bordier | 1844

Investment review – End Q4 2024

December 2024

Financial markets look set to close out the year on a reasonably high note after another strong leg up in values during the final quarter, powered by Donald Trump's re-election as US president, reductions in interest rates and money flowing quite freely both into and around a range of assets.

Maintaining stockmarket positioning at the upper end of our strategic ranges has proved beneficial this year, as has our bias towards the US stockmarket which, once again, has led the charge. Bond markets have been unusually volatile given some uncertainties over inflation and central bank policy, but have still made reasonable headway. Similarly, our allocations to market-neutral 'alternative' investment funds – where relevant to the investment mandate – have also produced solid returns with very little volatility and minimal correlation to the general direction of both stock and bond markets. It is rare to have a year when every mainstream asset class has contributed in some way to the overall return, but it is pleasing to have participated well in most of the action and to have seen some of our earlier repositioning bear fruit.

The past year has, though, proved fairly tumultuous on a number of fronts. Geopolitical tensions and conflicts have combined to create an unstable backdrop whilst major elections and political upheaval across the globe have also added another layer of uncertainty for markets to grapple with. The main event for global investors in the latter part of 2024 has been the US election, the result and implications of which have now become more the obsession rather than the inflation and interest rates debate that had dominated market sentiment for much of the year beforehand.

The consequences of Trump 2.0

Even before Trump sets foot again in the White House, investors – us included – have already been busy in recent weeks assessing the likely tailwinds and headwinds for financial assets of his second stint as president. The Republican administration will still inherit quite a strong economy overall. But we are now promised a more extreme 'pro-growth' agenda where the economic cog wheels are likely to be oiled through the promise of lower taxes, reduced regulatory burdens and increased expenditure on critical infrastructure, while an attempt will be made to strengthen America's internal economy through the imposition of further tariffs on those key trading partners that are deemed to be a threat to the president-elect's 'America First' goals. We are under no illusion that Trump's protectionist policies could complicate the economic landscape, including the inflation outlook, but the current working assumption, at least in the near term, is that the new leadership will give a further boost to the US market and parts of the economy that need it most.

All the promised initiatives are likely to be positive for the US dollar too, a currency to which we are happy to retain good exposure.

"Maintaining stockmarket positioning at the upper end of our strategic ranges has proved beneficial this year..."

bordier | 1844

A stronger dollar may not suit Trump if he wants to make American exports more attractive to overseas buyers, but he will find out soon enough that going too hard on protectionist policies, including tariffs, will have unintended consequences that may be counterproductive to achieving his aims.

Near term tailwinds… and headwinds

From a stockmarket perspective we believe the likely winners from the new Republican administration will be US companies most exposed to the domestic economy, specifically mid- and small-sized businesses representing more of America's heartland. We already have good exposure to such companies via active, unconstrained US managers, several of which have been increasing exposure to consumer discretionary, industrials and financials sectors. These areas are seen as being the beneficiaries of a stronger macro environment, lower taxes, 'onshoring' of US manufacturing, 'reshoring' of supply chains and deregulation, and should be less impacted by trade tariffs. Our US investment funds have performed well of late, but we have further accentuated the 'domestic America' theme by introducing some dedicated exposure to smaller US companies in order to refine our exposure to this vast market of opportunity.

Areas potentially under some pressure from the election result include the renewable energy sector, at least in the short term, given Trump's scepticism regarding climate change and the risk that he might try to repeal some aspects of the Inflation Reduction Act. As a result, we have reduced exposure to environmental and sustainable energy themes, using proceeds to increase the exposure to smaller US companies, as noted.

Infrastructure and AI still favoured

We are not inclined to change the two other key themes in portfolios, namely global infrastructure investment and the beneficiaries of artificial intelligence ('AI'). We expect Trump to favour infrastructure spending, and the repair of America's roads, bridges and water infrastructure should continue to be supported under the Infrastructure Investment and Jobs Act. Similar spending is required across many other developed world economies, while the infrastructure projects required to support the expected economic expansion in the developing world makes this a truly global theme with the potential for long term excess growth. Infrastructure assets should also be a clear beneficiary of a lower interest rate environment.

No investment update would be complete these days without some comment on AI, a theme which has continued to occupy column inches in the media and dominate in terms of its influence on stockmarket returns this year, particularly in the US. Our dedicated global AI fund has continued to forge ahead over the course of the year, producing some very strong gains since we first introduced the theme in the autumn of 2023. The rise in capital expenditure, from the largest companies in the world, continues to drive investment in AI and shows few signs of abating. Our investment has not only been powered by good commitments to the 'enablers' of AI – principally those companies facilitating the necessary infrastructure to make AI work (and the clearest beneficiaries of the expansion of AI to date) – but also an increasing number of early AI 'adopters'. Investment in the AI theme requires vision, but it does seem that we are close to a pivot point where AI begins to shift beyond experimentation to implementation and wider deployment, creating both winners and losers in its wake.

"Our dedicated global AI fund has continued to forge ahead over the course of the year..."

This subtle shift from the enablers to the users of AI is broadening the opportunity set for investors and we feel that our chosen active manager is in a strong position to identify the long-term impacts of AI and root out the best opportunities, many of which have yet to be fully understood or recognised by the market.

General valuations and market breadth

We also see more widespread broadening of markets in the coming year. Most stockmarket valuations are generally still on the cheaper side of historic averages and we expect a backdrop of lower inflation and reduced interest rates to help drive corporate profitability and maintain healthy profit margins. Even in the upper echelons of the US market the more richly-valued heavyweights have substantially justified their premium ratings to date with continued strong results. As already noted, the US stockmarket has, once again, been the principal driver behind global equity market returns in 2024 and there is every chance that the new president will help perpetuate that momentum, at least in the near term. But we are beginning to see some healthy broadening of the search for the next market leadership, with investors' focus shifting slightly away from larger companies, and 'giant tech' in particular, towards medium- and smaller-sized companies. This is not just a US phenomenon but a subtle shift that we see occurring in other regions too where investors can still find undemanding share valuations and companies that should benefit most from looser monetary conditions and more relaxed lending standards. Most of our underlying managers have a free rein in terms of where to search within each market, and it is good to see many of them being proactive in searching for latent value and growth opportunities outside of the mainstream market heavyweights.

Divergent paths for developed world growth and inflation?

Regionally, Europe's economic and political woes now seem likely to take activity, inflation and interest policy on a very different path to that of the USA. The post-covid period has already opened up a big gap in economic terms: the size of the German economy, for example, is still the same size almost five years on, in contrast to the US economy that has grown by more than 11%. Current forecasts suggest the eurozone as a whole might muster around 1% economic growth next year, but that is still no more than half what is expected from the USA, further widening the gap between Europe's largest economy and that of the dominant USA.

Weaker economic activity in the eurozone means that inflation is now expected to track well below the European Central Bank's ('ECB') 2% target, meaning the central bank is likely to cut interest rates more aggressively than the US Federal Reserve. This is a distinct change from earlier in 2024 when a more unified convergence of inflation – and hence monetary policy moves by the world's key policymakers – had been envisaged for 2025.

Interest rates still coming down, but divergence here too

Overall, whether it will be as a result of Trump's policies or ongoing structural issues and political upheaval in Europe, the job of central banks has not been made any easier and the risk of policy error has seemingly increased in recent weeks. The next few months are likely to see further cuts in interest rates, but the earlier prospect of everyone adopting the same playbook has diminished.

"...the US stockmarket has, once again, been the principal driver behind global equity market returns in 2024..."

bordier | 1844

As things currently stand, another 1% reduction in both US and UK interest rates – to around 3.75% – can be expected over the coming year, whereas the ECB may be forced to loosen policy more aggressively, with interest rates falling to around 1.5% by the end of 2025 in order to address the eurozone's stagnating economy.

This divergence, reflecting a combination of the likely inflationary consequences from Trump's expected initiatives and Europe's ongoing struggles could require some further changes to our strategy as 2025 unfolds. Bond markets are already pricing in the altered picture for inflation and likely need for different approaches to monetary policy, with 5-year European government bond yields, for example, already more than two percentage points below those of equivalent US Treasury bonds.

Our strategic bond fund managers are well-equipped to alter positioning within bond markets, but if inflation really takes off in the US then it may be time to batten down the hatches once again in fixed interest markets – as we did successfully during 2022 – by fundamentally dialling down risk both through dynamic maturity management and fundamental reductions in fixed interest exposure in favour of more 'alternative investments'. This is not something we are concerned about now, but is an area we will be watching closely as Trump gets his feet under the Oval Office desk again.

Europe slipping behind

The ECB may do its bit to stimulate growth in the long run, but in the meantime the structural and political headwinds in Europe – and now the potential double-whammy from increased trade tariffs – are likely to restrain its progress versus the innovation, stimulus and long-term growth drivers that the likes of the US and Asia can bring to the party. ECB chief, Christine Lagarde, has acknowledged that greater frictions on global trade will be damaging to Europe's economy and she has encouraged Europe's political leaders to buy more US goods rather than enter into an acrimonious trade war. This may be easier said than done, but at least there is some recognition of the threat to growth and some determination not to accentuate Europe's issues.

There are still bright spots in Europe, the Spanish economy being one of them where its more service-orientated economy, much of it linked to tourism, should allow it to escape some of the harsher implications of any increased tariffs imposed on core European manufacturing-orientated economies. Our exposure to continental European stockmarkets is quite modest, and the exposure we do have via active managers is linked to more international revenues than to companies directly impacted by Europe's malaise. But if issues deepen then we are prepared to take action.

UK not faring much better

On a relative basis, the UK economy may no longer be the weakest link in Europe, but its status is not much to celebrate either: its economic growth is expected to average out at little more than 1.5% per annum over the next five years, according to government forecasts. The economy has made little, if any, progress since the Labour party took charge, possibly held back by pre-Budget uncertainty but also the drag from the legacy of higher inflation and interest rate policy which is still leaving its mark on restrained business investment and consumers' spending habits.

"Our strategic bond fund managers are well-equipped to alter positioning within bond markets..."

There are still some big question marks over how much the Chancellor's recent tax-raising budget will hit profits and the UK's competitiveness in the near term. The proposed rise in employers' National Insurance, for example, could rub salt into the wound if it pushes up wage and consumer price inflation, thereby introducing some further uncertainty about how far policymakers feel it is safe to go with interest rate cuts over the coming year. It is an understatement to say that the new UK government probably has its work cut out to prevent the UK economy from being consigned to a lengthy period of lacklustre growth.

Poor sentiment surrounding the UK does mean that its stockmarket valuations generally remain quite depressed. There are undoubtedly some high quality, domestic and geographically-diverse companies listed on the UK exchanges which are bucking the trend. Some of these will have fallen below the investment radar amidst the general investment apathy for UK investment and could now be in the sights of corporate finance teams seeking ideas for merger and acquisition activity. There are therefore still plenty of interesting opportunities for selective stockpicking, but we do need to see a more widespread profits recovery for general investment appeal to improve and for stocks to see some re-rating. We have measured exposure to the UK but will continue to review our positioning, mindful both of the depressed valuations but also – like the eurozone – its anaemic growth outlook versus the rest of the world.

Risk of self-harm to US from excess tariffs

Trump will be well aware that the imposition of blanket tariffs and the direct and indirect damage that this could do to its trading partners. The 'reshoring' of America's supply chains will be impossible without some adverse impact on America's economy, so we can expect the pre-election extreme tariff rhetoric to be watered down and/or used as a bargaining tool in helping to deliver Trump's ambitions. In all likelihood there will be exemptions and carve-outs to protect as much as possible of the US economy from self-harm. There will undoubtedly be retaliatory measures too and the re-routing of goods to avoid the most draconian of measures. China's export market is already showing a pick-up in pace, perhaps an indication that some front-running of tariffs has begun, whilst the re-routing of goods via countries seen as less impacted by tariffs, such as Vietnam, is also likely. Ultimately, there are likely to be few winners in any aggressive global trade war, but if things do intensify we can expect a fair amount of creative dodging, much of which will be difficult to police, by those countries and companies most impacted by a more stringent tariff regime.

Positives for the wider Asian region

Some observers may see Trump's potential tariffs as being the biggest risk for China. This is certainly something that will need to be factored in once we know more of the detail and also the scale of any retaliatory response. But for now, it is China's internal challenges of high debt and weak domestic demand that are the priority. China has been doing its best, through a range of stimulus measures, to keep its 5% growth target vaguely on track. These initiatives, principally focused on easing monetary policy and supporting the property market, have provided a welcome boost to a flagging stockmarket in recent months. There have also been positive spillovers into the wider South-East Asian markets which consider China as their largest trading partner, a source of tourists and investment, as well as a huge export market.

"Ultimately, there are likely to be few winners in any aggressive global trade war..."

bordier | 1844

Our underlying Asian managers have navigated the choppy waters quite well this year, producing some solid gains, and we are hopeful that a combination of fundamentally stronger economic activity permeating the region than many advanced economies, further stimulus measures from the likes of China, a pick-up in domestic consumer demand and the re-routing of trade can offset some of the likely tariff headwinds. We expect these factors to help release more value from the region's generally inexpensive stockmarkets in the coming year.

Outlook for 2025

Overall, we remain quite upbeat about the prospects for 2025, although recognise we will need to keep an agile mindset. Most economic forecasters are predicting growth in the global economy above 3% for the next couple of years. This is by no means spectacular but is broadly in line with pre-pandemic averages and, importantly, higher than at the start of the year following upgrades to US economic growth which have more than offset the deterioration elsewhere, notably from the eurozone. For now, we are comfortable with being skewed to the US and also to Asian markets, where valuations do not reflect the fact that the region is expected to grow at more than twice the pace of the developed world.

The world stage is complicated both economically and politically, but fundamentally we see a backdrop of falling interest rates and a lower cost of capital, 'pro-growth' policies from new governments and improving profits growth expectations as being supportive for investment risk-taking. We therefore move into the new year happy to maintain our allocations to stockmarkets at the upper end of strategic ranges. This is counterbalanced, where relevant to the risk mandate, with our increased allocations to bond markets and still good commitments to alternative investments, and a low exposure to cash.

We make no apology for this update being overtly centred around the US – it is deservedly where most of the action and narrative is currently focused. But we are also mindful that in the long run stock and bond markets take more notice of profits, inflation and monetary policy than presidents – what seems logical in theory may not necessarily play out precisely in practice. We also know that we must not neglect other important areas of growth or recovery potential whilst the main spotlight is on the US. Maintaining diversity through a range of asset classes and underlying managers will therefore be as important as ever. Whilst we remain optimistic for the year ahead, we stand by to expect the unexpected and adapt our strategy, if necessary, as the start of the next quarter-century unfolds.

Risk warnings

This document is issued and approved by Bordier & Cie (UK) PLC ('Bordier UK'). Incorporated in England No: 1583393, registered address 23 King Street, St James's, London, SW1Y 6QY. The company is authorised and regulated by the Financial Conduct Authority ('FCA').

Bordier UK is a specialist investment manager dedicated to providing portfolio management services. We offer Restricted advice as defined by the FCA, which means that if we make a personal recommendation of an investment solution to you, it will be from Bordier UK's range of investment propositions and will reflect your needs and your approach to risk.

This document is not intended as an offer to acquire or dispose of any security or interest in any security. Potential investors should take their own independent advice to assess the suitability of investments. Whilst every effort has been made to ensure that the information contained in this document is correct, the directors of Bordier UK can take no responsibility for any action taken (or not taken) as a result of the matters discussed within it.

CL10579/20241218/1.0