VAN LANSCHOT KEMPEN

INVESTMENT MANAGEMENT

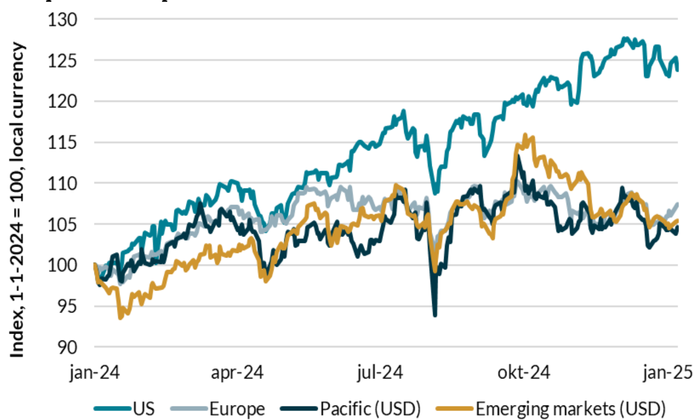
Asset Allocation Outlook

January 2025

- No end-of year rally but 2024 was a good year for US equities
- Rising bond yields hinder US equities but we remain positive
- Trends in emerging markets give us no reason to hold an overweight

There was no end-of-year rally in 2024. In fact, the final trading week in the US was the worst since 1952. Global equities declined in December, with the US posting a slightly larger loss than Europe in local currency. The Tokyo equity market climbed, but as the Japanese yen decreased in value this didn't benefit foreign investors. The lack of an end-of-year rally in the US isn't that much of a surprise. Up to the end of November, the S&P500 had noted an upturn of 26.5%. Such a strong rally makes it difficult to accelerate further at the end of the year. The S&P500 recorded an increase of 23.3% over 2024, far higher than Europe (6.5% in euros), Pacific (6.7% in US dollars) and emerging markets (5.4% in US dollars).

US equities under pressure



Source: LSEG, Van Lanschot Kempen

The exceptionally impressive performance in the US was driven largely by the Magnificent 7, which make up over 30% of the index. Based on the total return, so including dividends, the performance was 25.0% in the US (in US dollars), 10.1% in Europe (in euros), 8.1% in emerging markets and 7.3% in Pacific (both in US dollars).

Equities outperformed the safer bond asset classes in 2024. Rising long-term bond yields are squeezing government bonds, with only a downturn in short-term yields in the Eurozone providing relief. On balance, returns on US government bonds were almost zero, while government bonds from Eurozone countries earned a return of 1.8%. With yields rising at the short and the long end in the UK, the return on Gilts was negative in 2024. Tighter spreads meant that returns on investment grade credits were slightly higher but still lower than the worst-performing equity region. At a return of over 8%, high yield credits managed to outperform emerging market equities by a small margin. Real estate had a difficult year due to rising capital market yields. The total return on the global index was only just positive. The US noted a stronger positive result and Europe a negative return. Commodities earned a positive return of 5.4%. Oil prices fell on balance, despite geopolitical tensions, while metals were squeezed by the weak Chinese economy. Gold stood out at a price gain of 27.1%.

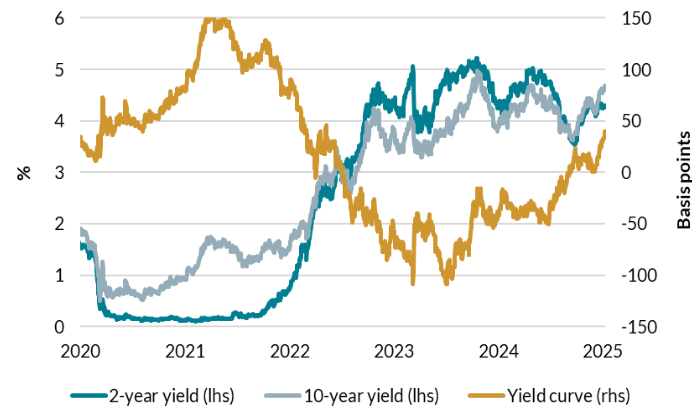
We've made no changes to our investment policy since early November when we reduced European equities to a neutral weight. We head into 2025 with an equity overweight concentrated in the US. Within US bonds, we prefer government bonds to investment grade credits. In contrast, in the Eurozone we prefer investment grade credits.

US equity markets less optimistic

The euphoria on the US equity markets following the presidential elections dissipated somewhat in December. Shortly after the elections, the S&P500 passed the 6,000-point mark, shooting up towards 6,100 points in early December. After a volatile second half of December, the index closed 2024 below 5,900 points. The weakness extended into the first weeks of 2025.

There are two reasons for this in our view. Firstly, the downside of potential economic measures from the yet to be formed Trump administration is now clearer. Import tariffs also have a negative impact on US businesses and US consumers as many products will become more expensive. This fuelled fears of the second reason, namely inflation and fewer cuts to interest rates. On 18 December, as widely expected the Fed cut interest rates by 25 basis points but was also much more cautious about future rate reductions.

Steeper US yield curve due to higher long-term yields, despite Fed cutting interest rates

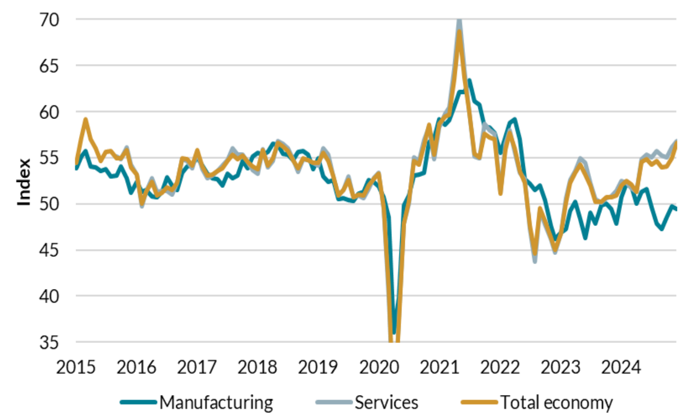


Source: LSEG, Van Lanschot Kempen

The remarks from policymakers after the meeting were dominated by a slower pace of interest rate cuts. One policymaker wants to keep rates restrictive for longer, another thinks inflation is uncomfortably above the Fed's target rate and a third said there was still work to do on inflation. The Fed also published new growth, inflation and interest rate projections on 18 December. These confirmed the picture of an economy that's slowing slightly, but the forecast for inflation was higher. It looks as if some of the policymakers have already incorporated the potentially inflationary effects of Trump's policies into their projections. The median projection for all policymakers only contains two interest rate cuts this year. Incidentally, this is reasonably in line with what the market thought prior to the meeting. Yields nevertheless climbed in the US. Ten-year yields increased to 4.7% at the start of January, their highest level since April 2024. What's also remarkable is that 2-year bond yields have risen from 3.6% to 4.3% since the Fed started cutting interest rates in September. This derives from the market's strongly reduced expectations for the total number of cuts. It was the upturns in yields in December and early January that had an adverse effect on equities.

Looking forward, we're positive about US equities, mostly because of the strength of the US economy. Leading indicators have corroborated this in recent weeks. Although the purchasing manager index (PMI) for industry declined marginally, the ISM index for industry was in fact higher. The upturn in new orders was particularly encouraging. The PMI for the service sector even climbed to its highest level since October 2021 and is pointing to sound growth.

Positive mood among purchasing managers in US service sector



Source: LSEG, Van Lanschot Kempen

The level of optimism among small businesses, which received a boost after the elections, also stands out. On the job market, at the end of December the number of weekly jobless claims dropped to its lowest level since April, while job creation accelerated in December. We don't anticipate much further upturn in US yields for 2025; instead, we see potential for yields to come down slightly from current levels. This means that interest rate markets won't hinder equity markets, enabling the latter to climb in line with the growth in corporate earnings.

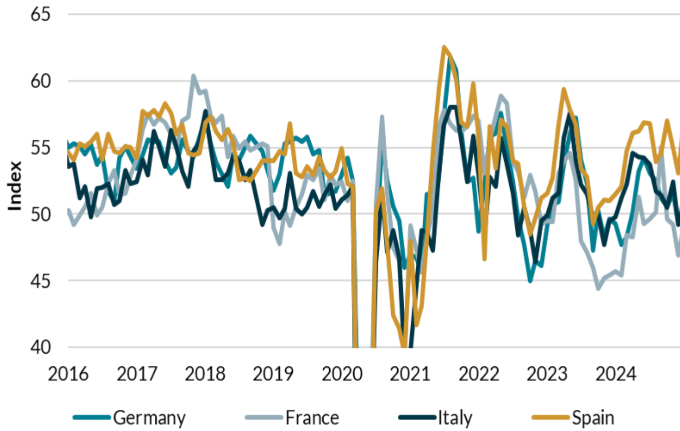
Mixed picture in the Eurozone

European equities have been displaying close to a sideways trend since September 2024. Realised corporate earnings have been moving sideways since 2023 and expected earnings for 2024 and 2025 have been adjusted downwards over the past year. This is despite economic growth accelerating in the course of 2024 to about the long-term trend rate in the third quarter, consumer incomes rising and unemployment remaining low.

Leading indicators also provide a few bright spots. Following a downturn in the PMI for the service sector to

below 50 in November, the index returned to a level that points to growth in December. France was the only sizeable country still pointing to contraction, while the exuberant optimism of the Spanish service sector stands out in the medium-sized economies.

PMIs for service sector in Eurozone cautiously optimistic



Source: LSEG, Van Lanschot Kempen

The industrial sector remains weak, however, especially in Germany and France. Spain is also doing well in this respect. The PMI for the whole Eurozone economy stands at just below 50, pointing to stagnation. The sharp downturn in the Economic Sentiment Index in December points to a downside risk for economic growth.

If the economy continues to grow, as we anticipate driven mainly by consumers, and earnings expectations are adjusted downwards by a large enough amount, we think there's capacity for European equities to climb. We expect the ECB to cut interest rates further, which will also provide a boost. Valuations are less of a barrier here than in the US. However, we don't think that moment has arrived yet, all the more so as potential import duties in the US pose a risk to the sentiment on European equities.

With a modest outlook for economic growth and inflation in December right in line in the eurozone, we do not see a strong reason for a rise in bond yields. We think rising yields in Germany were mainly driven by higher US yields. We think this largely applies to the UK too. The Bank of England left rates unchanged in December, but more policymakers then expected voted for a rate cut. The stronger rise in UK bond yields may have been driven by a weaker fiscal position than in the eurozone on average and a stronger dependency on foreign capital. The Gilt crisis of 2022 may also still be in investors' memories. Anyway, we see potential for falling yields in Europe, but only once the dust settles in the US government bond market.

Emerging market equities lag behind

Emerging market equities enjoyed an upward trend in the first half of 2024, received a boost from the announcement of stimuli in China in September but subsequently fell again. That weak phase at the end of 2024 is visible in a range of countries. In China, it was because the announced policy measures are still inadequate for tackling the structural problems. Monetary stimulation has little effect in an economy grappling with high levels of debt and where there's little consumer confidence. Lending growth has declined over the past year, despite the central bank cutting interest rates and introducing lower reserve requirements for banks. Retail growth is weak; industrial growth is marginally better. Yet industry is being adversely affected by strong price competition, which translates into declining corporate earnings. The PMIs for the service sector have bounced back slightly in recent months but there's little visible improvement in industry. Chinese growth could improve somewhat in the short term, but we think it's unlikely to persist. The bond market also expects ongoing weakness in the Chinese economy and low inflation. Yields on Chinese 10-year government bonds have fallen to 1.6%, their lowest-ever level. In comparison, in Japan, where the central bank is raising interest rates, yields on 10-year government bonds have risen to 1.2%. Chinese 30-year bond yields are even well below their Japanese counterparts.

Chinese 30-year bond yields point to a Japanese scenario

Source: LSEG, Van Lanschot Kempen

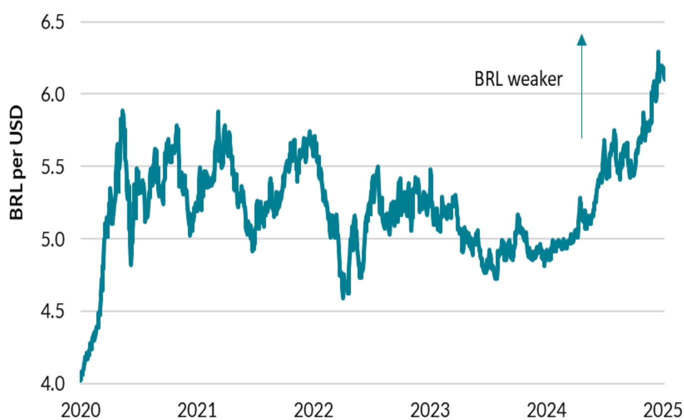
South Korea, another powerhouse in the MSCI emerging market equities index, is likewise struggling because of the weakness in global industry. After surging to over 50 in November, the PMI for industry dropped back below that level in December, pointing to stagnation. The country also has high levels of consumer debt, which has had a greater impact since the central bank raised interest rates. The Bank of Korea has since cut rates again twice, but with inflation rising slightly in recent months and a depreciating Korean won, the question remains whether rates will be

reduced further. On top of this, the country is experiencing political turmoil.

In Asia, Taiwan is doing better. Unlike the surrounding countries, Taiwanese industry is much more focused on the tech sector. In November, industrial production was up by over 10% in a year and the PMI points to ongoing growth. The Taiwanese equity market also outperformed the MSCI index for emerging markets in 2024.

The Brazilian equity market has experienced difficulties in the last few months. It noted a loss of about 10% over 2024 as a whole. There's little noteworthy about growth, although at an average of 2.8% over the last four quarters, the rate ought to be slightly higher for an emerging market. Industrial growth was slightly higher at about 4%. Corporate earnings are being squeezed hard, however. Leading indicators are moderately positive. Inflation is rising in Brazil though and was close to 5% in November. The central bank raised interest rates three times in 2024, in December by a full 1 percentage point. Ten-year bond yields have risen to almost 15%. The Brazilian central bank is always quite activist about its interest rate policy, leading to periods of aggressive interest rate hikes interspersed with periods of sharp cuts to rates. In addition, national debt is rising fast. The market's lack of confidence in the Brazilian economy is visible in the value of the Brazilian real, which has dropped to its lowest level in decades.

Sharp depreciation in the Brazilian real



Source: LSEG, Van Lanschot Kempen

Alongside specific challenges for individual countries, US import duties pose a risk for all emerging markets. These will initially be directed mainly at China, but if the US sees signs of Chinese trade being rerouted via other countries, duties could quickly be introduced for those countries as well.

Emerging market equities are cheap but there's good reason for this. Incidentally, earnings growth has improved marginally. After an almost continuous downturn in earnings between 2022 and mid-2024, earnings reverted to growth in the second half of 2024. The most recent data nevertheless point to stagnating realised earnings and declining expected earnings. We've retained our neutral position in emerging markets.

Investment policy unchanged

Just before the US elections, we reduced the European equity weight in our model portfolios from an overweight to neutral. We had already harboured doubts about earnings trends in Europe and foresaw risks for Europe if Trump were elected president. We maintained our overweight in US equities though, as economic growth and earnings growth are stronger there. This has so far proved to be the right decision. European equities have remained almost unchanged since then, while US equities have climbed slightly. We've opted to retain this preference now as well. US equities are expensive, but we don't expect that to change much in the next few months. After the upturn in bond yields in recent weeks we anticipate this headwind dying down. The main reason for us adopting an overweight in the US, however, is the stronger dynamics in the economy and corporate earnings.

For government bonds, we continue to expect that coupon rates will largely determine returns, although it's true that US government bonds are now more attractive following the upturn in yields. Within government bonds we therefore prefer the US and within US investment grade we prefer government bonds to credits. Spreads on US credits are tight. They only need to widen slightly to squeeze returns so that these are lower than those on government bonds. We likewise find spreads on high yield credits too tight.

Real estate is sensitive to interest rates. As we don't anticipate any significant movements in rates in 2025, we assume that interest rates will have little effect on listed real estate. Versus interest rates, valuations are expensive for global developed real estate and neutral for Europe; it's for this reason that we haven't taken a position in real estate. Supply/demand ratios aren't positive for commodities. The weakness in global industry and declining growth in China are restricting demand, while there's a plentiful potential supply of oil.

Tactical outlook

Asset class	
Equities	**Overweight**
The MSCI global equity index declined marginally in December, with a slightly larger loss in the US than in the other regions. This was mainly prompted by rising bond yields, in response to the prospect of the Fed making fewer cuts to interest rates. Other potentially negative aspects of the new Trump administration's economic policy also adversely affected US equities though. We've retained our underweight, which is concentrated in the US. US economic growth and earnings growth are both sound and we still expect the Fed to reduce interest rates a couple of times in 2025. In Europe, we anticipate low growth, while earnings trends are even less strong. We've maintained our neutral position in this region. This also applies to the Pacific region. US import duties pose a risk for emerging markets and in our view economic trends in a number of large economies aren't robust enough for us to adopt an overweight. We've retained our neutral position in this region as well.	
Government bonds	**Neutral**
Bond yields climbed in December. Short-term yields rose by less than long-term yields in the US, UK and Germany. In the US, the upturn in yields was primarily driven by the Fed, which offered up the prospect of higher inflation and fewer interest rate cuts at its December policy meeting. In Europe, monetary policy expectations were largely unchanged, but bond yields mostly mimicked the upward movement in the US. We potential for yields to come down in the US and in Germany. In the Eurozone, a high number of interest rate cuts have been priced in, while the number stands at just one in the US. If US inflation comes down further and growth eases somewhat, as we expect it to, this might give the Fed room to implement more cuts. The potential introduction of import tariffs could well pose an upward risk for inflation in this respect. A small overweight in US government bonds and a small underweight in the Eurozone combine to form a neutral position.	
Investment grade credits	**Underweight**
Spreads on US investment grade credits were unchanged in December. At 82 basis points, spreads are 40 basis points below the average over the past five years. Just how tight spreads are is demonstrated even more clearly by the fact that they briefly reached their lowest level since 1998 in December. Such tight levels make US investment grade credits unattractive versus government bonds in our opinion. The economic outlook for the US is sound in the short term, but spreads only need to widen by a small amount for investment grade credits to underperform versus government bonds. Spreads tightened by a few basis points in the Eurozone. Eurozone spreads are tight too but less extreme than in the US. Spreads account for a much larger portion of the total interest compensation in the Eurozone than in the US. This reflects the less positive outlook for the Eurozone. Moreover, investment grade credits in the Eurozone are less sensitive to changes in interest rates than their US counterparts. Within investment grade credits we therefore have a relative preference for the Eurozone versus the US.	
High yield credits	**Underweight**
US and Eurozone spreads on high yield credits moved in different directions in December. US spreads widened by 20 basis points, while Eurozone spreads tightened by 30 basis points. In the US, the increase matches the loss on the equity market. Higher bond yields are also negative for high yield credits, as companies in this asset class are often more aggressively financed (i.e. have a larger amount of debt) and more frequently at flexible interest rates. We can discern no obvious reason for the contraction in spreads in the Eurozone. December's movements in the US and Eurozone are virtually the reverse of those in November, which means that on balance there's been little difference between the two regions in the last two months. Our outlook for high yield credits hasn't changed. We think spreads are extremely tight, making this asset class unattractive in relative terms versus government bonds. Even if the economy continues to grow over the coming quarters, we still view the spreads as small. This is because companies will face higher interest charges. Furthermore, we know that if the solid sentiment on this market deteriorates, the liquidity of these bonds will quickly dry up and spreads will widen. The tight spreads mean there's less upward potential in this class than for equities.	
Emerging market debt	**Neutral**
In December, yields on emerging market debt issued in US dollars climbed in response to the higher underlying yields in the US. Spreads contracted though. A small upturn in yields was also visible for bonds listed in local currency. Currency movements meant that the return in euros was flat to marginally positive. Spreads on emerging market debt in US dollars remain attractive, despite the contraction and the bonds now enjoying a more neutral valuation than other asset classes. This attractiveness is mostly to be found in the weaker countries though. Little risk premium has been priced in for the other, more robust countries. Growth is sound in emerging markets and there's relatively little exposure to Asia compared to emerging market equities or bonds issued in local currency. This reduces their vulnerability to Trump's import tariffs, although they are of course still a risk. We still expect the Fed to cut interest rate a couple of times in 2025, which will boost this asset class, although the Trump administration's policies are also a factor here. The interest compensation on emerging market debt in local currency is too low compared to developed countries. Currencies could likewise be squeezed by Trump's import tariffs.	

Asset class	
Listed real estate	**Neutral**
Listed real estate has underperformed versus general equities since 2022-2023 when interest rates climbed. Higher interest rates made rental yields less attractive in relative terms and led to higher interest charges for property companies. Since then, this asset class has moved closely in line with interest rate expectations. Yields have been rising since mid-September and continued to do so in December. This has adversely affected listed real estate, which noted negative returns in December in the global developed, US and Europe regions. In addition, apart from the office sector, vacancy levels are low. Rental growth is being boosted by inflation and economic growth. We expect this to continue given the small supply of new properties in the real estate sector. We hold a neutral outlook for this asset class. Valuations are relatively low versus general equities. Versus interest rates, global developed listed real estate is expensive and European real estate has a neutral valuation in our opinion. Transactions remain at low levels but an increase in transactions in 2025 will create greater clarity on the value of the underlying properties.	
Commodities	**Neutral**
The Bloomberg general commodity index climbed by 1% in December. Oil prices increased by a few percent, while the price of metals and gold declined slightly. We see no reason to change our neutral position in commodities. The OPEC countries have maintained their production restrictions but have sufficient capacity to increase production if demand permits this. The weakness in global industry and China is likewise squeezing the upward potential for oil prices. We see little upward potential for metals for the same reason. The price of gold remains high. We think the gold price is mainly being shored by up by the gold purchases of central banks. It's impossible to predict how long this will persist. Gold is an interesting investment at times of uncertainty but given its high price a large amount of uncertainty and/or lower interest rates have already been priced in.	

Market review

Equities

	Index	Past month	Past 3 months	From 31-12-2022
Global (MSCI AC)	939	-6.2%	-5.9%	6.5%
Developed markets (MSCI World)	2800	-6.4%	-5.8%	7.6%
Emrging markets (MSCI EM)	939	-4.7%	-6.6%	-1.8%
United States (S&P500)	4229	-6.3%	-5.1%	10.2%
Eurozone (EURO STOXX 50)	4096	-4.4%	-6.9%	8.0%
United Kingdom (FTSE 100)	7470	0.1%	-0.8%	0.2%
Japan (Topix)	2275	-3.2%	-2.0%	20.3%
Netherlands (AEX)	720	-3.5%	-7.3%	4.4%

Government bonds (10-year)

	Yield (%)	Past month (bp)	Past 3 months (bp)	From 31-12-2022 (bp)
United States	4.80	62	94	92
Japan	0.77	13	36	35
Germany	2.97	42	53	40
France	3.53	46	56	42
Italy	4.24	-13	65	-9
Netherlands	3.32	43	53	41
United Kingdom	4.60	17	16	93

Investment grade credit

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2022 (bp)
United States	126	7	-34	-4
Eurozone	155	-1	-6	-12

High yield bonds

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2022 (bp)
United States	420	54	33	-49
Eurozone	449	-7	-1	-63
Emerging markets (USD)	441	23	-107	-11
Emerging markets (Local currency)	205	-7	-7	-81

Real estate

		Past month	Past 3 months	From 31-12-2022
Global		-6.7%	-6.8%	-6.8%
North-America		-8.2%	-9.0%	-7.3%
Europe		-5.5%	-1.1%	-9.9%

Commodities

		Past month	Past 3 months	From 31-12-2022
Bloomberg index		-2.6%	3.6%	-4.7%
Base metals		-3.2%	-0.6%	-9.7%
Brent oil (USD per barrel)	90.92	3.6%	23.0%	11.4%
Gold (USD per troy ounce)	1825	-6.4%	-5.4%	-0.1%

Returns in local currency
bp = basis point (0.01%)
Data as of 10 January 2025
Source: LSEG

Author

Joost van Leenders
Senior investment strategist
j.vanleenders@vanlanschotkempen.com
M +31 6 82 83 11 89

Van Lanschot Kempen Investment Strategy & Tactical Asset Allocation

Yaela van Raalte – Head Investment Research
Luc Aben – Chief Economist
Pieter Heijboer – Head Investment Strategy
Joost van Leenders – Senior investment strategist
Jorn Veeneman – Senior investment strategist
Danny Dekker - Investment strategist

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INVESTMENT MANAGEMENT

Beethovenstraat 300
1077 WZ Amsterdam
Postbus 75666
1070 AR Amsterdam

T +31 20 348 80 00
vanlanschotkempen.com/investment-management