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MONTHLY MARKET VIEWPOINT

TWO SIDES OF THE COIN

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- There are two sides to the Trump-victory coin: higher growth and inflation should be positive for equities, but it also means higher policy rates and bond yields.
- 2025 global growth prospects remain positive for risky assets. We will nonetheless likely see increasing divergence between regions in terms of growth, inflation and monetary policy.
- The (consensus) view that US equities will outperform we believe is the correct one, though eventually all the good news should be priced in and opportunities will likely then be found among the laggards.
- We expect successful asset allocation this year will find greater opportunity in relative value positions over calling the direction of markets. Diversification will be critical.

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The returns on US equities after the reëlection of Donald Trump were unsurprising given what his win implied for the outlook on US growth and inflation (and hence corporate profits). By contrast, the moves in Treasury yields were not what one might have anticipated.

Higher growth and inflation also imply higher Treasury yields – the other side of the Trump-victory coin. The 10-year Treasury yield did rise post-election but by just 17bp, before subsequently dropping back, hitting a low of 4.15% in the first week of December.

It was all rather too easy. And all the more so because — aside from the potential for higher yields — the returns did not seem to reflect the looming risks from tariffs, immigration and taxation.

No surprise, then, that it did not last, and it was the Fed that was the main catalyst for the reversal. When asked soon after the election how the Fed would take into account the policies of the incoming administration, Fed Chair Jerome Powell stated: "We don't guess, we don't speculate and we don't assume." This led investors to conclude that, as no one yet knew the details of Trump's policies, there would be few changes to the Fed's 'dot plot' or Summary of Economic Projections at the following meeting.

The post-election gains in US equities were not initially accompanied by rising bond yields. That has changed.

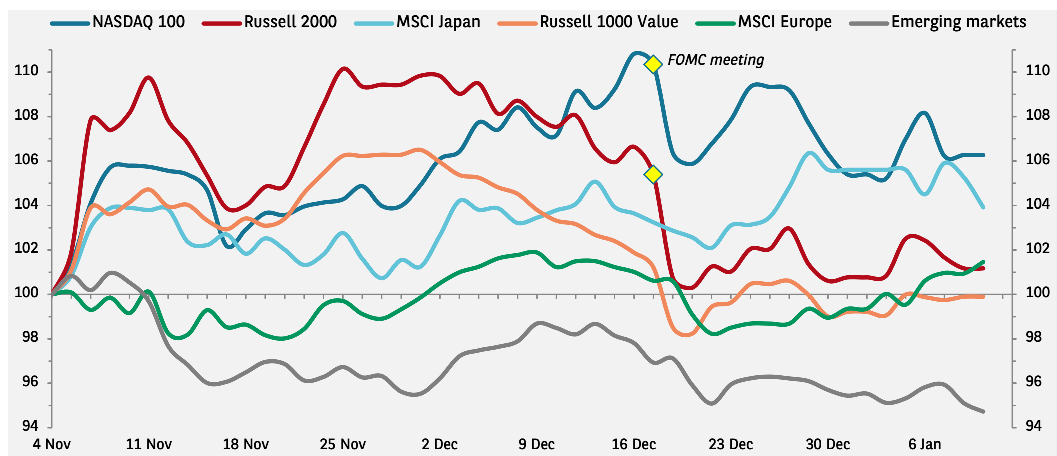
The mid-December Federal Open Market Committee (FOMC) meeting, however, showed the central bank to be clearly worried about the outlook for inflation, and consequently less inclined to reduce the fed funds rate in the quarters ahead. Ten-year Treasury bonds reacted by continuing a sell-off that had begun the week prior, with yields ultimately increasing by more than 50bp from the prior low.

Some US equity indices had already been lagging as bond yields rose, but the decline accelerated following the FOMC meeting. It also spread to the NASDAQ index, which until then had been resilient (see Exhibit 1).

Exhibit 1

The FOMC's December meeting accelerated the decline in US equity markets

4 November 2024 = 100



Data as at 9 January 2025. Sources: FactSet, BNP Paribas Asset Management..

If there was any comfort for investors suffering negative portfolio returns in the last two weeks of the year it was that they had a lot of company given how consensual the view was that US equities would outperform.

Does the recent change in tone from the Fed mean that the overweight-US-equties view needs to be revisited? While one should regularly question an investment case, we believe the justification for an overweight remains in place.

As noted, higher yields are assumed to be one of the consequences of higher growth and inflation. The surprise is not that this has happened, only that it took longer than expected. The key question now is whether the sell-off in Treasuries is over or whether there is further to go.

One should recall that 10-year Treasury yields reached 5% in October 2023. Markets will always be data dependent, so if economic growth accelerates yet further, yields could indeed rise more.

We believe, however, that the repricing due to recalibrated expectations for the Fed has run its course. If that view is correct, and Treasury yields remain around their current levels, then the main driver of equity index returns from here should be earnings.

The negative earnings trend for emerging markets is partly a function of the strong US dollar.

On this point, the picture is encouraging. Earnings expectations had been rising since well before the election for the NASDAQ index as artificial intelligence-related investments and spending fed through to corporate profits (see Exhibit 2).

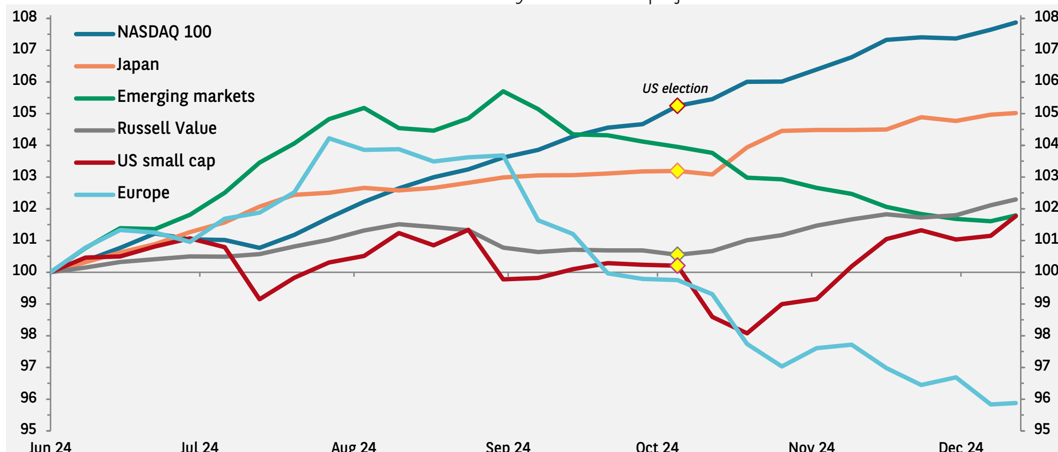
There has been a turnaround, though, in the trend for US value and small cap stocks since the election as analysts anticipate the benefits for profits of deregulation, tariffs, increased mergers and acquisitions (M&A) activity, and tax cuts.

Looking outside the US, Japanese equity index forward earnings-per-share (EPS) estimates, too, had been increasing before the election faster than in other non-US markets. They have picked up pace slightly since. If this continues, it would likely be premised on a weaker yen as a more hawkish Fed boosts the dollar. The outperformance of Japanese versus non-US equities in 2024 (on a hedged basis) was partly a function of a weakening currency.

Exhibit 2

Expectations for earnings next year rising except for emerging markets and Europe

Next-twelve-month EPS estimate in local currency terms except for EM in USD



Data as at 9 January 2025. Sources: FactSet, BNP Paribas Asset Management

Worsening sentiment on Europe

In contrast to these positive trends, forward estimates for emerging markets and for Europe have moved in the opposite direction. The underlying dynamics, however, are quite different. The negative trend in Europe reflects deteriorating analyst sentiment on the outlook for corporate profits in the region, reversing the positive revisions in the first half of the year. Worryingly, the downward revisions span all market sectors.

Potentially significant reductions in policy rates from the ECB should eventually turn the growth momentum around, but that presumes there is no shock to the region from the imposition of tariffs by the Trump administration.

For emerging markets, the negative trend is not as bad as it seems as the EPS projection shown is in US dollar, not local currency, terms. This reflects the fact that foreign investors generally do not attempt to hedge their investments in emerging markets and receive the hard currency return.

The local currency version of the emerging market EPS estimate has gained 2% since September 2024, compared to the fall of 4% shown in the chart. This divergence reflects two factors: a weaker currency boosting the domestic value of exports (as is the case for Japan). A rising local currency EPS estimate may also reflect a more positive domestic earnings environment. This is likely the case for China, for example. Recent government stimulus is being reflected in higher estimates for corporate profits. In some instances, however (for example, Turkey), both the local currency and US dollar estimates are falling, pointing to a worsening domestic outlook.

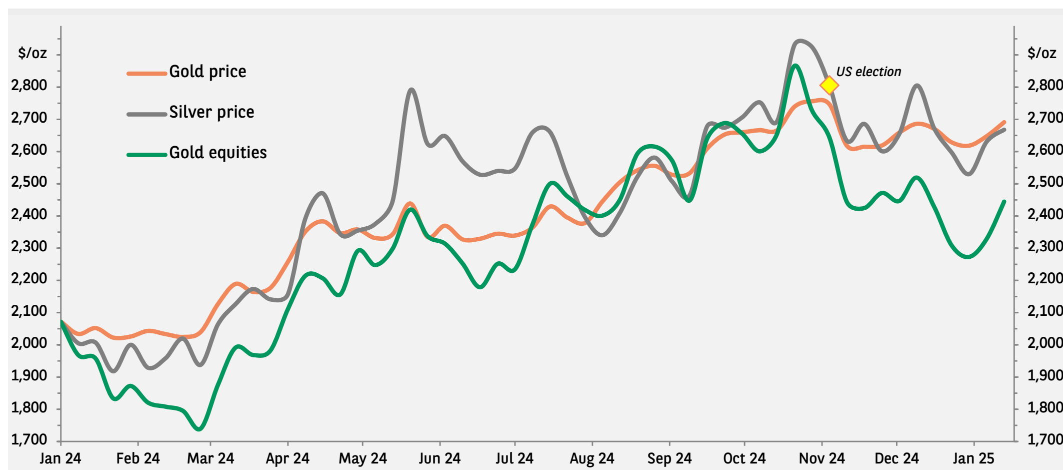
Silver and gold

Returns since the US election for gold and silver have been lacklustre (see Exhibit 3). Nonetheless, we believe the factors that drove gold's strong performance in 2024 — geopolitical worries, sticky inflation, central bank buying — look set to continue in the new year. The recent price declines have led us to increase our allocations.

Exhibit 3

Silver trended along with gold in 2024

Silver and gold equities* indexed to gold price as at 1 January 2023

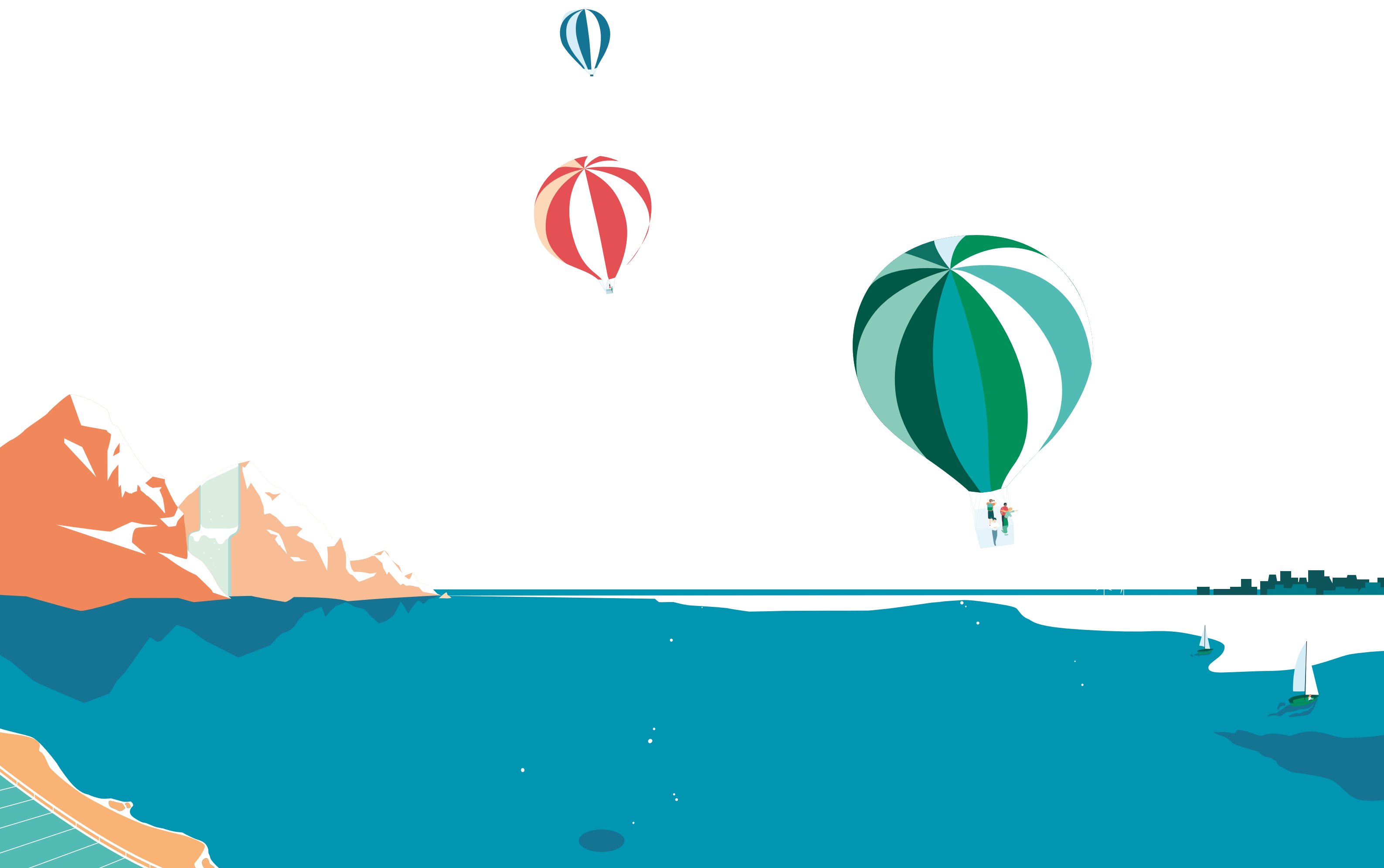


Data as at 9 January 2025. *MSCI AC World IMI Gold in USD. Sources: FactSet, BNP Paribas Asset Management.

Gold may also function as a hedge if we see an overheating US economy push Treasury yields higher. The second half of December saw gold outperform both equities and fixed income as yields rose and equities slid.

MULTI ASSET CLASS VIEWS

- We enter 2025 with a moderately overweight equity exposure, mainly to US equities, where high levels of corporate profitability should support superior EPS growth despite higher yields. With valuations looking stretched on mega caps, we have diversified our positions towards the S&P equally-weighted index, where we find more value.
- Our position is neutral on sovereign bonds. We nonetheless reflect the increasing economic decoupling between US and Europe through a long position on European bonds and a short position on US Treasury notes. Our conviction remains positive on euro investment grade credit. The asset class should be a relative safe haven in a context where rates volatility could continue to be higher than credit spread volatility due to companies' solid fundamentals.
- Despite possible headwinds from higher US bond yields and a stronger dollar, we maintain a diversification position in gold, which should be supported by renewed emerging market central bank purchases and steady private investor demand in a context of fiscal and geopolitical uncertainties.



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