Cross-Asset Quarterly Outlook

December 2024*

Overview

Countdown to January 20th

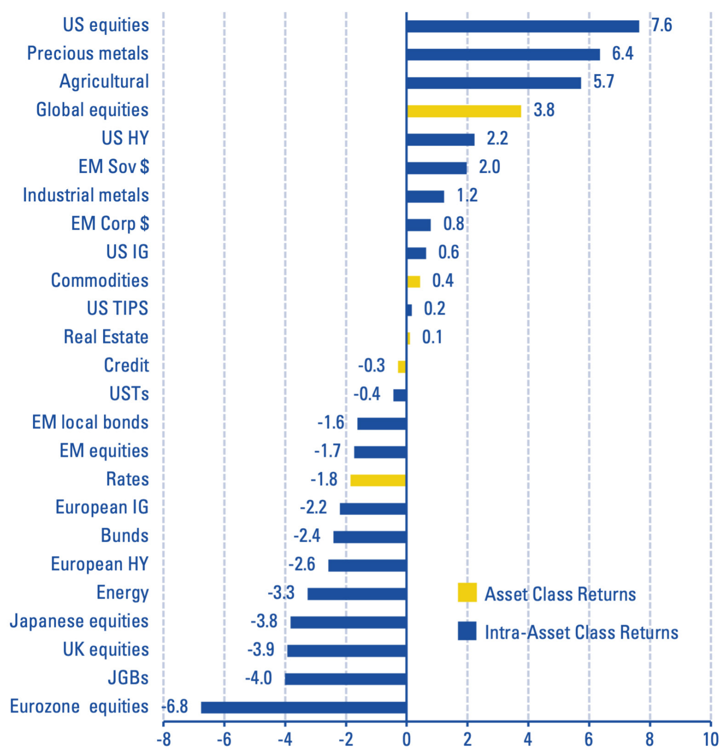
- *Trump 2.0 will add to macro uncertainty going into 2025.*
- *Tariffs and immigration restrictions could weigh on earnings growth, while tax cuts and deregulation may provide further short-term support for richly priced US equities. We remain neutral equities.*
- *We favour exposure to US TIPS and gold, upgrading the latter, given that both assets should benefit from lower real rates.*
- *Allocation adjustments also include JGBs (upgraded to neutral), Bunds (upgraded to overweight), and Global IG Credit (down graded to neutral).*

The market reaction to the US election mostly followed a similar trend to November 2016. Global equities are rising, credit spreads are tighter, and the US dollar is appreciating. US equities were the best-performing asset over the quarter (Chart 1). As outlined in our recent Special Report, *The Art of Fading the Trump Trade* (November 2024), Trump 2.0 will face different constraints than Trump 1.0. His administration will inherit a different US and global economy, a wider budget deficit, and financial markets that are more optimistically priced for further 'US exceptionalism'. The implications are that many 'Trump Trades' are vulnerable to reversal, as happened during his first term in office.

Before the US election, our baseline view was that US economic growth would slow below trend, and the Fed would cut interest rates. We do not see this baseline view materially changing. However, the uncertainty surrounding the implementation and sequencing of Trump 2.0 policies gives greater weight to our alternative scenarios. Tariffs and immigration restrictions could weigh on growth and reignite recession concerns given an already fragile US labour market. Note that US activity data (e.g. ISM) and equities fell in 2018 as the US-China trade war commenced (Chart 2). On a more upbeat note, tax cuts and deregulation could add further support for equities, similar to 2017. An improvement in business sentiment, coinciding with interest rate cuts, is a favourable environment for equities. We are agnostic whether Trump and the Republican-controlled Congress will prioritise their more growth-oriented policies. Still, we are sceptical that the US can sustain its growth resilience given the wide budget deficit (-6.9% of GDP vs. -2.6% in November 2016) and the slowing US labour market. Our bias is for lower real rates, supporting US TIPS and gold.

Activity indicators still favour a pro-cyclical bias at the margin, but the strength of our signals is fading, leading us to maintain a neutral equity allocation. For example, the global composite PMI is still above trend at 52.3 but has fallen since May 2024. The loss in economic momentum is also occurring with a less attractive equity risk premium and ultra-tight credit spreads. Another reflation rally, similar to 2017, has a more challenging backdrop. Debate remains around the magnitude and scope of US tariffs, but tariffs will likely rise. Therefore, 2018 may be a more relevant reference period, which included a c.20% peak-to-trough decline in US equities and deterioration in business sentiment.

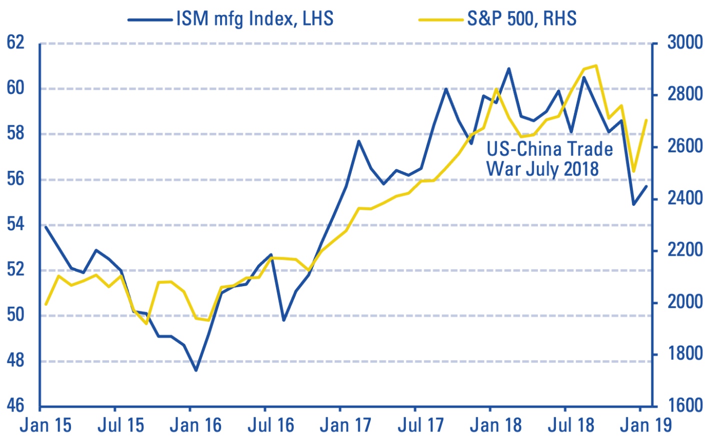
Chart 1: Asset returns, Sep-Nov, %



Source: Bloomberg

**The publication reflects asset performance up to November 29, 2024, and macro events and data releases up to December 5, 2024, unless indicated otherwise.*

Chart 2: ISM and S&P 500 2015-19



Source: Bloomberg

Asset Allocation

	Chg	-3	-2	-1	0	+1	+2	+3
EQUITIES	-				■			
RATES	-					■		
CREDIT	↓		■					
REAL ESTATE	-				■			
COMMODITIES	-					■		

	Chg	-3	-2	-1	0	+1	+2	+3
US equities	-				■			
Eurozone equities	-			■				
UK equities	-			■				
Japan equities	-				■			
EM equities	-						■	
USTs	-					■		
TIPS	-						■	
Bunds	↑					■		
JGBs	↑				■			
EM local bonds	↓		■					
US IG credit	↓				■			
US HY credit	-	■						
European IG credit	↓				■			
European HY credit	-			■				
EM Sov $ credit	-				■			
EM Corp $ credit	-				■			
Energy	-				■			
Industrial metals	-					■		
Precious metals	↑						■	
Agricultural	-				■			

Note: Up/down arrows indicate a positive or negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Source: CLIM

Market Strategy:

The outcome of the US election does not change the constraints on the economy and markets. Global and US equities are trending higher, but valuations indicate poor future return prospects relative to bonds. A material growth slowdown does not appear imminent. However, the current US fiscal constraints raise the prospects for a downshift should the Republican-controlled Congress place greater focus on the large US budget deficit. The Treasury nominee, Scott Bessent, has advocated for a 3% budget deficit, and fiscal hawks may sway policy in the Republican party. A slowing labour market and depleted pandemic savings may add to these pressures. Accordingly, we do not rule out Trump 2.0 maintaining some positive market momentum short-term, but we favour some defensive exposure as the more market-negative scenarios could materialise in 2025.

- We remain *neutral* on **equities**. Earnings continue to grow, but rich valuations already reflect an optimistic outlook. Intra-equities, artificial intelligence (AI) and advanced chip demand are strategic themes that will transcend the current political noise. We continue to favour EM, given its large weighting to advanced tech hardware, while we remain underweight Europe.
- In **rates**, we stay *overweight*. We take profits on our Japanese government bonds' (JGBs) underweight, moving it to neutral. In addition, we move overweight German Bunds as the economy continues to weaken. These positions add to our existing US duration overweight with a preference for US inflation protection. In EM, we move local bonds to underweight. The current index yield is unattractive, and reducing EM currency exposure provides some portfolio protection against tariff threats.
- We remain *underweight* **credit** via global high yield (HY) credit. US HY credit spreads have tightened due to lower-than-expected default rates. We stay underweight, anticipating some mean reversion in HY defaults in 2025, which implies wider spreads. Also, we reduce global investment grade (IG) debt to neutral due to unattractive spreads.
- Our **real estate** allocation remains neutral. The asset class offers long-term value if rates fall. However, we see better value in government bonds over the next year.
- We remain *overweight* in **commodities**. We increase our overweight to precious metals and expect the uptrend to continue as real rates fall and central bank purchases support prices. We also retain a small overweight to industrial metals.

Equities

Neutral

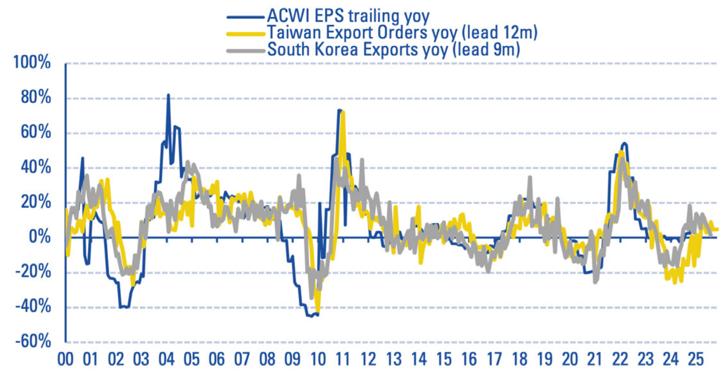
> *Equity market valuations are elevated, and the US index is highly concentrated. We maintain a neutral position while favouring the structural demand for AI via EM.*

Global Equity Indicators

	3Y history	Latest	
Global P/E		21.2	Nov
DM P/E		22.5	Nov
US P/E		27.4	Nov
Europe P/E		14.9	Nov
Japan P/E		15.0	Nov
EM P/E		13.7	Nov

Source: Bloomberg, MSCI

Chart 3: Taiwan Export Orders, South Korea Exports and ACWI Trailing Earnings growth



Source: Bloomberg

Asset	View	Chg	Commentary
Global equities	0	-	Short-term indicators remain supportive for equities, with the global composite PMI above trend and macro momentum still positive. Central bank cuts will also provide some support. However, we are more cautious over the medium term as valuations are elevated (especially relative to bonds and gold), and some labour market indicators suggest we are late-cycle.
US equities	0	-	US earnings continue to grow strongly, but a handful of large tech stocks dominate these. The US tends to outperform in a slower global growth environment, but the crowded long US position keeps us cautious, as valuations look stretched. Protectionist policies, if introduced, will also impact US multinational firms.
Eurozone equities	-1	-	Risks to earnings are skewed to the downside, with economic activity remaining weak. Earnings look vulnerable to being revised lower. As a pro-cyclical market, a global slowdown has historically resulted in Eurozone underperformance. The bloc is also vulnerable to tariffs under the new Trump administration.
UK equities	-1	-	Falling rates do not bode well for the more value-oriented UK large-cap equities. Excess OPEC+ capacity has weighed on oil prices, which is a headwind for equities due to the UK's high energy sector weighting.
Japan equities	0	-	In Japan, corporate governance reforms remain supportive and could unlock further value. On a more cautious note, a global economic slowdown and lower US rates are historically a headwind for the MSCI Japan Index. Likewise, the undervalued yen is a risk for future local market returns should it strengthen further.
EM equities	+2	-	EM equities offer exposure to the AI trade given the concentration of tech hardware and semiconductor industries in Taiwan and South Korea's stock markets. Moreover, EM valuations are much more attractive than the US. The US dollar remains expensive, implying risks are skewed to the downside, which historically benefits EM equities. US tariffs are a potential headwind.

Note: Up/down arrows indicate a positive or negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Rates

Overweight

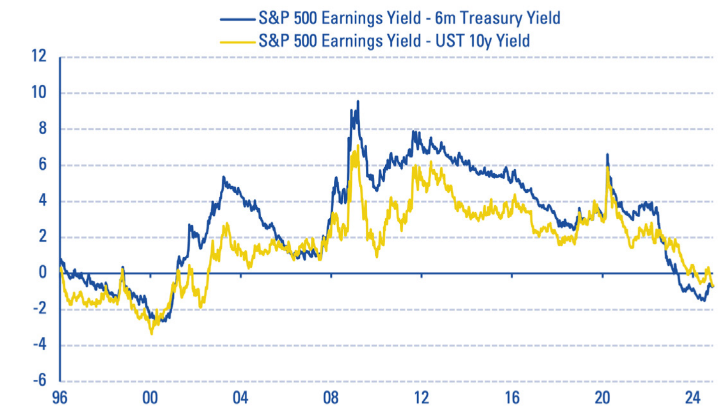
Most major central banks (ex-Japan) are expected to cut rates. Despite concerns over budget deficits, fixed income still offers protection in an economic slowdown. We prefer inflation-linked bonds.

Global Rates Indicators

	3Y history	Latest	
Global Govt Yield		3.0	Nov
UST 10Y Yield		4.2	Nov
TIPS 10Y Real		2.0	Nov
Bund 10Y Yield		2.1	Nov
Italy 10Y Yield		3.3	Nov
JGB 10Y Yield		1.0	Nov
EM Local Yield		3.7	Nov

Source: Bloomberg Barclays Indices, US Federal Reserve. Yield in %pts

Chart 4: S&P 500 Earnings Yield Spread, %pts



Source: Bloomberg

Asset	View	Chg	Commentary
USTs	+1	-	Policy rate cuts should provide support for US government bonds. A slowing labour market supports the case for rate cuts, and over the past year, inflation data has trended closer to the Fed's target. However, some of the Trump administration's policies may prove inflationary. There are also fears about the US fiscal deficit and the growing interest costs, though this is not exclusive to the US and may not affect UST auctions in the near future.
US TIPS	+2	-	US TIPS currently offer an attractive real yield and will likely benefit from Fed rate cuts. While not our baseline view, the credibility of the Fed's long-run inflation target could be tested during the second Trump presidency, and TIPS should offer some protection from this tail risk. Furthermore, if an increased use of tariffs pushes prices up, then inflation-linked bonds should benefit.
Bunds	+1	↑	The ECB is expected to cut rates further as the European economy weakens and inflation remains subdued. These factors should continue to support Bunds. We increase our position, funded by a reduction in European credit, given the tightness of corporate spreads.
JGBs	0	↑	Japan is the outlier among developed market central banks as they continue to raise rates and end their ultra-loose monetary policy – an unattractive backdrop for fixed income. The speed of future policy tightening will be determined by inflation and wage growth trends. Significant JPY volatility is also complicating the policy outlook. We removed our underweight following a period where the yen had weakened, and JGB yields rose.
EM local bonds	-2	↓	Emerging markets are particularly vulnerable to the implementation of tariffs and new protectionist policies from the US. EM central banks were earlier than their DM peers to hike rates and were also quicker to embark on rate-cutting cycles last year. These factors were favourable for EM local bonds. As a result, the EM spread relative to US Treasuries has tightened, leaving limited value to extract at current levels. We move to an underweight position, in part to hedge our overweight EM equity position.

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Credit

Underweight

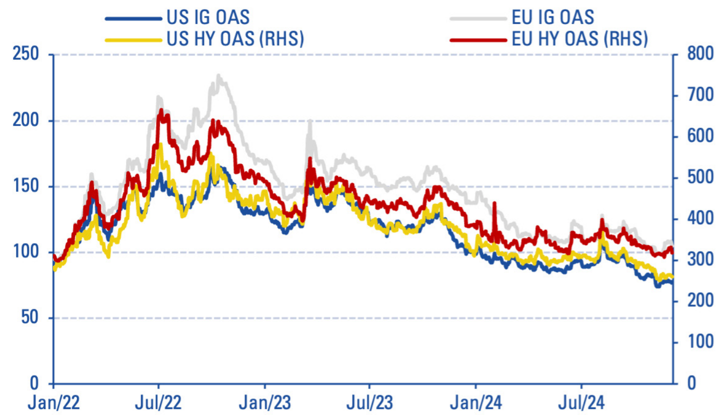
Global credit is vulnerable to a weaker growth backdrop, and the spreads do not currently offer adequate compensation.

Global Credit Indicators

	3Y history	Latest	
Global IG OAS		0.9	Nov
US IG OAS		0.8	Nov
US HY OAS		2.7	Nov
Euro IG OAS		1.1	Nov
Euro HY OAS		3.3	Nov
EM Sov $ OAS		2.6	Nov
EM Corp $ OAS		2.1	Nov

Source: Bloomberg Barclays Indices. Option-adjusted spreads in %pts

Chart 5: US and EU Corporate OAS (bps)



Source: Bloomberg

Asset	View	Chg	Commentary
US IG	0	↓	US corporate spreads remain tight due to resilient US economic growth. At current levels, IG offers limited potential upside relative to Treasuries. We still favour IG to HY, given that the higher-duration IG index should benefit from a broader rebound in fixed income assets and is less vulnerable in a possible slowdown. However, we move to a neutral position, preferring to be overweight gold and government debt.
US HY	-3	-	HY spreads are close to cyclical lows and are not priced for a significant rise in default rates. This scenario may happen if economic conditions deteriorate or companies are forced to refinance at higher rates. Even if one assumes the growth backdrop remains resilient, some modest mean reversion in default rates implies wider spreads.
European IG	0	↓	We have reduced our European IG position to neutral. Spreads have fallen to a level where investors are not adequately compensated for deteriorating economic conditions. Consequently, we reallocate the funds to Bunds.
European HY	-1	-	EU HY spreads remain tight relative to history, and default rates have risen steadily. If the European economic backdrop weakens further, for example, under the implementation of US tariffs, then this would keep default rates elevated. We see the risks being asymmetric towards wider spreads.
EM Sov $ credit	0	-	Spreads are tight relative to history. Lower US rates should support US dollar debt. In addition, a reversal in the USD trend is also supportive for EM debt. However, the threat of tariffs and further USD strength is a risk.
EM Corp $ credit	0	-	The EM corporate USD spreads are particularly narrow and do not offer an appealing entry point. Tariffs may cause EM corporate default rates to rise.

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Real Estate

Neutral

> *Early signs of a recovery are underway in the direct real estate market, but valuations are unattractive relative to government bonds.*

Asset	View	Chg	Commentary
Global Real Estate	0	-	In response to easier monetary policy, real estate is showing tentative signs of improvement as global direct transactions and investor sentiment appear to be bottoming out. Nonetheless, listed real estate still screens expensive against government bonds while retaining its value against equities. Meanwhile, there is bifurcation in the market, with the market recovery set to favour higher quality assets and sectors exposed to structural drivers such as nearshoring and demographics.

Note: Up/down arrows indicate a positive or negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Commodities

Overweight

> *We remain positive on gold amid easier Fed policy and structural demand from central banks, while copper still benefits from the shift to decarbonisation, despite tariffs posing a near-term downside risk.*

Asset	View	Chg	Commentary
Energy	0	-	President-elect Trump's policies of deregulating the US oil industry to boost output and tariffs are bearish for oil prices, particularly when the EIA is projecting the global market to tip into a surplus from 2Q 25. However, geopolitical tensions have increased speculative interest, and there is a risk that Trump could prove tougher on Iran and Venezuela. As such, we stay neutral.
Industrial Metals	+1	-	The near-term outlook for industrial metals is soft due to underwhelming stimulus from China and the prospect of tariffs. Additionally, speculative net long positioning suggests scope for further price falls. But beyond the near term, we are optimistic about the structural demand for metals from decarbonisation. Combined with constrained supply growth, the copper and aluminium markets are expected to be in a deficit, supporting prices.
Precious Metals	+2	↑	The post-US election dip in gold prices provides a good opportunity to add to our overweight position. The drivers of gold demand are still in place as gold looks able to benefit if nominal yields rise (due to US deficit concerns or currency debasement) or fall (Fed easing cycle) as the correlation between gold and US yields has weakened recently. Structurally, gold demand will be supported by central bank purchases amid de-dollarisation. For silver, whose industrial demand drivers make it more exposed to tariff risks, the deficit in the physical market should put a floor under prices.
Agriculture	0	-	Possible policies under President-elect Trump, ranging from tariffs to a Russia-Ukraine ceasefire, suggest a volatile price outlook for agricultural commodities. In addition, the anticipated La Niña weather phase is delayed and projected to be weak, meaning the weather outlook is also very uncertain. A low inventory base, except for soybeans, should limit price falls.

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KEY ASSET ALLOCATION INDICATORS *(All data shown are as at end-Nov 2024 unless otherwise stated)*

	ASSET ALLOCATION							PERFORMANCE						BENCHMARK INDEX & WEIGHTS	
	-3	-2	-1	0	+1	+2	+3	5Y	3Y	1Y	2023	Ytd	Sep-Nov		
EQUITIES				■				**71.3**	**24.9**	**26.1**	**22.2**	**20.3**	**3.8**	**MSCI ACWI**	**50%**
US				■				103.6	34.7	33.9	26.5	27.9	7.6	MSCI USA	25%
Eurozone			■					31.5	10.6	7.9	22.9	3.3	-6.8	MSCI EMU	7%
UK			■					33.9	28.8	15.6	14.1	10.6	-3.9	MSCI UK	3%
Japan				■				29.6	11.1	13.4	20.3	8.7	-3.8	MSCI Japan	5%
EM						■		17.1	-3.7	11.9	9.8	7.7	-1.7	MSCI EM	10%
RATES					■			**-12.7**	**-15.4**	**3.1**	**4.2**	**-1.1**	**-1.8**	**Bloomberg Barclays Global Treasury Total Return Index Value Unhedged**	**27%**
USTs					■			-2.4	-7.4	5.6	4.1	2.2	-0.4	Bloomberg Barclays US Treasury Total Return Unhedged USD	10%
US TIPS						■		11.9	-4.9	6.3	3.9	3.5	0.2	Bloomberg Barclays US Treasury Inflation-Linked Bond Index	3%
Bunds					■			-16.1	-18.3	2.2	9.3	-2.4	-2.4	Bloomberg Barclays Euro Aggregate Treasury Germany TR Index Unhedged USD	3%
JGBs				■				-33.7	-30.5	-4.2	-5.9	-9.0	-4.0	Bloomberg Barclays Asian-Pacific Japan Treasury TR Index Unhedged USD	5%
EM Local		■						-1.0	0.8	3.5	11.3	-0.2	-1.6	Bloomberg Barclays EM Local Currency Liquid Govt TR Index Unhedged USD	6%
CREDIT		■						**1.8**	**-5.6**	**7.5**	**9.6**	**3.1**	**-0.3**	**Bloomberg Barclays Global Aggregate Credit Total Return Index Value Unhedged USD**	**13%**
US IG				■				3.9	-4.9	8.7	8.5	4.1	0.6	Bloomberg Barclays US Corporate Statistics Index	4%
US HY	■							25.9	11.5	12.7	13.4	8.7	2.2	Bloomberg Barclays US Corporate High Yield Statistics Index	3%
European IG				■				-4.3	-7.9	4.5	12.0	0.5	-2.2	Bloomberg Barclays EuroAgg Corporate Statistics Index USD	2%
European HY			■					10.3	2.0	7.1	16.1	2.8	-2.6	Bloomberg Barclays Pan-European High Yield (Euro) Index Statistics USD	1%
EM Sov $				■				4.6	1.1	14.1	11.0	8.6	2.0	Bloomberg Barclays Emerging Markets Sovereign TR Index Value Unhedged USD	2%
EM Corp $				■				3.8	-2.0	11.2	6.7	7.9	0.8	Bloomberg Barclays Emerging Markets Corporates TR Index Value Unhedged USD	1%
REAL ESTATE				■				**-1.0**	**-6.0**	**17.5**	**8.7**	**7.8**	**0.1**	**FTSE EPRA/NAREIT Global Index Net TRI USD**	**5%**
COMMODITIES					■			**46.1**	**37.3**	**2.3**	**-4.3**	**5.8**	**0.4**	**S&P GSCI Total Return Index**	**5%**
Energy				■				32.2	55.4	-1.6	-5.2	3.7	-3.3	S&P GSCI Energy Total Return Index	2%
Industrial metals					■			43.1	-1.9	9.9	-4.5	5.9	1.2	S&P GSCI Industrial Metals Total Return Index	1%
Precious metals						■		72.0	46.3	28.6	11.5	28.0	6.4	S&P GSCI Precious Metals Index Total Return Index	1%
Agricultural				■				50.0	3.2	-5.7	-8.3	-2.5	5.7	S&P GSCI Agriculture Index Total Return Index	1%

Source: Bloomberg, CLIM

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