

2025 Outlook

Winter 2024/25

Our experts take stock of what has happened in 2024 and pause to look forward to what we might expect in 2025.

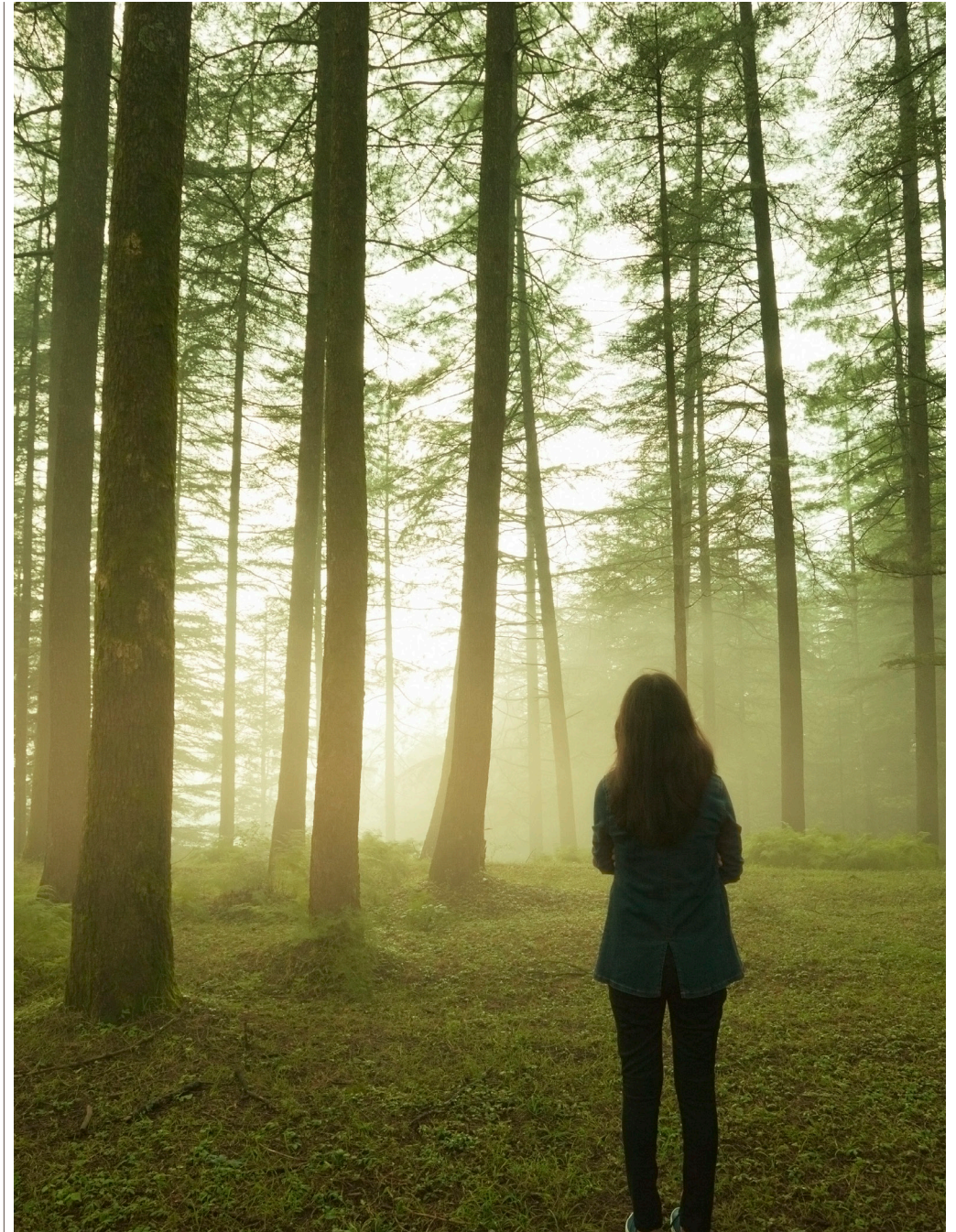


Seeing the wood for the trees



Tony Whincup
Head of Investment Specialists

Artificial Intelligence (AI), interest rates, Trump: with hindsight just a handful of words may arguably sum up markets in 2024. True, the horrors of war in Ukraine and the Middle East were writ large in the news and the human cost of so many lives ended and upended - disturbing and brutal - may impact markets yet. True, Labour's first Budget in 14 years will be consequential for businesses and individuals alike, but markets greeted fiscal plans with relative equanimity. Of all, Trump 2.0 suggests we are entering a new geo-political paradigm with far-reaching consequences until 2029 and beyond.





As 2024 unfolded, it became more likely that the US would avoid a recession. A so-called *soft-landing* scenario in which policymakers tame inflation with higher interest rates without destroying jobs and crashing the economy appears to be playing out. In major economies (excluding Japan), inflation has cooled and central banks are responding by relenting on interest rates. All major central banks have now cut interest rates at least once. We've likely hit peak rates but the journey down won't be smooth: data-dependent policymakers and frequent data revisions will jolt markets in 2025 as they did this year.

In 2024, the world's second largest economy, China, left investors guessing what it might do to revive itself. In October, policymakers eventually unleashed a package of measures over coming years potentially totalling 10 trillion yuan (~\$1.4trn) to resuscitate the property sector, support equity markets and restore confidence to both domestic and international investors. Investors responded in particular by pumping an unprecedented amount of cash into Chinese equities. This stimulus may be consequential and successful. China is grappling with a sensitive transition from an export-lead economy to a more

domestically-focused one with unhelpful demographics, and will probably undershoot its "around 5%" GDP growth target for 2024.

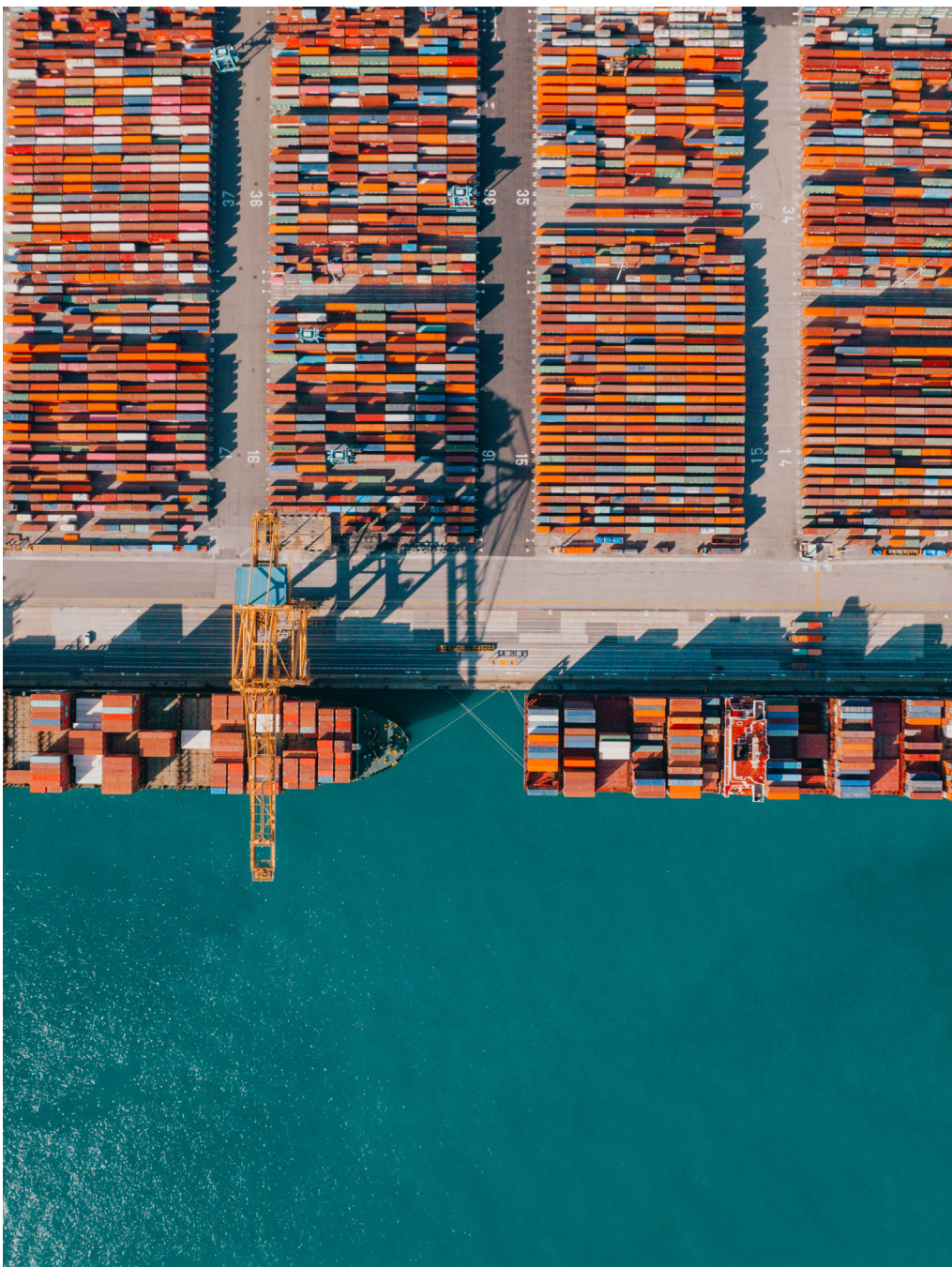
Global GDP growth has been acceptable, if muted. We expect around 3.2% GDP growth in 2024 and 2025 with a resilient US (+2.1%), better-than-expected UK (+1.4%) and Eurozone (+1.3%) all growing in 2025. Unemployment hovers around 4% in the US and the UK and around 6.3% in the Eurozone. Inflation (as measured by the Consumer Prices Indices or CPI) is forecast to be between 2.0% and

2.6% in these economies in the near-term, with ongoing concerns for Russian gas supplies feeding volatility in the Eurozone. Consumer confidence has ebbed with local factors such as the UK's Autumn Budget and US election delivering mixed surveys – but reality is likely better than sentiment.

In Europe, Germany's travails continued with the collapse in November of its three-party coalition imperiling Chancellor Olaf Scholz. Germany's economic malaise sees it teeter towards recession. After a euphoric Olympics, France's budget drama toppled Prime Minister Barnier's government and infected markets: at around 0.80%, the spread (or difference) in yield between France and Germany borrowing 10-year money stretched to its widest level since 2012. So-called 'bond-vigilantes' – bond traders who sell government debt in response to fiscal policies, thereby driving its yield up – are clearly signaling that to lend to France they want to be compensated for taking additional risk. With no election possible in France until July 2025, expect more inertia and *realpolitik: plus ça change*.

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The advance of the far-right in France, Germany and Austria will shape the EU narrative on key issues including immigration, border control and jobs. Scapegoat politics will reassert itself. For the UK, a new Labour government appears keen-ish for a rapprochement of sorts with the EU. Time will tell whether a potential Swiss-style EU-UK relationship will ease friction and reap economic benefits.

Trade wars were a constant drumbeat in 2024. Canada, the US and Eurozone slapped punitive tariffs on heavily-subsidised Chinese electric vehicle (EV) imports of up to 100%. Critical goods in sensitive industries – including active pharmaceutical ingredients, lithium and some minerals – face restrictions as governments pressure and incentivise companies to *on-shore, friend-shore and near-shore*. President Trump will arguably accelerate this from 2025.

Despite this tricky backdrop, major equity markets - including India's Sensex, Japan's Nikkei 225, the US's S&P500 and the FTSE100 - made all-time highs in 2024.

In the US, the fortunes of a handful of tech-titans - including *Microsoft, Apple, Amazon, Alphabet and Nvidia* – continued to support markets in 2024, although the outsize weights of these mega-caps caused widespread volatility.

Discerning between AI winners and *also-rans* remains a key theme into 2025. Certainly, *not owning* AI-exposed companies in 2024 has required

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courage by investment managers, whilst excitable investors have pushed many names to stretched valuations only to punish even mildly disappointing results. Some two years into a bull market since the S&P500 last troughed in October 2022, more sectors will likely need to participate to sustain the current rally into 2025.

Other breakthroughs also captured investors' imaginations in 2024. We watch the efficacy of novel weight loss drugs (which influence insulin and glucose production, digestion and appetite) with excitement and caution. And we're mindful of old-fashioned assets quietly breaking all-time highs: gold briefly surpassed \$2,700 per ounce on geo-political risk, central bank and retail buying, and less competition from yield-producing assets like cash as interest rates fall. Fixed income has been quietly delivering an attractive yield from quality and mostly short-dated maturities. And the variety of alternatives means there are many compelling contenders for a multi-asset portfolio.

Here our asset class heads share a brief view of positioning into 2025.

Our views into 2025

Portfolio Funds



Giles Parkinson
Head of Equities

It is now over a year since we reversed our cautious stance on markets and became the most optimistic we have been since managing the Close Portfolio Funds. As long as there are no signs that the United States has entered a recession, we will maintain an overweight stance on equities. Within fixed income we will continue to seek above-average yields for below-average risk in corporate bonds complemented by sovereign bonds to protect against a recession scenario, which is the main risk to the portfolio. However, as long as a 'soft landing' for the US economy and interest rates remains confirmed, we are vigilant for exogenous shocks such as pandemics and geopolitical upsets.



Sustainable Select Fixed Income



Andrew Metcalf
Head of Fixed Income

In January 2024, fixed income markets and macroeconomic data were markedly different than today. By almost every measure, markets now look more attractive as we write:

- The UK base rate was 5.25% and markets were uncertain about further rate increases; today it is at 4.75%, and markets are forecasting 2-3 rate cuts over the next 12 months
- UK inflation was 4.0% - well above the Bank of England's target of 2.0%; today, inflation is just 1.7%
- The 10-year UK Gilt offered investors a yield of 3.6%; today, the same UK Gilt pays investors 4.4%

Lower inflation, lower (and falling) Central Bank policy rates, and higher yields in risk-free bonds are a solid foundation for fixed income markets in 2025. Just as important however is the increased certainty we can add to this already solid footing: elections in the UK, US, Japan and France (representing c. 600 million of the c. four billion people eligible to vote in elections in 2024) have removed some of the major geopolitical 'unknowns' facing markets in early 2024.

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While forecasting the future is difficult given the huge number of variables involved, we take significant comfort from the relatively benign macro-economic outlook in the UK, especially: 'around target' inflation; expectations of political stability under the current Labour Government (reinforced by the very sizeable parliamentary majority); and relatively attractive yields in low-risk Government bonds.

As a result – and coupled with our ability to discern corporate bonds with adequate yields – we enter 2025 in a cautiously optimistic mood.

Managed Funds



Matthew Stanesby
Head of Collectives



James Davies
Managing Director, Managed Funds

When thinking about 2025 from an investment perspective, similar themes tend to recur: politics, the state of the economy and where we are in the interest rate cycle. Other regional or market-specific factors often feature strongly as well, such as China or the Middle East. And so, we find ourselves asking questions both familiar and new: What will the second Trump administration do, particularly in relation to tariffs? How will it deal with China? What might spring from a potential German election in the new year?

For what it's worth, our approach is to not get caught up too much in all of this and focus instead on firmer foundations. Is the US economy in broadly good shape? Yes, we think it is, and therefore there's the potential for US companies to continue to grow earnings. Do certain markets look cheap relative to the US? Yes, we think the UK and Europe both do and so present opportunities to allocate funds at relatively attractive valuations. Therefore, our positioning tends to reflect how we see the big picture overall as opposed to a reaction to any one specific event.

As a result, we are broadly positive on risk assets – meaning equities and credit (or corporate bonds) – believing that most developed markets should avoid recession. We aim to position our equity allocation to include a good spread of 'value' and 'growth' managers on the basis that while we want to benefit from the growth areas of the market, we are also cognisant that some sectors may be unjustifiably expensive to buy, including some 'tech'.

In the US, the UK, and Europe we have increased our exposure to small and medium-sized companies as these are cheap relative to their long-term valuations and should benefit from interest rates coming down, particularly if respective domestic economic growth accelerates.

Our view of government bonds is a bit more cautious given the fiscal spending plans for governments across the developed world. We think the increase in supply of government bonds may keep yields on offer higher than in the last decade. As usual, we want to maintain a healthy position to select 'diversifiers/alternatives' within our funds like infrastructure and gold, in addition to some hedge strategies. Historically these have provided alternative sources of return, as they did during the pandemic, and more recently the strong performance of the gold price over the last 12 months.

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Tactical Select Passive Funds

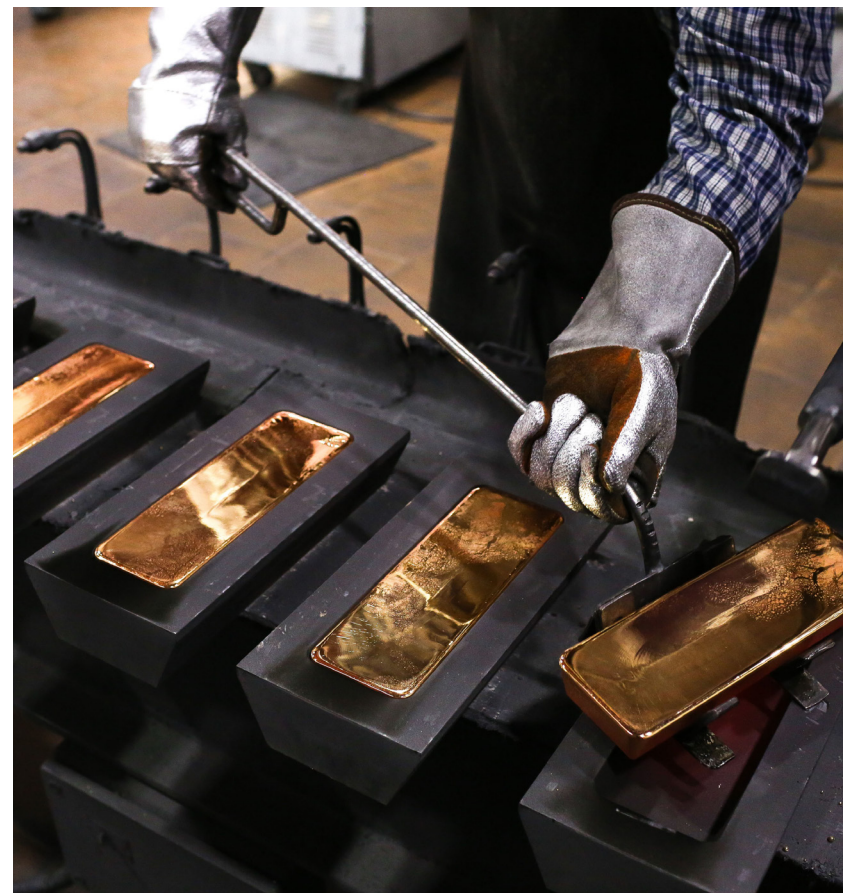


Weixu Yan
Head of Passives

Investment risks present at the start of 2024 (many alluded to herein, including the timing of interest rate cuts, inflation, 'soft-landing' and geo-politics) are still manifest today to varying degrees. This uncertainty renders a fund manager's job tricky and we therefore have not placed any strong conviction trades, keeping our investment decisions predominantly to a broad asset-class level, and generating excellent results for the Close Tactical Select Passive range. Gold, in particular, is a stand-out performer in 2024.

We have greater certainty in 2025 – with Trump in the US, Labour here in the UK, and major economies in decent condition. Even if economic worries reassert themselves in 2025, we know most developed markets are equipped with monetary policy tools to ease and stimulate.

This peace of mind helps us to feel broadly positive on risk assets. We too are positioning our equity allocation to capture both 'value' and 'growth' factors, mainly through a relatively high weight in UK equities, which predominantly consist of more-traditional 'value' sectors and companies; but also by remaining overweight 'tech' in US. We are looking for more targeted exposures - whether sectors or thematic - that would benefit from Trump's future policies, potential further China stimulus and an environment where company fundamentals drive stock market performance rather than sentiment. In Fixed Income we are looking to lower duration (or interest rate risk sensitivity) and get closer to a neutral position by buying shorter-dated maturities. We will be looking to take some profits on gold.



In the background, we continue our fundamental research with interesting new ETF launches in infrastructure, 'growth' assets in more concentrated mega-cap names as well as numerous small-cap exposures, all worthy of our attention.

Alternatives/Diversifiers



Alec Slater
Head of Alternatives

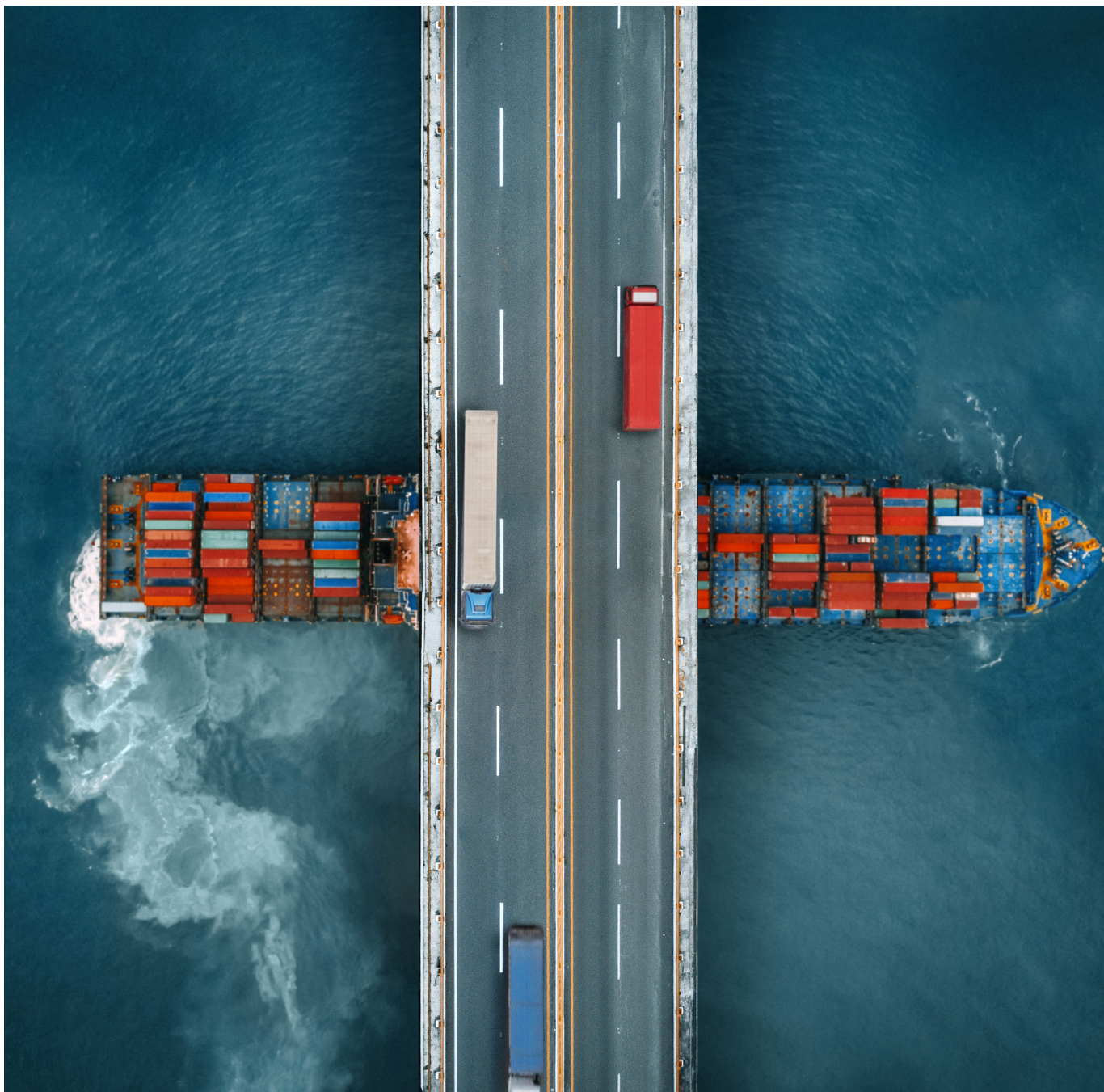
Our 'diversifying/alternative' investments continue to offer low correlations to more mainstream asset-classes and repeatable patterns of returns relative to our equity and fixed income allocations.

In 'real' assets (those typically offering inflation-protection) there is value where we are being compensated to wait until lower inflation and further interest rate cuts likely result in valuations strengthening due to future cashflows becoming more valuable. Hitherto, it has been a difficult environment for 'real' assets with desired rates of return rising in step with, and closely correlated to, gilt yields. But we continue to see decent yields across assets which have been beneficiaries of inflation, thereby offering an increasingly attractive real return with inflation-linked contracts that are still feeding into their long-term defensive cash-flows. We also continue to see disposals supporting valuations across real assets and continued deals across sectors due to the opportunities on offer.

Across investment trusts, it is positive to see mergers creating larger, more economical and liquid options for investors which should make the sector more resilient for the future. More active boards and share buy-backs are up nearly 100% compared to 2023, along with fairer treatment on reporting costs and charges to make the sector more investable, will all help to close investment trusts' discounts to their net asset values that widened with the rise in gilt yields. We believe that we are now in a sweet spot where we see strong fundamentals yet discounts to fair value. We expect a

continued acceleration in deal-making into 2025 with improving access to debt financing and record dry powder improving the significant lag in exit activity: pricing tension between willing buyers but reluctant sellers has resulted in 'deal-freeze' which we think is set to thaw.

Hedge Funds are set to continue to benefit from cross-asset volatility with alpha (a measure of out-performance against a benchmark) on the rise. For example, in Equity Hedge Funds our allocations have a low market exposure that can benefit from the style and factor (such as 'value' or 'growth') rotations we continue to see in different sectors; while our Macro Hedge Funds, which attempt to trade and benefit from broad market swings on political or economic news, have been able to use their varied toolbox, including trading interest rates and inflation curve inefficiencies which remain major market drivers. Markets have proven volatile in 2024, including a tumultuous period in early August that saw the VIX (which measures the equity market's expectation of volatility over the next 30 days based on S&P500 options) spike to one of the highest levels on record, and hedge fund managers have navigated it well. Hedge funds rotated out of momentum strategies and cut exposures broadly prior to the market drawdown during the summer, which aided performance. As performance has trended positively, new survey data shows that hedge funds are now one of the most in-demand asset classes for institutional investors.



Investing in a multi-polar world



Tony Whincup
Head of Investment Specialists



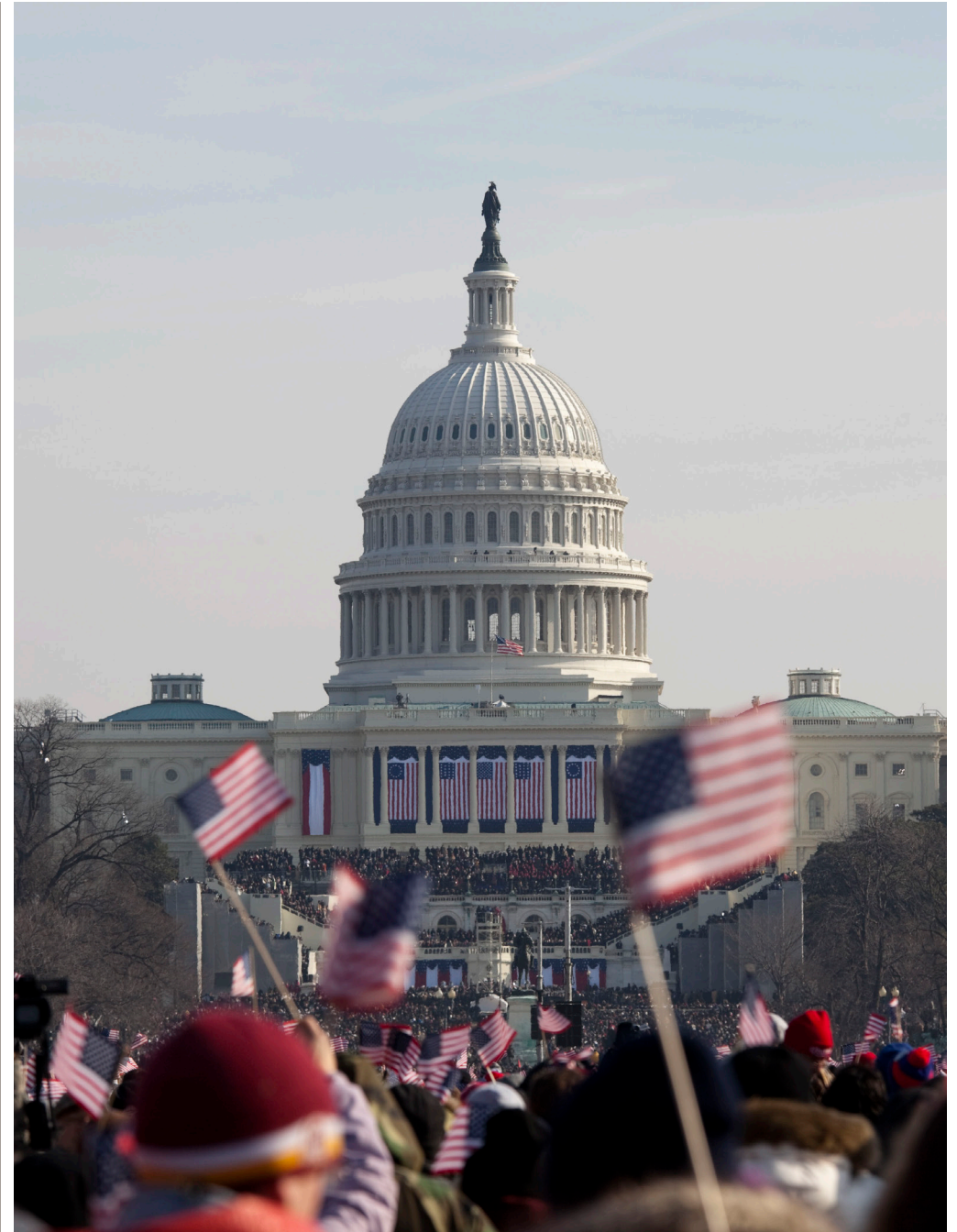
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Into 2025, the set-up looks acceptable from a macro-economic perspective. Globally, manufacturing is weak but the services sector is relatively strong – and in aggregate (as measured by forward-looking Purchasing Manager Indices data) the global economy is still expanding. There is still an outside but improbable risk that the US enters recession: after all, the US Federal Reserve (Fed) is cutting interest rates because the labour market is – if anything – too strong. These ‘good’ cuts are preferable to ‘bad’ cuts intended to juice a wounded economy.

With inflation falling and sufficient real wage growth, consumer discretionary spending appears supportive. With more clarity over the direction of policy now that major elections are done, some of the guesswork of 2024 is over. Barring conflicts interrupting oil supplies, with weakened demand and potentially increased supplies from OPEC+ nations (about 40% of global supply) there’s a chance oil’s mostly range-bound price of 2024 won’t spike and indirectly tax consumption. Although China remains a concern, we are buoyed by its initiation of ‘forward-guidance’ and the coordinated nature of its recent reflationary stimulus as it heads into a trade war with the US.

President-elect Trump’s effective coronation may pose significant risks and opportunities for markets. His *America-first* ambition will touch on almost every aspect herein, delivered by the ultimate prize: the trifecta of controlling Congress (both the House of Representatives and the Senate) and presidency. He may therefore wield considerable power with global consequences for trade, interest rates and inflation. Although the gap between rhetoric and deed will be unpredictable, Trump 2.0 will arguably be unfettered second time around. In 2016, Trump was still “draining the swamp” of rivals and naysayers but now has near-complete control of the GOP; the Supreme Court has effectively granted sitting presidents criminal immunity; and congressional checks may be weak.

US exceptionalism and protectionism will have profound consequences for the global economy. More friction may crimp GDP growth and feed inflation forcing the Fed to recalibrate interest rate policy. Markets are already pricing in fewer interest rate cuts and a higher neutral level for rates over the next 12-24 months. Trump may also test the Fed’s independence: its chair Jerome Powell has dismissed the idea that Trump could legally fire him.



That said, Trump's rather old-fashioned view of the stock market as a barometer of his success has clearly driven indices higher. The S&P500 closed above 6,000 for the first time and the Russell 2,000 index of smaller US companies advanced ~10% in the week after the election result, on expectations of lower taxes and greater deregulation, before taking a breather. US Treasury bond yields have risen and the US dollar strengthened since Trump's re-election.

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Longer-term, structural trends including decarbonisation, mitigating the impacts of global warming and deglobalisation will remain key in a multi-polar world.

We remain dedicated to our fundamental research and analysis of investments we believe offer optimally attractive risk-reward payoffs for clients of all risk profiles. We remain alert to the risks and alive the opportunities and look ahead with cautious optimism.





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