CITY OF LONDON
Investment Management Company Limited

Cross-Asset Quarterly Outlook

March 2025

Overview

Weighing Policy Uncertainty

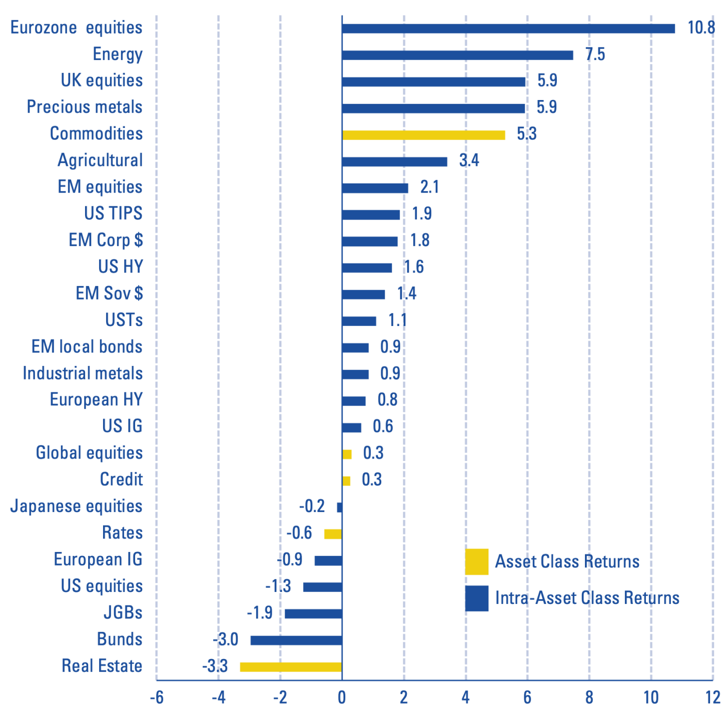
- *The post-US election market optimism has faded, with global equities underperforming US Treasuries.*
- *Tariffs and US policy uncertainty are rising, leading to increased market volatility and early signs of economic slowing.*
- *The Trump administration may tolerate weaker activity in the short term to achieve long-term goals, but significant market drawdowns could prompt policy adjustments.*
- *Market strategy is unchanged this quarter: overweight commodities (metals) and rates (preference for US duration), and underweight credit (global HY). We stay neutral equities.*

Our previous Cross-Asset Quarterly followed the re-election of President Trump. At the time, the market appeared to be anticipating a similar reflation dynamic to his first term in 2017. However, some of this optimism is fading, with global equities lower over the past three months both in absolute terms and relative to US Treasuries (see Chart 1). We assess these moves as a reflection of two main factors: 1) the equity risk premium is depressed, requiring a higher hurdle (i.e. robust earnings growth) to justify stock outperformance, and 2) the Trump administration has so far prioritised its tariff policy, creating a headwind for global growth and earnings. The key question is how much tolerance the Trump administration has for US economic and financial market weakness, particularly as policy uncertainty begins to affect activity.

One measure of US economic policy uncertainty is the Baker, Bloom, and Davis index (see Chart 2), which implies a sharp rise in market volatility. Historical spikes in market volatility (VIX) tend to correspond to weaker economic growth and earnings. There is evidence of some slowing based on higher frequency data. For example, the Atlanta Fed's GDPNow index sharply fell into negative territory in early March (see Chart 3). The large drop is mostly explained by trade data showing a significant front-loading of imports ahead of tariffs. Still, some other subcomponents are also decelerating in the nowcast estimate, while several other indicators are also signalling weakness - US economic surprises are negative, capex intentions have fallen, and consumer confidence surveys reflect greater concern about the outlook.

President Trump's March 5th speech to Congress acknowledged "there will be a little disturbance [from tariffs]", but "it won't be much". We expect the Trump administration to have some tolerance for weaker activity in the short term to achieve their longer-term policy goals (e.g. manufacturing reshoring). However, below-trend growth and a material equity market drawdown would likely motivate some course correction from the administration. For reference, the S&P 500 experienced a 19.5% drawdown between September and December 2018 as the US-China trade war intensified. At the time of writing, the S&P 500 is about 5% below its record high reached in mid-February. On a more optimistic note, global earnings expectations are still buoyant (ACWI +11% EPS growth for 2025), and sentiment appears to be improving in Europe and China despite tariff threats. The overall path for global equities is less clear over the coming months, keeping us neutral in our allocation.

Chart 1: Asset returns, Dec-Feb , %



Source: Bloomberg

**The publication reflects asset performance up to February 28, 2025, and macro events and data releases up to March 6, 2025, unless indicated otherwise.*

Asset Allocation

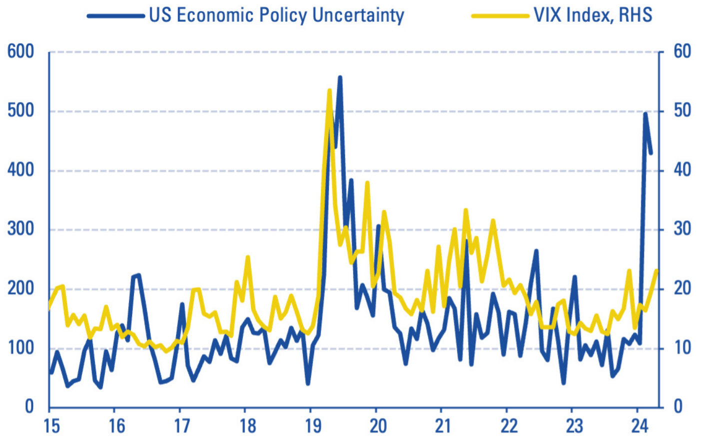
	Chg	-3	-2	-1	0	+1	+2	+3
EQUITIES	-				■			
RATES	-					■		
CREDIT	-		■					
REAL ESTATE	-				■			
COMMODITIES	-					■		

	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.

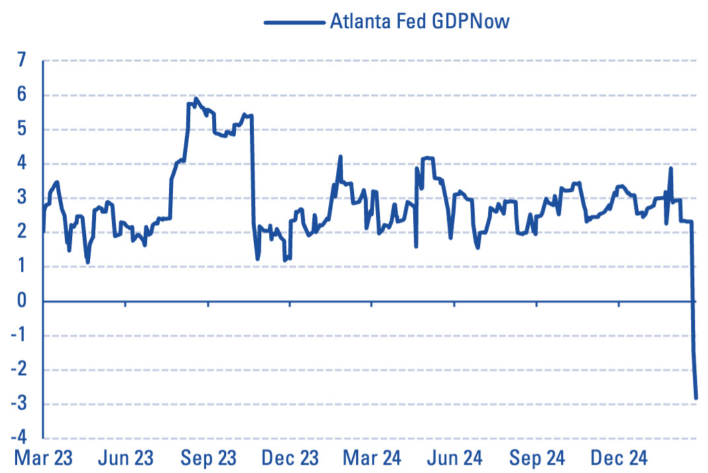
Source: CLIM

Chart 2: US Economic Policy Uncertainty and VIX



Source: Bloomberg and Baker, Bloom, and Davis

Chart 3: Atlanta Fed GDP Nowcast



Source: Federal Reserve and Bloomberg

In other asset classes, the Trump administration is providing more explicit guidance. Various key people, including Treasury Secretary Scott Bessent, have expressed a desire for "lower rates" and stated that the 10-year Treasury yield is a critical metric. The path for controlling rates with an independent Fed is less clear. Still, their explicit metric and focus on inflation and lower energy prices provide some confidence that rates will be a central consideration in policy. Rising interest payments and the growing US budget deficit leave the administration limited space to ignore one of their primary measures of success. Furthermore, should US rates continue tightening (relative to the rest of the world), that will weigh on the US dollar (see Chart 4). A USD depreciation aligns with President Trump's goal to improve domestic export competitiveness and reduce the US trade deficit.

Market Strategy:

President Trump's policies are disrupting previous market trends and keeping policy uncertainty elevated. However, the administration's goals and constraints provide enough information to develop a framework for navigating the coming months. We make the following allocation adjustments this quarter:

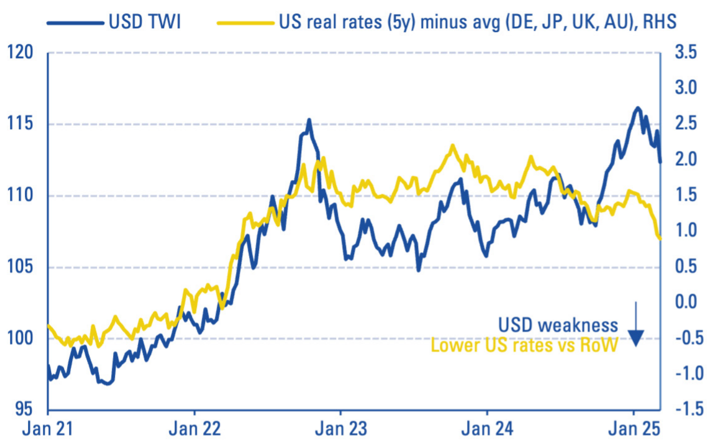
- We remain *neutral* on **equities**. The combination of tariffs, policy uncertainty, and unattractive valuations is a downside risk for global equities. However, more supportive policies in Europe and China, as well as structural growth in artificial intelligence (AI), provide some positive offset. We made some intra-equity adjustments. We favour overweights to Japan (upgraded) and EM, funded from the UK. We also upgraded Europe to neutral.
- In **rates**, we stay *overweight*. We continue to favour US duration. The Trump administration's bias for lower energy and rates provides further support for US bonds. We also remain overweight German Bunds and underweight EM local bonds.
- We remain *underweight* **credit** via global high yield (HY) credit. US HY credit spreads are closer to cyclical lows, providing a limited cushion for adverse shocks. We anticipate some mean reversion in HY defaults during 2025, which implies wider spreads.
- Our **real estate** allocation remains neutral. The asset class offers long-term value as rates fall. However, we currently see better value in government bonds.
- We keep our *overweight* in **commodities** via our overweight in both precious and industrial metals. A weaker USD environment is historically positive for metals. Our positive commodity view does not include energy (neutral), given the Trump administration is actively trying to lower energy prices.

*Justin Kariya***

March 6, 2025

This document includes contributions from Tom Traill and Yasemin Engin.

Chart 4: USD versus Rate Differentials



Source: Bloomberg

Equities

Neutral

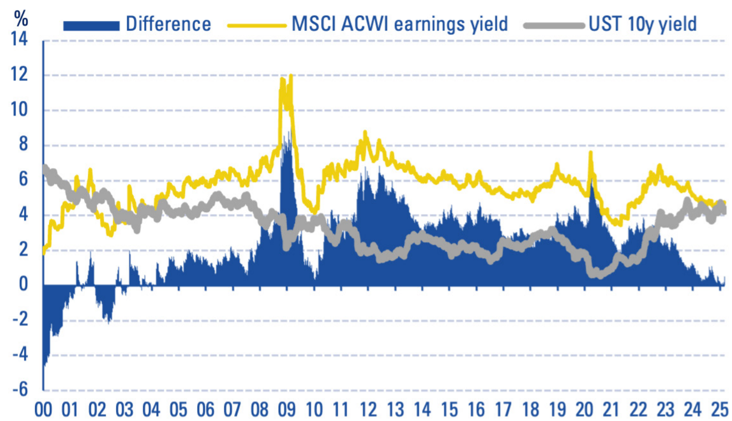
> *Equity market valuations remain elevated, and there is significant uncertainty surrounding the path of US trade policy. We maintain a neutral position while favouring EM and Japan.*

Global Equity Indicators

	3Y history	Latest	
Global P/E		21.0	Feb
DM P/E		22.2	Feb
US P/E		25.8	Feb
Europe P/E		15.6	Feb
Japan P/E		14.9	Feb
EM P/E		14.1	Feb

Source: Bloomberg, MSCI

Chart 5: Global equities are richly valued relative to Treasuries



Source: Bloomberg

Asset	View	Chg	Commentary
Global equities	0	-	Global equities have been impacted by growing uncertainty surrounding US trade policies. If global economic growth remains above trend, then equities can continue to outperform. On balance, equities are unappealingly priced, both relative to fixed income and to their historical average. We remain neutral.
US equities	0	-	The US index has seen strong earnings growth, but greater AI competition from China has added some additional risk for richly priced US tech stocks. US equities have begun to underperform international equity markets in recent weeks. US tariffs and policy uncertainty are weighing on US activity, which is a downside risk for earnings.
Eurozone equities	0	↑	The Eurozone economy still faces headwinds – not least the potential for US tariffs – but there have been signs that the data has troughed. Valuations are cheap. Adjustments to the German debt brake should boost industrial activity. We upgrade our position to neutral.
UK equities	-2	↓	UK large-cap stocks lack a catalyst for a re-rating. Earnings continue to lag the global benchmark. In addition, declining oil prices are weighing on the energy sector. We move slightly more underweight.
Japan equities	+1	↑	Japan's corporate governance reforms remain supportive and could unlock further value. Lower oil prices are historically beneficial for Japan. The yen is undervalued, implying some upside for unhedged USD-based investors. The equity market has cheapened while earnings remained strong. We move overweight.
EM equities	+1	↓	US tariffs are a potential headwind, but EM equities offer exposure to AI growth, given the concentration of tech firms in Taiwan and South Korea. Moreover, EM valuations are more attractive than the US. The US dollar has been cheapening but remains expensive. USD risks are skewed to the downside, which historically benefits EM equities. We remain overweight, but reduce our position compared to last quarter.

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

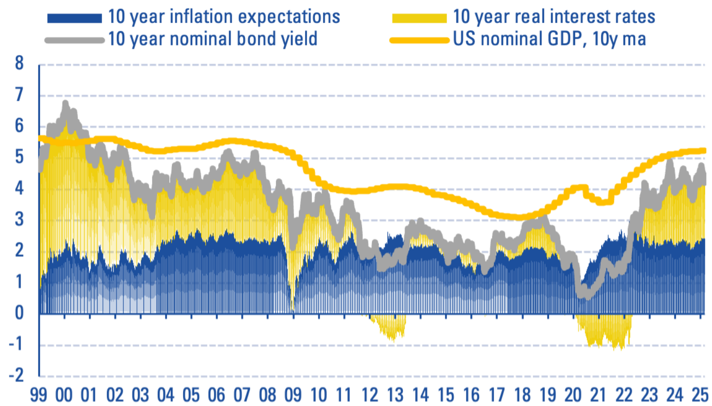
> *Developed market central banks (excluding Japan) are expected to cut rates further. The timing of additional cuts is less clear, given recent above-target inflation prints, but yields are attractive relative to other asset classes.*

Global Rates Indicators

	3Y history	Latest	
Global Govt Yield		3.1	Feb
UST 10Y Yield		4.2	Feb
TIPS 10Y Real		2.0	Feb
Bund 10Y Yield		2.4	Feb
Italy 10Y Yield		3.5	Feb
JGB 10Y Yield		1.4	Feb
EM Local Yield		3.6	Feb

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

Chart 6: US government bonds and nominal GDP (%)



Source: Bloomberg

Asset	View	Chg	Commentary
USTs	+1	-	Expectations for rate cuts have been scaled back as inflation remains above target. However, US policy uncertainty and tariffs have started to feed into growth concerns, supporting traditional safe haven assets such as Treasuries. The government's ability to reduce the fiscal deficit will likely come under more scrutiny later this year. Still, the Trump administration has effectively communicated its policy focus on lowering bond yields so far. We remain overweight.
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 coming years, 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. We remain overweight.
Bunds	+1	-	The ECB is expected to cut rates more than the US as the Eurozone economy is currently weaker and has lower inflation. These factors should continue to support Bunds. The Euro bloc is vulnerable to US tariffs, which if introduced, may cause a further slowdown in the region. A loosening of the German debt brake does open the door for a large increase in the supply of bunds; however, we do not expect the recent Bund selloff to persist. We remain overweight.
JGBs	0	-	The Bank of Japan is the only developed market central bank expected to raise rates. Inflation has become more robust, providing a supportive backdrop for further rate hikes. Although yields may continue to rise, the yen has fallen to a level where it appears cheap, and currency gains may outweigh any JGB weakness. We remain neutral.
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 quicker to embark on rate-cutting cycles. 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 remain underweight.

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Credit

Underweight

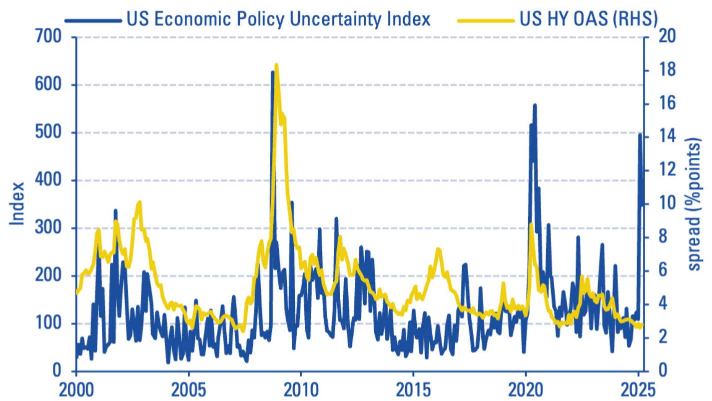
> *Global credit is priced for perfection in the face of rising uncertainty and rapidly evolving policies. The spreads do not currently offer adequate compensation.*

Global Credit Indicators

	3Y history	Latest	
Global IG OAS		0.9	Feb
US IG OAS		0.9	Feb
US HY OAS		2.8	Feb
Euro IG OAS		0.9	Feb
Euro HY OAS		2.8	Feb
EM Sov $ OAS		2.5	Feb
EM Corp $ OAS		2.1	Feb

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

Chart 7: High Yield spreads are not reflecting the current degree of uncertainty



Source: Bloomberg

Asset	View	Chg	Commentary
US IG	0	-	US corporate spreads remain tight. At current levels, IG offers limited potential upside relative to Treasuries. In addition, a recent rise in policy uncertainty may lift market volatility, which is typically associated with wider spreads. We maintain a neutral position.
US HY	-3	-	US HY spreads are at historically low levels and do not adequately compensate for the possibility of rising default rates. Scenarios such as a deterioration in economic conditions or a growing need to refinance at higher rates could lead to widening spreads, as could even a limited degree of mean reversion. As the chart above shows, spreads do not account for the recent rise in economic policy uncertainty. We remain underweight.
European IG	0	-	We keep our neutral European IG position. Spreads have fallen to a level where investors are not adequately compensated for the prevailing economic conditions or the increased uncertainty over their future path. Consequently, we prefer bunds.
European HY	-1	-	EU HY spreads remain tight relative to history, and default rates have risen. If the European economic backdrop weakens, for example, under the implementation of US tariffs, then default rates would likely rise further. We see the risks being asymmetric towards wider spreads and maintain our underweight position.
EM Sov $ credit	0	-	Spreads are tight relative to history. Lower US rates should support hard currency debt. In addition, a reversal in the USD uptrend is also supportive for EM debt. However, EM are vulnerable to US 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. We remain neutral.

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Real Estate

Neutral

> *Indicators from the direct real estate market suggest that the worst of the downturn is over. However, valuations are still not attractive enough against government bonds to justify a change in allocation.*

Asset	View	Chg	Commentary
Global Real Estate	0	-	Continued central bank easing and steady growth should help the ongoing improvement in investor sentiment, as evidenced by the acceleration in global transaction activity in the direct real estate market during Q4. The residential and industrial sectors should benefit from structural drivers such as demographics and nearshoring, respectively. There is still a bifurcation between prime and secondary assets, particularly in offices. Listed real estate's valuation against government bonds is still expensive, but it looks cheap against equities.

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Commodities

Overweight

> *We maintain our positive stance on gold as prices are supported by tariff uncertainty and central bank buying, while copper is set to benefit from the ongoing shift to decarbonisation.*

Asset	View	Chg	Commentary
Energy	0	-	The global oil market balance is projected to tip into a surplus from Q2, while President Trump's campaign promise to lower energy prices is bearish. The latter could be achieved through deregulation, a deal with Iran, a Russia-Ukraine ceasefire, or tax incentives. Meanwhile, US tariff threats pose a downside risk to prices by weighing on demand. The US natural gas market is tight, which should support prices, while the return of Russian gas is a bearish risk for European natural gas prices. Therefore, we maintain our neutral energy allocation.
Industrial Metals	+1	-	Amid a tentative turnaround in the global manufacturing cycle, the demand-sapping nature of tariffs and the absence of large-scale Chinese stimulus suggest a weaker price outlook for industrial metals. The US has already levied 25% tariffs on aluminium and steel, with copper likely next. However, we retain our overweight allocation as we are optimistic about the structural demand for metals from decarbonisation. This primarily impacts copper, with the copper market projected to be in a deficit from 2025 onwards, supporting prices.
Precious Metals	+2	-	Lofty valuations and stretched speculative positioning suggest some near-term pullback in gold prices is likely. However, central bank purchases amid de-dollarisation supports gold prices. Heightened geopolitical uncertainty from tariffs reinforce the de-dollarisation shift and helps to explain the weakening correlation between gold prices and real rates. Meanwhile, the projected deficit in the silver market should put a floor under prices.
Agriculture	0	-	Uncertainty over trade flows is high as US tariffs and retaliatory tariffs from targeted countries have included agricultural products. Negotiations and trade deals are likely to follow, similar to the US-China Phase One deal. As such, prices are likely to be volatile. The low inventory base for agriculture, except soybeans, should put a floor under prices.

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

KEY ASSET ALLOCATION INDICATORS *(All data shown are as at end-Feb 2025 unless otherwise stated)*

	ASSET ALLOCATION							PERFORMANCE						BENCHMARK INDEX & WEIGHTS	
	-3	-2	-1	0	+1	+2	+3	5Y	3Y	1Y	2024	Ytd	end Nov-end Feb		
EQUITIES				■				**82.5**	**30.0**	**15.1**	**17.5**	**2.7**	**0.3**	**MSCI ACWI**	**50%**
US				■				112.6	39.9	18.1	24.6	1.4	-1.3	MSCI USA	25%
Eurozone				■				59.8	27.9	10.6	2.6	11.4	10.8	MSCI EMU	7%
UK		■						59.3	25.1	18.7	7.5	8.9	5.9	MSCI UK	3%
Japan					■			41.4	15.9	0.7	8.3	0.2	-0.2	MSCI Japan	5%
EM					■			23.2	1.4	10.1	7.5	2.3	2.1	MSCI EM	10%
RATES					■			**-15.5**	**-13.1**	**1.5**	**-3.6**	**2.0**	**-0.6**	**Bloomberg Barclays Global Treasury Total Return Index Value Unhedged**	**27%**
USTs					■			-5.6	-3.5	4.9	0.6	2.7	1.1	Bloomberg Barclays US Treasury Total Return Unhedged USD	10%
US TIPS						■		9.7	-2.3	6.4	1.8	3.5	1.9	Bloomberg Barclays US Treasury Inflation-Linked Bond Index	3%
Bunds					■			-19.9	-17.3	-1.0	-5.7	0.5	-3.0	Bloomberg Barclays Euro Aggregate Treasury Germany TR Index Unhedged USD	3%
JGBs				■				-36.5	-29.7	-4.8	-13.1	2.8	-1.9	Bloomberg Barclays Asian-Pacific Japan Treasury TR Index Unhedged USD	5%
EM Local		■						-0.3	2.8	2.7	-2.2	2.9	0.9	Bloomberg Barclays EM Local Currency Liquid Govt TR Index Unhedged USD	6%
CREDIT		■						**-0.8**	**-0.6**	**5.4**	**1.1**	**2.3**	**0.3**	**Bloomberg Barclays Global Aggregate Credit Total Return Index Value Unhedged USD**	**13%**
US IG				■				0.4	1.1	6.6	2.1	2.6	0.6	Bloomberg Barclays US Corporate Statistics Index	4%
US HY	■							27.2	15.6	10.1	8.2	2.0	1.6	Bloomberg Barclays US Corporate High Yield Statistics Index	3%
European IG				■				-5.4	-4.8	2.5	-1.8	1.5	-0.9	Bloomberg Barclays EuroAgg Corporate Statistics Index USD	2%
European HY			■					12.3	6.7	4.6	1.4	2.1	0.8	Bloomberg Barclays Pan-European High Yield (Euro) Index Statistics USD	1%
EM Sov $				■				3.0	10.1	10.8	7.0	2.9	1.4	Bloomberg Barclays Emerging Markets Sovereign TR Index Value Unhedged USD	2%
EM Corp $				■				2.9	7.0	8.6	7.0	2.7	1.8	Bloomberg Barclays Emerging Markets Corporates TR Index Value Unhedged USD	1%
REAL ESTATE				■				**2.4**	**-7.3**	**9.2**	**0.6**	**3.6**	**-3.3**	**FTSE EPRA/NAREIT Global Index Net TRI USD**	**5%**
COMMODITIES					■			**76.0**	**10.6**	**5.7**	**9.2**	**1.9**	**5.3**	**S&P GSCI Total Return Index**	**5%**
Energy				■				74.2	15.8	1.9	9.9	1.4	7.5	S&P GSCI Energy Total Return Index	2%
Industrial metals					■			52.8	-14.4	9.8	2.8	3.8	0.9	S&P GSCI Industrial Metals Total Return Index	1%
Precious metals						■		72.8	45.0	37.3	26.1	7.5	5.9	S&P GSCI Precious Metals Index Total Return Index	1%
Agricultural				■				57.2	-9.8	4.3	0.4	0.4	3.4	S&P GSCI Agriculture Index Total Return Index	1%

Source: Bloomberg, CLIM

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