tariffs hikes by President-elect Trump, fiscal pumping and growth-boosting measures implemented by the U.S. and China, together with global monetary easing, will undoubtedly impact favourably on their exports and domestic economy.

Net, net, we are projecting a higher U.S. and global growth scenario next year. While this is favourable for corporate sales and earnings, the side effect is likely higher inflation. The latter may force central banks to halt their monetary easing policy and potentially reverse direction. This is particularly the case of the U.S..

If so, this would be a negative factor impacting the equity and crypto bull markets. Fixed income markets will likely to be affected too. While not as bad as in 2022, the potential intensity of the sell-off in equity markets depends on the then-positioning and sentiment of investors.

Base case: inflationary pressure could return.

We expect a higher U.S. and global growth in 2025. with higher inflation to halt easing policy.

Financial Markets' Outlook

Firstly, as a result of our macroeconomic views expressed above, we would advocate a flexible asset allocation in 2025, rather than blindly and complacently implementing, throughout the whole year next year, an overweight position in equities, on the common assumption that “American Exceptionalism” will take the investor to even more glorious days!

In this sense, GOJI's strategic view differs somewhat from a wholeheartedly bullish consensus view of a continuing strong U.S. equities market, through the whole of next year.

Having said that, we would note that we can indeed see FOMO buyers in U.S. equities pushing U.S. indices to a higher peak in H1. And as we have seen in the past, Momentum and FOMO buyers usually just want to chase the rally, and have tended to ignore the valuation factor. The S&P 500 is historically expensive as the charts below show:



Source: Current Market Valuation

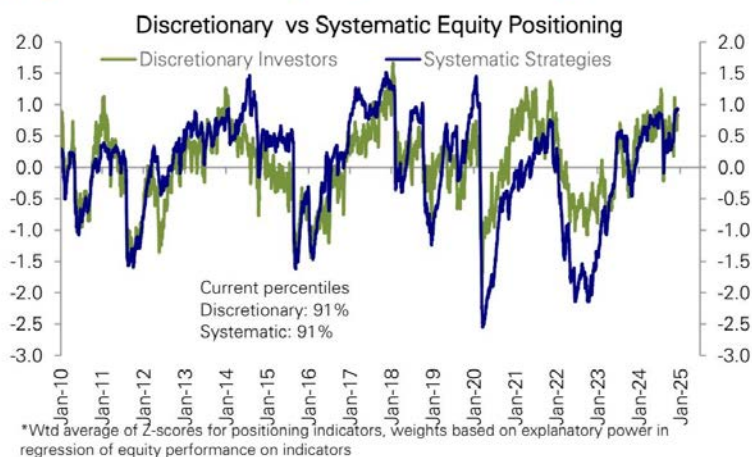


We advocate a flexible asset allocation in 2025.

It is worth noting that Investors' positioning and sentiment in the U.S. equities market is reaching high levels of euphoria at present. The picture in Chinese equities is the reverse.



Source: Deutsche Bank Asset Allocation

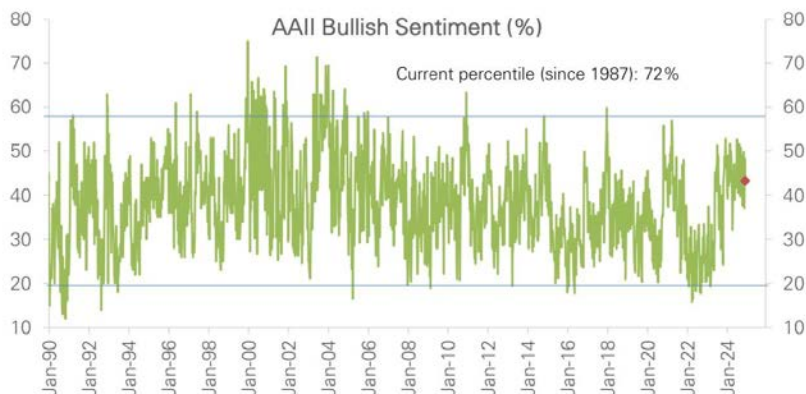


Source: Deutsche Bank Asset Allocation

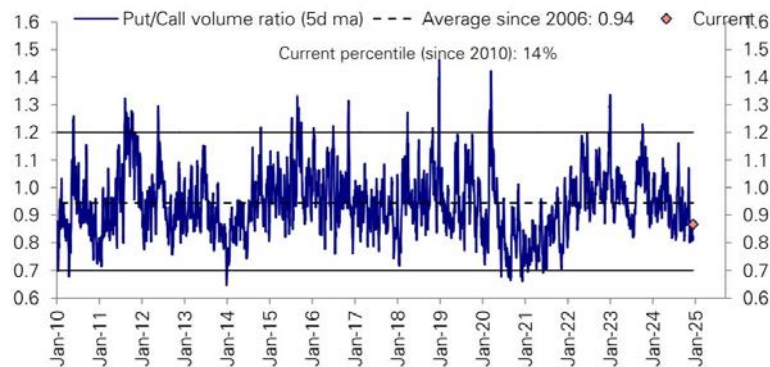
Sentiment in U.S. equities is reaching euphoria.

The charts in the previous page show how strong and steady the S&P 500 Index has been, which, consequently, has been pulling in lots of momentum and FOMO buyers.

Their bullish sentiment (charts on overpage) is clear to see, with many more bulls than bears, and many more upside call options have been bought (few cared about buying puts for protection purposes).



Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation



Source: CBOE, Haver Analytics, Deutsche Bank Asset Allocation

The above charts show how the hot theme of "American Exceptionalism" has already attracted many investors to the U.S. equity market. They are at or close to their maximum exposure. In addition, there was a recent rush to buy U.S. Technology stocks again. As a result, U.S. investors are at their peak exposure in this hot sector.

In our opinion, despite that fact that Cash was trash in 2023 and 2024, it may play a more useful role in 2025. We would prefer Cash to Bonds because it is not our view that bonds offer good fundamental value at current levels, particularly given our U.S. inflation risk scenario.

Cash to play a useful role in 2025.

The Way We See It

Asset Allocation Views

In summary, we would advocate a neutral to slightly underweight allocation to U.S. equities versus the rest-of-world investment universe in the first part of 2025.

As we believe that it is likely that we will, at some stage next year, see one or more severe corrections, caused by growth or inflation disappointments, and most importantly, a potential reversal of the easy monetary policy of the U.S. Fed, as higher inflation threatens again.

As far as Bonds or other Fixed Income allocation is concerned, we would stay modestly underweighted.

We would be slightly overweight Cash, keeping our powder dry for cheaper equity opportunities.

We would also retain our modest exposure to Commodities.

As far as currencies are concerned, since the U.S. Dollar has become more expensive since Mr. Trump's victory, we would be neutral on FX at present.

Expect to see a severe correction due to growth or inflation disappointments next year.

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