ASSET ALLOCATION INSIGHTS

Monthly Update | Issue 99 | 28 February 2025

Near-term caution warranted

Key takeaways

- Overall, the macro and liquidity conditions are still positive for risk assets, even if downside risks and uncertainties have increased recently. While earnings growth momentum continues to accelerate, equity market valuations remain rich, especially in the US. We also observe some deterioration in market dynamics: sentiment is overbought, and market breadth has been deteriorating. While we maintain a constructive view on equities, we move to a more balanced positioning in terms of asset classes and regions and downgrade our view on equities from overweight to neutral.

- While we still have a structural preference for US equities over the rest of the world, we are neutralising our tactical regional stance as valuations and macro-economic momentum may lead to a continuation of the dynamics at play since the beginning of the year.

- Within rates, we adopt a more neutral stance on long-term government bonds, as potential downside risks to growth now balance the uncertainties around the inflation outlook. We continue to favour the 1-10 years segment in the fixed income allocation.

- We keep our gold and hedge funds exposure for diversification purposes. Our stance on currency –overweight dollar against major pairs except Swiss franc— is unchanged.

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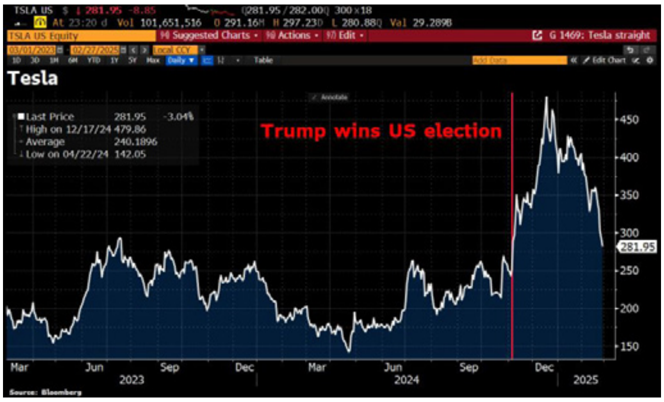
During the first two months of the year, equity markets mostly moved upward across much of the globe. These are likely a result of lower central bank rates and steady economic and earnings growth, despite the overhang of tariffs and inflation.

The start of this year is also marked by a rotation in asset classes, style and sector leadership.

When Donald Trump won the election on 5 November, the so-called "Trump trades" surged—crypto, tech, oil, and banks all rallied. US Treasury yields and the dollar were moving higher and US exceptionalism was the name of the game.

But since President Trump officially took office on 20 January —and especially over the past week— these trades have started to unwind.

Is it the end of the equity bull market?
Is it time to move from "risk-on" to "risk-off"?



Source: Bloomberg

Near-term caution warranted

President Trump has only just started his second term, and he is living up to his promises of disruption. From tariff threats for all the major US trade partners to comprehensive and immediate cuts in Federal spendings, the US President is already reshaping America's economic policies. This is before the Congress has even started discussing a $4.5 trillion tax cut plan partly financed by $2 trillion of slashed spendings. In the meantime, President Trump is radically shifting the US's foreign policy, especially their involvement in European and Middle East affairs.

This hyper-activism and radical shift in policies had been announced during the election campaign and was certainly among the main drivers of President Trump's election. Still, the extent of his shock and awe approach comes as a surprise for many, from country leaders to his own US citizens. Concerns around the potential inflationary impact of tariffs, or of rapid cuts in federal civilian employees appear to have dampened households' confidence and spendings in the recent weeks. Some signs of slowdown have emerged even if fundamental drivers of growth remain robust (high employment, business investment).

The rest of the world is also adjusting to the new US stance. Europe finally realises that it must take its destiny into its own hands, whether it is from a military and defence perspective or from an economic standpoint. Warning calls for improving Europe's competitiveness have been multiplying since the Draghi report last year, with European Central Bank President Christine Lagarde and European Commission President Ursula von der Leyen issuing a joint statement in February. German elections have opened the door to more growth-supportive economic policies, even if the prospect of significant fiscal stimulus is constrained by the composition of the new Bundestag. Swiftly building a governing coalition is now of the essence in Germany, as Europe needs leadership from its largest economy if it is to embrace structural economic reforms while facing the external challenges of a new world order. The US, decisively reshaping their economy for sustained higher growth, and China, still in the process of building up on its domestic market, will not wait.

Our take

Economic growth appears to have slowed down this month in the US, while it has remained moderately positive across other major developed economies. A gap persists in most economies between the manufacturing sector, that has been under pressure for the past three years, and the service sector that has been the main growth driver so far. However, recent developments point to a tentative improvement in manufacturing sectors' dynamics, particularly visible in the United States.

The recent weaker economic activity and confidence data in the US need to be confirmed, as they may have been caused by President Trump's and Elon Musk's disruptive announcements in their first weeks in office. This uncertainty raises potential downside risks for the US economy after the spectacular growth of the past quarters. However, with tax cuts down the line, a still robust labour market, and the Fed ready to cut rate as soon as growth and inflation dynamics soften, the outlook remains positive for the world's largest economy.

In parallel, while economic activity remains subdued in Europe and China, recent developments have been rather reassuring. Both regions have stabilised since last year's pronounced deterioration. In China, after a first plan in September to stem the collapse of the real estate market, revive credit growth and support the equity market, the authorities are set to continue supporting economic activity this year, with a much-awaited plan targeted toward domestic consumption. In Europe, a potential shift to more growth-supportive policies will, even in a best-case scenario, take time to materialise, and remains subject to elevated uncertainties. Furthermore, the prospect of US tariffs remains a significant headwind for sentiment and activity in the short run. However, the continuation of monetary policy easing by the ECB, the SNB and the BoE are likely be supportive for economic activity and to contain immediate downside risks to growth.

THE WEIGHT OF THE EVIDENCE

Our asset allocation preferences are based on 5 indicators, including 4 macro and fundamental indicators (leading) and 1 market dynamics (coincident). The weight of the evidence suggests maintaining a constructive view on equities, even if downside risks to the macro outlook and uncertainties around liquidity dynamics warrant a slightly more cautious and balanced approach. Below we review the positive and negative factors for each of them.

Pillar 1

Macro cycle (POSITIVE with more downside risks)

Amid different and sometimes diverging regional dynamics, global economic growth continues to be positive in the first months of the year.

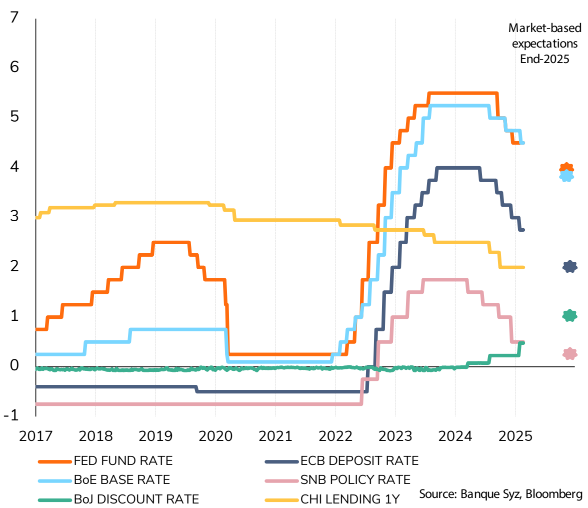
The US economy is losing some momentum as consumer confidence and spendings are softening. Uncertainty around inflation dynamics and on the impact of President Trump's administration policies (tariffs, public spending cuts…) may affect households' consumption behaviour, even if underlying drivers of growth (high employment, business investment) remain supportive for growth prospects. In the meantime, China's and Europe's dynamics have stabilised after the 2024 slowdown, and the risk of further slowdown has abated.

Inflation remains above central banks' targets and has proved to be stickier-than-expected across developed economies. External factors (tariffs, energy prices) could still fuel upward price pressures in the months ahead but underlying dynamics, especially wages growth, can be expected to gradually ease.

In this context, developed market (DM) central banks will extend their rate cut cycle, with the pace and magnitude of additional monetary policy easing dependant on growth and inflation developments.

Central banks' key rates

Dots are market-based expectations for rate levels at the end of 2025



This macroeconomic backdrop of positive global growth and central banks' rate cuts continues to be supportive for risk assets, even if softer growth dynamic in the US and uncertainties around the inflation outlook have recently raised downside risks to this scenario.

Pillar 2

Liquidity (POSITIVE based on forward-looking factors)

Among the different factors driving global liquidity, some of them remain neutral while others, especially the forward-looking ones on the impact of monetary and fiscal policy, are positive.

The pullback of the US dollar since January has allowed global M2 proxies to pick up after the Q4 slowdown, and Global M2 is growing in line with GDP. Central banks continue to run down their balance sheets in the US and Europe, even if most of the adjustment has already been done. Real interest rates are still moderately positive.

However, easy broad financial conditions, prospects of further rate cuts in 2025 and fiscal policies that will likely be supportive for economic activity in the months ahead point to positive liquidity dynamics in the months ahead.

Liquidity dynamics should therefore remain supportive for financial assets in the near future, provided expected developments in monetary and fiscal policies materialise.

Pillar 3

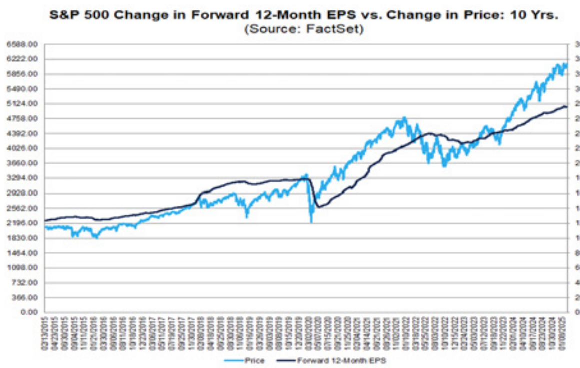
Earnings (POSITIVE)

Q4 earnings season has been fairly strong. With 77% of S&P 500 companies reporting actual results, 76% of S&P 500 companies have reported a positive EPS surprise and 62% of S&P 500 companies have reported a positive revenue surprise.

For Q4 2024, the blended (year-over-year) earnings growth rate for the S&P 500 is 16.9%. If 16.9% is the actual growth rate for the quarter, it will mark the highest (year-over-year) earnings growth rate reported by the index since Q4 2021.

Earnings are expected to accelerate in 2025 as more sectors are contributing to growth.

The US continues to outpace other regions, but Europe is also improving after a weak low single digit growth in 2024.

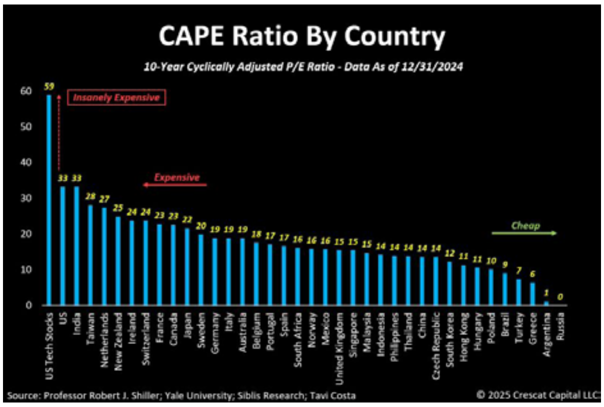


Source: Factset

Pillar 4

Valuations (NEGATIVE)

Market valuation overall remains high as US equities are very expensive on every metrics. As shown on the chart below, US equities now have the highest CAPE ratio globally. More importantly: the tech sector alone is at a staggering ~60x CAPE. In other regions, including Europe, valuations are more reasonable.



Source: Tavi Costa, Bloomberg

Pillar 5

Market Factors (from POSITIVE to NEUTRAL)

Our proprietary indicators signal has been downgraded to neutral at 50% allocation to equity.

The trend indicators have been downgraded to neutral in US equity markets. Moreover, US market sentiment has turned negative in the USA and finally market breadth remains weak both in the in the USA and in Europe.

INDICATORS REVIEW SUMMARY - OUR FIVE PILLARS

With 3 pillars signalling an overweight, 1 in neutral (market dynamics) and 1 in underweight (valuations), the weight of evidence is slightly positive for equities.

Nevertheless, the slight deterioration of macroeconomic and liquidity pillars combined with elevated valuations and deteriorating market dynamics lead us to move from overweight to neutral on equities.

Underweight -	Neutral =	Overweight +
		Macro Cycle
		Liquidity
		Earnings Growth
Valuations		
	Market Factors	←

INVESTMENT CONCLUSIONS

- Overall, the macro and liquidity conditions are still positive for risk assets, even if downside risks and uncertainties have increased recently. While earnings growth momentum continues to accelerate, equity market valuations remain rich, especially in the US. We also observe some deterioration in market dynamics: sentiment is overbought, and market breadth has been deteriorating. While we maintain a constructive view on equities, we move to a more balanced positioning in terms of asset classes and regions and downgrade our view on equities from overweight to neutral.
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TACTICAL ASSET ALLOCATION (TAA) DECISIONS

Equity (decreased to NEUTRAL)

Decrease US back to neutral.

Bonds (increased to NEUTRAL)

Increase Govies 10+ to neutral.

ASSET ALLOCATION GRID

TACTICAL ASSET ALLOCATION (TAA) 28.02.2025

	Underweight -	Neutral =	Overweight +
Asset Classes		Cash	
		Equities	←
	→	Fixed Income	
		Alternatives	
Fixed Income			Govies 1-10 (local)
	→	Govies 10+ (local)	
		Corporate IG (local)	
		High Yield (local / global hdg)	
		EM Debt	
Equity		United States	←
		Eurozone	
		UK	
		Switzerland	
		Japan	
		Emerging Markets	
Alternatives		Hedge Funds	
Commodities			Gold
		Commodities	
Forex (vs. USD)	EUR		
		CHF	
	GBP		
	JPY		
	EM Currencies		

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