Hymans Robertson Investment Services (HRIS)

Market opportunities and risks for 2025

December 2024

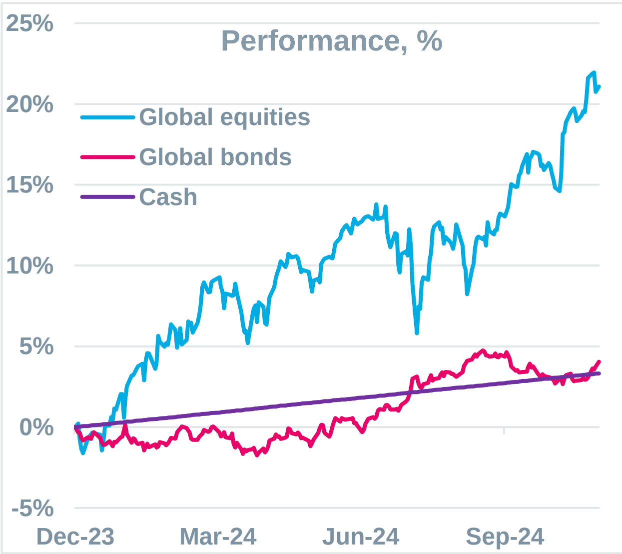
- 2024 was billed as "the year of the election", this meant at the beginning of the year there was uncertainty as to what political change might bring to economies and markets.
- However, as a whole, equity markets have sailed through, posting strong returns over the year; albeit bond returns have been more muted as many of the expected interest rate cuts failed to materialise.
- Looking forward, key themes include Trump's election victory giving a new perspective for global markets, with uncertainty as to how other countries will react - most notably an economically fragile China.
- In addition, will the Bank of England continue to cut rates slowly or pick up the pace if slack appears in the labour market.

As 2024 wraps up we reflect on how the economic landscape has changed and what it has meant for financial markets. We also look ahead to our thoughts for 2025 and what investors should pay attention to next year.

2024 saw equities shrug off political uncertainty

The key question for investors going into 2024 was how fast central banks would start to reduce interest rates. Of equal importance was what would be the reason for these cuts. Would it be because inflation had been contained or because of an economic slowdown? The answer, for now it seems, is the former. The Bank of England started cutting rates in August and has done so by 0.5% so far. The Federal Reserve (Fed) started later but has been cutting faster, by 0.75% in total by November, with a good chance of more cuts in December. Economic growth, meanwhile, has held up, especially in the US.

Overall, the equity market had an incredibly strong year as the prospect of falling interest rates, without an economic slowdown, boosted investor sentiment. The strongest performance came from large American tech companies, especially Nvidia, as enthusiasm towards leaders in the Artificial Intelligence (AI) sector accelerated. Even so, there were periods where anxieties towards an economic slowdown briefly appeared. In late August, a couple of weaker-than-expected data points temporarily caused panic around global markets. This spread to the Japanese market which fell by 12% in one day after a rapid strengthening of the yen. The panic was short-lived though, and the global equity market recovered in a matter of weeks.



Source: Morningstar

2024 was dubbed as the year of the election, with over half the world going to the polls. The UK election had a limited impact on markets, given the strong expectation of a Labour victory going into election day. In the US, a close election was expected but what we got was an emphatic victory for Trump. Markets quickly pivoted towards 'Trump trades' reflecting the expected winners and losers from Trump's expected policy agenda.

What opportunities, and threats, could we expect from 2025?

America First?

We've written previously about the market reaction to Trump's election victory. Although the initial few days of large market movements have subsided, uncertainty remains as to what the Trump presidency will look like. This means that we could continue to see volatility as the market digests new policy developments. There is a strong case, and it has been widely made, for the continuation of American exceptionalism – the idea that the US economy and stock market will outperform others. Of course, any investment decision needs to be made in the context of the current price, and how much the market has already incorporated this conclusion into US stock market valuations. It's worth noting the US market is up around 5% since the election result (to end of November), compared to an almost 2% loss for the rest of the world. The S&P500 also looks expensive relative to history, meaning the market may already be priced for perfection. The US market is also heavily concentrated in the tech mega-cap firms meaning exposure via non-market cap routes of implementation, such as factor-based investing, can help reduce this stock concentration risk.

Bank of England likely to remain cautious with rate cuts heading into 2025

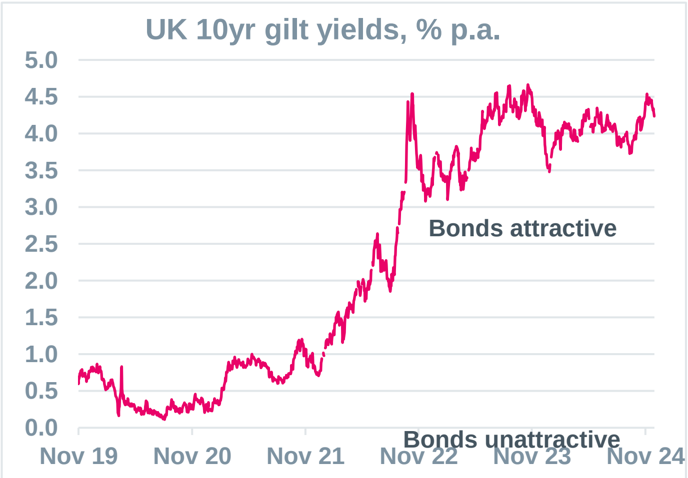
Following October's Budget, the Bank of England (BoE) is set to take a more cautious path with slower interest rate cuts, at least in the first half of the year. On the face of it, the Budget has boosted demand, through higher government spending, while constricting the supply of the economy, through higher NI contributions and taxes. Both increase the risks of further inflation. However, if we see the clear loosening in the labour market (higher unemployment or lower wage growth) than the BoE has been waiting for, then this could give the BoE the green light to cut at a faster pace than markets are expecting.

Tariffs may hurt an already deflating China

The economic fortunes of China will continue to have an impact on certain parts of the market. The onset of the first stage of the trade war between the US and China during Trump's previous term in 2018 coincided with a period of market turbulence. The same is possible this time around. However, potentially of more importance is how much stimulus China's government announces to combat the ongoing domestic economic issues. The Chinese stock market rose around 20% in a matter of weeks this September after an initial announcement of stimulus. It has since fallen back as further details have disappointed investors. It's expected that there are still some measures left in the tank and the government might be waiting to see the full extent of Trump's tariffs. Further expansive measures would be seen positively by markets.

Bonds should continue to show their worth next year

After over two years of sharp increases to bond yields, many expected the central bank interest rate cuts in 2024 to lead to falling bond yields. Fiscal expansion, and slower than expected rate cuts, has meant this hasn't been the case. UK yields at the end of November were around 0.7% higher than at the end of 2023. Although the performance tailwind from falling bond yields hasn't arrived in 2024, this only increases the prospect of a good year for bonds in 2025. Government bonds should also provide better downside protection in the event of a market selloff.



Source: Bank of England

In summary, while US equities may benefit from continued momentum, their high valuations and concentration, strengthens our preference to not naively follow the market, but instead access equities in a regional and style diverse manner. Bonds offer attractive yields relative to recent history, most notably government bonds, but high issuance and concerns over inflation volatility support our more diversified approach to access bond markets at this time.

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