2025 Global Market Outlook Webinar Transcript

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Panelists:

- Arif Husain, CFA®, Head of Global Fixed Income and Chief Investment Officer
- Stephon Jackson, CFA ®, Head of T. Rowe Price Investment Management
- Sébastien Page, CFA®, Head of Global Multi-Asset and Chief Investment Officer
- Blerina Uruçi, Chief U.S. Economist
- Justin Thomson, Head of International Equity and Chief Investment Officer

Moderator:

- Ritu Vohora, CFA®, Investment Specialist, Global Capital Markets

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Ritu Vohora

Hello and thank you for joining us for the T. Rowe Price 2025 Global Market Outlook: Investing during transition.

I'm Ritu Vohora, an investment specialist covering global capital markets. My role is to provide clients with a broad perspective into the views of our multi-asset, equity, and fixed income investors at T. Rowe Price.

2024 has been a remarkable year. The S&P 500 has hit 50 record highs and counting so far this year. Gold is on track for its best performance in 45 years and Bitcoin has crossed the $90,000 threshold. Meanwhile, bond yields have been on a roller coaster ride, as markets have tried to anticipate policy shifts. The much-anticipated rate cutting cycle has begun, with 71% of global central banks cutting rates this year. But all eyes have been on the Fed, as good progress on inflation and a softening of labor markets enabled to move to less-restrictive policy.

In recent weeks, markets have also cheered a decisive end to political uncertainty in the race to the White House that had prevailed in the months leading up to the U.S. election. But with the prospect of higher tariffs and lower taxes under Republican government, what are the economic and market implications? To help us understand what this all means for asset markets as we look ahead to 2025, joining me in the London Stock Exchange studio today are:

Justin Thomson, head of International Equity and CIO. Welcome, Justin.

Justin Thomson

Thank you, Ritu.

Ritu Vohora

And another regular on this panel, Arif Husain, head of Global Fixed Income and CIO. Welcome, Arif.

Arif Husain

Right.

Ritu Vohora

And last, but definitely not least, Sébastien Page, head of Multi-Asset and CIO. Sébastien is also author of “Beyond Diversification” and a soon-to-be-released book on the psychology of leadership. Congratulations, Seb, on your new book, and welcome.

Sébastien Page

Thank you, Ritu.

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Ritu Vohora

And it's great to have you in the studio with us in London. So thanks for being here.

Sébastien Page

Yes. Excited to be here.

Ritu Vohora

We'll also be hearing from Steph Jackson, head of T. Rowe Price Investment Management and Blerina Uruçi, chief U.S. economist, who joined me from our Baltimore studio earlier this week to discuss the U.S. economy and the opportunity set in U.S. equities.

So let's kick into the conversation, and before we get stuck in, I just want to get a sense of your view as we look ahead to 2025. The Trump trade is in play, stocks seem to be in euphoria, but when I look at bond markets, we're seeing high yields and a lot more volatility. So quick fire round.

Are you bullish or bearish, Justin?

Justin Thomson

Well, when I started my career, we had a third dimension; had lots of Scots in our office. We used to say, ‘bullish, bearish, or Scottish.’ I would say Scottish, trending bearish.

Ritu Vohora

Scottish trending bearish. Arif?

Arif Husain

I think both. Uncertainty is high. We're going to see a lot of volatility.

Ritu Vohora

OK. And Seb?

Sébastien Page

Wait, you're both bearish and bullish?

Arif Husain

Of course.

Sébastien Page

OK, I'm moderately bullish.

Ritu Vohora

OK, that’s interesting. And it’s an interesting perspective, not to have a consensus view, because when you look at the broader market narrative, the bullish consensus is pretty much broad-based.

So Seb, maybe I can start with you. Let’s look at it from a flip-side of the conversation. What's the bearish narrative and what are the bears missing?

Sébastien Page

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OK, so you want me to play devil's advocate, I suppose. Have you heard bears on tv, recently? I haven't heard any. Let me try to squeeze a bearish narrative from the data. I haven't heard any. Unemployment is rising. Historically, that is a bearish signal for the economy.

Second, manufacturing is slowing. The Purchasing Manager's Index is at 47. That indicates contraction in manufacturing in the U.S. data. And third, the yield curve is disinverting, which is historically a recession signal.

So if you take those three and you can even run models and show that the probabilities of recession are high. But let me play…to your question...What the, what are they missing? Let me play devil's advocate on that devil's advocate position. I think the bullish narrative is much more compelling.

The Citi Economic Surprise Index is going up and up for the last three months in the U.S., Atlanta Fed GDP now, which is a nowcast of the economy, it's about 50 basis points higher than it was at the beginning of the year. The Purchasing Manager's Index for services is at 56, which is massively expansionary. The Fed is easing into easy conditions.

Fiscal spending is pedal to the metal, 6-7% of GDP. We're talking about lower taxes, we're talking about deregulation. Corporate earnings are going up, and on and on and on. So I think the bullish narrative overwhelms the bearish narrative.

Why am I only moderately bullish? It comes down to valuations. Valuations are elevated and I know we're going to talk about that today.

00:08:23 Ritu Vohora

So coming to Arif now, you know, Seb's talked around kind of the bullish and the bearish narratives. And we were at the UK Conference here in September when the Fed had just cut by 50 basis points. It was the big news and you said the Fed is eye-catching, but it can be deceiving. What really matters for markets is going to be the U.S. election. Now that we have a result, what's your outlook on markets?

00:08:50 Arif Husain

I think I'll stand by that statement. So that we'll talk a lot about the Fed today, but they are largely on autopilot. They're kind of boxed in. They did their eye-catching 50 basis points and then we're shocked as data started to accelerate. So they're all, yeah, all autopilot, let's say for the Fed for a little while.

And in terms of the U.S. election and to go back to my previous answer, why I'm neither bullish or bearish at the moment. I think you're going to see extreme outcomes, essentially, and the reason I believe that is, is because we now have, we know the result of the election. You've got this clean sweep.

You've also got China stimulating. You've got Japan doing quantitative tightening. There's a lot going on in the world, as well as some of the geopolitical events happening. So I think that area of volatility uncertainty, even though we've got the results of the election, is still very, very high.

Now, in terms of that election, you have a clean sweep, right? So there is no real control, there's no opposition. What is the limiting factor? I think the market's going to play that role. So the Trump trade is alive and well—until it isn't and the market rebels back against it. So for me, I think it's really important to focus on the signal rather than the noise. And unfortunately, we're going to see a lot of noise, very little signal, certainly over the next two to three months. So very, very important, you know, fade any extreme in the markets and really, just look at what really is going on underneath all the noise.

00:08:08 Ritu Vohora

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That's a really good point and I think for investors take away, it's so easy to caught up in the headlines, but focusing on the fundamentals is really going to matter.

So coming to you now, Justin, Arif talked there about China sort of easing policy and we've seen more recently they have shifted to provide some stimulus to help support the economy. But we haven't seen the fiscal bazooka, particularly given a Trump win, and that's kind of dampened the mood in China. How do you see the role of China playing out in the global economy?

00:08:37 Justin Thomson

Well, let's be clear about what they have done and what they haven't done.

So what they have done is backstop the equity market in China with a very large fund that enables corporates to buy back their stock. They've recently backstopped local government finances with a big local government debt for central government swap. In terms of fiscal, what we haven't heard yet, we haven't heard anything about consumption, and we haven't heard really about material measures to deal with the underlying problem of the economy, which is unsold housing stock.

To your point about Trump and the impending threat of tariffs, I think they're keeping some powder dry. They're keeping some powder dry and may respond with fiscal response once they've seen what's in front of them. They have several, there's several measures: direct fiscal-to-consumer, they may, they may devalue the currency, which won't be good on a headline level for markets.

But to come back to your question, what part does the Chinese economy, I would say China is too big, both from the demand side and the supply side, not to be intertwined with the global economy. Those supply chains are so sophisticated, so cost-effective, so important for the rest of the world, that China will remain a huge part of the global economy.

That said, going forward, we're going to have to get used to a China that doesn't grow at 5, 6, 7% and a China grows at 2, 3, 4 %, and that's a function of demographics, as a function of household formation. And most importantly, it's a function of what they need to do, which is a change in business model from a fixed capital-led to a much more and export-led economy to stimulating their own consumer demand.

00:10:44 Ritu Vohora

OK. And that's something to watch in in 2025 and I think Arif, in the past you've mentioned China has actually exported deflation to the rest of the world and that could potentially persist, which has ramifications for Europe and of course, here in the UK as well.

OK, now let's take a closer look at the U.S. economic outlook with Steph and Blerina.

00:11:07 Ritu Vohora

Welcome, Blerina and Steph. Thank you so much for joining us today.

00:11:11 Blerina Uruçi

Thank you, Ritu. It's a pleasure to be here.

00:11:13 Steph Jackson

Yeah. Same. Thank you very much.

00:11:15 Ritu Vohora

Great. Well, let's get straight into it. Lots to talk about, about the U.S. economy. So Blerina, maybe I could start with you. The U.S. economies continue to outperform the rest of the world for a number of years now and they've now, and they’ve now delivered nine consecutive quarters of growth. And we've also just had

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the dust settle on the U.S. election, with a decisive victory for Trump and the Republicans, and they're actually inheriting a very strong economy. So do you believe the U.S. exceptionalism can continue?

00:11:46 Blerina Uruçi

It's a great question, Ritu. And I would say that I remain optimistic about the U.S. economy. I think the ingredients are there for the economy to expand by about 2.5% in 2025, continuing the strong track record we've seen in the last couple of years.

And before I dig into the ingredients that I think are going to drive the economy and growth next year, let's for a moment pause and think about what do we mean by U.S. exceptionalism. And here we're talking about growth. So in the U.S., the economy expanded by about 3% over the last couple of years annually. And then when you compare that to other developed markets, such as in the eurozone, UK, or Canada, it's been about two-twice, or three times as fast.

And so what have been the key ingredients for the growth in the U.S. and looking forward to 2025, I think the key is with the U.S. consumer. I think U.S. consumer is about 70% of the economy, which means in the U.S., we have a large and closed economy. And why is that important? I think it matters because it means all, the most of the demand that we need to generate growth comes from domestic markets. It makes the economy less exposed to a slowdown, say in economies like China or the euro area.

And what drives the U.S. consumer is really the labor market. We have a strong labor market. The pace of job creation has slowed, but companies continue to hire and we're not seeing signs of mass layoff. Couple this, let's call it job security for the consumer, with the fact that the balance sheets are healthy. And we don't have any deleveraging ahead of us.

And on top of that, the fact that wealth, the wealth side of the consumer balance sheet is doing well, both in terms of housing wealth, as well as the stock market, I think the ingredients are there to have the consumer continue to drive the economy in 2025. And then the other pillar that has made a difference for growth in the U.S. versus the rest of the world has been fiscal policy.

We have deficits of about 6-7% of GDP, with the unemployment rate at a record low. You compare this with the fiscal impulse in Europe or in Canada, it's much larger in the U.S. And then projections are that it's going to continue to be at this levels for the next couple of years. So even though fiscal is not an incremental increased impulse, it's still supportive of growth. And I think, yes, we do expect the economy will remain resilient next year.

00:14:30 Ritu Vohora

OK, so strong economy doesn't look like it's running out of steam anytime. And you mentioned that, Blerina, fiscal policy. So with President Trump in the White House in January, you know, how are you thinking about the key policy priorities for him? And I think importantly, you know, what's kind of the timeline around implementation?

00:14:48 Blerina Uruçi

So I will say I would divide the policy priorities of the new administration into three areas: trade, immigration, and fiscal policy. And everything that I'm going to say here, I think has a large degree of uncertainty because what I'm running my thoughts and projections on, is on campaign promises. The administration has not had an opportunity to announce the details of its policies. But I think the way it's going to play out is that we have a lot that the administration wants to do in its first year in power. I don't think it will want to use political capital in Congress to address all of these areas.

So I think trade and immigration are more likely to be addressed pretty quickly through executive order and then using Congress to pass tax extensions; the tax cuts in the TCGA. So with tariffs, I think in particular if we wanted 10% tariffs across the board, we need Congressional approval for that. But the

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administration and the President can write Section 301 executive orders to impose specific tariffs on specific countries and goods. And I think this is how it's going to play out, at least initially.

Similarly for immigration, I don't think we're likely to see comprehensive immigration reform early on in the administration, but we're likely to see executive orders that slow down the flow, the net flow of migrants into the labor force.

And then for fiscal, I think the Congress, especially with the Republican sweep, Congress, is going to be ambitious and try to extend the TCGA in the first half of the year, but certainly by the end of 2025, we should see an extension of tax cuts.

00:16:43 Ritu Vohora

OK. Thank you for that, Blerina. That's a great summary.

You know Blerina has outlined some of the policies there and we can always see the Trump trade in markets in recent weeks, you know, we've seen the post-election surge with the U.S. equity market, the S&P 500 broke 6,000 for the first time. We've also seen small-caps rally very significantly on the hopes there of tax cuts and deregulation. And of course, all of this comes with the background of the Fed easing policy.

So you know, standing here today, what's your outlook for corporate earnings and how are they companies going to navigate these changes? And given the animal spirits we're seeing in the markets, you know, do you see any risk that maybe the market is not reflecting that could potentially generate volatility in 2025?

00:17:27 Steph Jackson

Thanks for the question. From an investment perspective, we really feel as though corporate earnings are going to be much stronger and are in a position to accelerate going forward, particularly in small-caps. It's not well known or well-studied, but small-caps tend to be a fairly good inflation hedge in market environments characterized by lots of inflation. So we expect higher corporate earnings, although at this particular point in time, we feel as though their earnings estimates may be a bit high and are likely to come in lower. You're exactly right, animal spirits have clearly been released and in those environments, stronger economic activity usually leads to better corporate earnings.

From a risk perspective, we would just say that investors need to ponder how much of the good news has been pulled forward in current valuations and valuations are very high. We got there very quickly leading into the election and then post the election.

Excluding the largest and riskiest names, we still think mid-cap represents, sort of, the best place to invest in in terms of opportunities. We think, when you when you think about where they are from a valuation perspective, their valuations are very reasonable, relative to history, relative to large cap. And so, we still think that's mid-cap stocks have more upside potential than large.

00:18:54 Ritu Vohora

OK, thanks for that, Steph. And we can dive into some of the more specific opportunities you're seeing. And I think you made a really interesting point. I mean, I think there's still a lot of uncertainty, but some of those policies could certainly be inflationary.

Blerina, bringing you back into the conversation now, we saw the Fed cut rates for the second consecutive time in November. And Powell's been quite clear, you know, that there was no pre-set path for the pace of rate cuts and actually the election wouldn't impact monetary policy. But you know Steph’s talked about some policies that could be inflationary there.

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Is there a risk we see that reacceleration and does that then impact the path of policy going forward in 2025?

00:19:31 Blerina Uruçi

Ritu, I think the Fed has put itself in a fairly tight corner here, having started the easing cycle with a bang with a 50 basis point cut and then being surprised to the upside by the data. So I think even before we had the uncertainty about the new administration and what that means for inflation going forward, I did think that the market was pricing too much certainty, with too much certainty, that inflation would come down to 2% in a very well-behaved fashion. And so we have this fundamentally resilient economy that we just spoke about and markets are optimistic about the outlook under new administration and then we add to that another layer of uncertainty.

So we discussed already the three policy pillars that will be the priority of this new administration. Now let's think about how can they affect inflation.

In my view, the net effect is going to be towards higher inflation and the market is already trading that way. We look at break-evens there, higher the long end of the curve has been increasing as well. Even though the front-end is more anchored because of the Fed being in a cutting cycle. So then I think when I'm looking at tariffs—and we have experience with tariff increases from 2017 and '18─they serve as a one-off shock to the price level. So there is a period where prices increased, but it's not sustained higher inflation. Now what we need to take into account here is, is the economy going to behave exactly like it did in 2017, this time around? And I look at what's different now versus then. Back then, we had inflation being below target for a number of years. Consumers had pricing power, not companies. And then the fiscal situation was such that that the deficit was much lower than it is right now.

Right now, we're coming out of three years of above target inflation. Firms have pricing power and have been able to pass on larger increases to the consumers. And so this would point in the other direction. Now directionally, I would say, and, also the fiscal situation, we have a higher deficit. So directionally, I'm looking at higher inflation and the risk is whether this shock will de-anchor inflation expectations, that's key for central bank policy.

If it doesn't, I think the Fed can stay the course, not deliver as many cuts as it's promised in its recent forecast, but not necessarily need to hike interest rates. So, for tariffs, I'm looking at a relatively short leash in terms of the effect. I think it happens. The effect on inflation happens next year.

Immigration is a bit more complex. It depends on how it's implemented, but certainly we should think about what does higher net migrant flows mean for the U.S. economy over the last two years. They have really helped to loosen the labor market. We have vacancies that firms couldn't fill for about a year or so with increased labor supply. Those vacancies came down, which pressures came down. So I think if we really restrict the flow of net migrant flows in a situation where the U.S. economy remains resilient in a year or two, we could be looking at another tighter, hotter labor market.

00:23:02 Ritu Vohora

So coming back to you now, Steph, you talked around sort of where valuations now are in equity markets, particularly in the U.S. and I think the story in 2024 was very much dominated by AI and just a handful of stocks. But when I look across valuations across all sectors, they still look elevated. You know, is there still a case for U.S. equities to move higher from here and you know, you highlighted some opportunities, but where are probably the most attractive opportunities be it by sector or by market cap?

00:23:29 Steph Jackson

Yeah, we believe that the bull case for stocks is much broader going forward and small-caps and mid-caps look more attractive and generally do better in inflationary environments, as you point out. This is largely because of better pricing flexibility for smaller cap companies. The average stock, really excluding

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the MAG 7, or the Magnificent 7, is really only up about 10-11%. So you really have had a very concentrated market in terms of what is driving stock performance. AI names have really been on a tear and the CapEx spending has not slowed down there.

But we have much more attractive valuations when we look more deeply at down cap and elsewhere in different indices, where the average stock looks more like 17 to 18 times forward earnings, versus, you know, 25 to 26 times for the overall index.

There's a bull case for several sectors. In particular, financials, where we think less regulation and the potential for loan growth that will be driven by an increase in economic activity will be very helpful to their bottom lines. And also with less regulation comes the potential for more M&A activity, which tends to push up premiums up for those financial stocks.

We think energy is going to be a particularly interesting area, and we think the outlook for liquefied natural gas-oriented companies is very good. They also are an AI beneficiary. And so hopefully we'll begin to see some of the benefits of all the spending began to show up for several energy companies. We also expect increased drilling activity and so, many oilfield services companies should begin to do better.

And obviously no one has missed that crypto is hot again and we think that's going to be an area of significant upside.

Selectively, some other stocks that we think are interesting or some other areas that are interesting include financial tech and IT services. Both are areas that have fairly cheap valuations and have been at trough utilization rates and also are long-term beneficiaries of AI. So we'll be on the lookout for some significant improvement and some of the productivity from the innovation in AI in those spaces.

More broadly, we do see a potential risk of some reversion to the mean for some stretched valuation areas in the market, particularly AI. It indicates more broadly that perhaps value can outperform growth. And then we've been saying that for quite some time. But we think that this might be we might be approaching a tipping point.

The market has some of the markings of a bubble, that is narrow trades, extended valuations, crowded trades in particular. But in some ways, it feels too early to be a bubble. There are no signs of capitulation at the top: that is where people become so frustrated, they just throw money at every idea that's been going up and we're not really seeing signs of that just yet. The consensus optimism around this new administration, as reflected in the market action that we've seen going into the election and then post the election, gives us, you know, some concern that people are beginning to behave like lemmings and sort of all heading in the same direction. The resurgence in risk assets I mentioned, crypto and Bitcoin, and this continued strength in AI CapEx spending, all give us some sense that we could be heading towards a bubble.

But we don't see signs of a catalyst to pop the bubble, nor that capitulation at the top. And so we're likely to see markets go higher first, before we actually approach bubble territory.

00:27:30 Ritu Vohora

Well, thank you for that Steph and Blerina. We're probably at time now. So I want to close off the session with two questions for you. This is the speed round. So as we look ahead to 2025, what is the one risk that you're most worried about and where do you see the biggest opportunity? Blerina?

00:27:47 Blerina Uruçi

OK, so let's start with the risk and end on a high and positive note. I would say fiscal is probably the biggest risk that I foresee because of the size of the deficit and the potential that this could have on yields in the long end if we don't address the sustainable path of debt. And then the more positive note would be productivity growth. Steph already spoke about generative AI and how that can affect sectors other than

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tech. If this positive productivity shock shows up in the economy could have positive implications all around.

00:28:24 Ritu Vohora

And for growth as well as you outlined, so coming to you now, Steph.

00:28:28 Steph Jackson

I would say the biggest risk is unexpected inflation, which could have an impact on incomes, which sort of bleeds into top line as well as in corporate earnings being disappointing. Of course, small-caps do tend to be a good inflation hedge and are more insulated than large caps. Tied to that, there is potential for a momentum reversal, that is momentum stocks have done very, very well over the last year. There is a risk that, if you study history, that that does not continue and likely leads to value outperforming growth and this momentum-driven market to slow down significantly.

In terms of opportunities, there are several areas we're excited about: GARP stocks in general, which are growth at a reasonable price ideas at a lower beta but have reasonably good outlooks in terms of corporate earnings. And then there are several segments I talked about: small-caps and mid-caps, but I would zero in on energy. I would also highlight financials or banks, financial tech as well as IT services and then of course healthcare and select areas of software we still think are attractive.

00:29:38 Ritu Vohora

Great. Thank you, Steph and Blerina, that's been a great conversation. And if I could summarize, looks like U.S. growth is going to be resilient, but there are risks around fiscal policy and inflation, but plenty of opportunities across a broad range of sectors. So thank you so much for joining us from Baltimore today and sharing your perspective. We appreciate your time.

00:29:58 Blerina Uruçi

Thank you, Ritu.

00:29:59 Steph Jackson

Yeah. Thank you.

00:30:01 Ritu Vohora

Great. So, we heard from Steph and Blerina there and they outlined both the U.S. economic outlook and some of the opportunities, particularly in U.S. equities and specifically, you know you talked earlier, Justin, around tariffs. Blerina also talked about tariffs being a priority for Trump in his first 100 days. Who are the biggest losers, out of Trump tariffs? What about Europe?

00:30:24 Justin Thomson

Well, let's not forget that tariffs are a tax. And to the extent they're a tax, they created mainshock. So potentially we're all, we're all losers here. In pecking order, it'd be China, would be EU, particularly Germany, and would be Mexico, where the biggest deficits with the U.S.

00:30:44 Ritu Vohora

And I guess in Europe already seeing slower growth on the back of that uncertainty, you know companies are not investing, businesses not spending.

00:30:52 Justin Thomson

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That's right. I mean, I mean there are a number of structural issues rather cyclical than around Europe. I mean energy supply, which they navigated so far so well - transition to EVs, which is having a big structural effect on the German auto market.

So yeah, there are significant structural headwinds there. And to the extent Europe is, European demand as a function of demand coming out of China, the second order effect from tariffs could be weakening of demand in in Europe as well. So yes, Europe is potentially at the nexus of tariffs being imposed.

00:31:39 Sébastien Page

And Justin, Europe doesn't have the same technology sector as the U.S., right?

00:31:46 Justin Thomson

That is true. That is true.

Which, obviously in terms of, in terms of recent growth and the trends that have been driving growth, such as the AI investment boom has is, is significant, you are so right.

00:31:58 Ritu Vohora

And what do we think about EM more broadly? Obviously, we've talked about China sort of diversifying the supply chains. Where are the potential winners? Potentially in frontier markets?

00:32:08 Justin Thomson

Well, I mean, let's say that on the on the face of it, rising rate, stronger dollar, imposition of tariffs, it's a pretty heavy cocktail, negative cocktail for emerging markets. But emerging markets have been there, been here before and emerging market policymakers know how to navigate such volatility.

And a lot will depend on the response. The response. Now, if it is a 60% tariff hike on Chinese-originated goods, you would need a 20% devaluation to offset that. But you know, the losers on the face of it are going to be around the Pacific Rims, those that supply around China. Vietnam has been a big beneficiary of Chinese tariffs so far. I think there is headline risk there as well.

But remember, I mean, that's on the face of it. Emerging markets, compared to where we've been in history, foreign exchange reserves are very healthy. External balances are much better-positioned than we've been before. So you know, I think that what the implications are from emerging markets are less obvious than might seem from a headline level.

00:33:27 Ritu Vohora

Yeah. And from the data I've seen, the U.S. consumer actually faces the bulk of the tariff in terms of higher inflation.

So coming to you now, Arif.

You know, Blerina talked there about one of the key risks is around fiscal policy. The U.S. deficit is on track to be 7% of GDP at the end of the year. I think the interest expense alone is going to be higher than the defense budget, which is mind-boggling.

When should we start worrying about the debt burden? I feel like we talk about it, but when do we actually start worrying?

00:33:57 Arif Husain

You should be worried right now. I think, certainly, the initial reaction in the bond market post-the election was to go after some of the fiscal laggards. So, the European peripheral market got hit. The UK bond market got hit, and so did the U.S. Now there's been plenty of volatility.

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So I think you got to be worried about the bond market. I'm on record of saying I think the U.S. 10-year will get to 5%. I said that before the election.

There's only more evidence, new information, to think, to believe that and frankly, I said 5%, because 5% you need to go through 5 to get to 6.

So for me, what will create fiscal austerity? What will create a little bit more discipline around the deficit? Can't see it. I really can't see it. And really, I think the real thing that most people miss when they're just looking at the U.S. fiscal deficit is a really simple point, which is the U.S. are not the only people who need to sell a lot of debt. A huge, huge amount of debt.

You know, Justin was talking about Chinese stimulus a moment ago. Guess what that is: debt issuance. And every country with the exception of Germany, actually, the German debt break is one of their structural, one of the structural issues holding them back a little bit, but from a bond holder's perspective it's a positive, right, but other than that, everyone is selling lots and lots and lots of debt in a time when central banks are no longer buying it. And so from a global perspective, I think we really need to worry about deficits and the lack of plan to address them. And the U.S. is at the front of the queue there. You know, every week, every second week, they've got to, they come with massive bond issuance and really to my mind, bond yields need to be a lot higher to be competitive. And you've got to see a much steeper yield curve to make that longer duration debt a lot more attractive.

00:36:06 Sébastien Page

Arif, did you, did you just call for 6% U.S. 10-year as a possibility?

00:36:11 Arif Husain

I think we'll see 5 before 6, that's for sure.

00:36:11 Sébastien Page

That's for sure.

00:36:17 Arif Husain

But I think that, you know, there is so much debt that clearing price of that debt is not known yet. So I think we need to look at every single range of possibility.

00:36:27 Justin Thomson

And this is you 'bearish slash bullish'.

00:36:30 Arif Husain

That's bearish on the bond market, but yeah, another part of that is growth is pretty good and we've talked about inflation as well. So there are a lot, there's a deficit argument for rising yields, but there are lots of other supporting arguments there.

00:36:46 Justin Thomson

What I guess the counterpoint is, if there isn't fiscal constraint from Congress or fiscal constraint from politics, it's the bond. It's the bond market, it's bond market vigilantes. Perhaps the stock market will put the brakes on policy.

00:37:02 Sébastien Page

OK, before we all panic.

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If U.S. Treasuries are no longer the safe asset; the anchor in global institutional investors' portfolios, what is?

In other words, I think there's demand for U.S. Treasury that's different from sovereign debt from other nations. I'm just trying to just calm us down here.

00:37:25 Ritu Vohora

Because actually the volatility in the 10-year, I mean we were a 5% handle almost last year, we were 3% at the beginning of this year and now we're almost 4.5%, right? So it's just feels, to your point, very volatile, which you don't expect of a U.S. Treasury.

00:37:39 Arif Husain

Well. To my mind that that almost speaks to the point that can it actually be the risk-free asset when you've got that much volatility? And to my mind, I would argue that cash is still playing that role and actually as much as I hate to say this, the U.S. equity market goes up at pretty much in every circumstance, so….

There are other options, but at some point, the demand for Treasuries will come back. Ultimately, we just need to get to that clearing price where that money moves from cash into Treasuries.

00:38:15 Ritu Vohora

And Seb, coming to you, given what Arif's talked about as an asset allocator, how should investors think about positioning for 2025? You know, are stocks still going up in the U.S.? How do they think about hedges in their portfolios? How are you thinking about your positioning?

00:38:29 Sébastien Page

So yeah, you asked me to play devil's advocate earlier and give the bearish narrative. Now, want to play devil's advocate on the bearish narrative to explain how we're positioned. There is an argument to be made that valuations are rich. The forward price/earnings ratio, looking out 12 months on the S&P 500, is 22. By historical standards, that is really high. However, if you look behind those valuations, you have very high return on equity for large-cap tech companies, and if you adjust for return on equity, the valuations don't look nearly as expensive. Also, most investors don't realize that there are other stocks in the world. No, investors know that, but if you look at the average stock in the world and calculate its price/earnings ratio, it's between 13 and 14, which is the, actually the 30-year average. So you can do that with the MSCI All-Country World Index equal weighted. So, there are caveats on the bearish narrative where we all panic about valuations.

Valuations are high but adjusted for return on equity and looking at a broader set of companies and stocks, they're not that high. On the number one argument that you hear from the bears, which is a valid argument, the increase in unemployment by 70 basis points in about 18 months. Blerina mentioned this, unemployment is actually strong. You have to look at the level, too. Yeah, the level is 4.1%. The long-run average for unemployment in the U.S. is 5.7%.

So you have a full employment economy, which means a strong consumer, which Blerina mentioned. So you look at fairly expensive markets, but upward movements in the economy in the U.S., we end up in our Asset Allocation Committee, moderately bullish. We have a small overweight to stocks.

If we see pullbacks that are more technical, the volatility that Arif talked about, we might actually add to stocks, but otherwise we're positioned for a market broadening. So we have overweights to value stocks, international small-caps, and EM.

The other part of our positioning which is in aligned with Arif, and Arif is on our Asset Allocation Committee so we listen to him, is that there is potentially an upward risk to rates and inflation. So actually

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net short duration, we have an overweight to cash and an overweight to credit and we have an overweight to real asset equities, which give you a positive equity risk premium over time and a levered response to inflation shocks.

00:41:21 Ritu Vohora

In fact, that's one of the audience questions we've had is how do we position for potential reflation. It's through real assets.

00:41:27 Sébastien Page

That's one that I like, you can buy inflation-linked securities, TIPS, or linkers, but I like having a real asset equities position overweight as a hedge to an upward shock in inflation. Think energy companies, even REITs or metals and mining, and commodities-linked companies. Those companies give you a pop if you get an unexpected rise in inflation. And I'm not talking about 7, 8, 9 %, I'm just talking about the fact that swap markets currently are pricing about 2.5% for U.S. inflation.

Earlier this year, for the first three months of the year, if you analyze the inflation rate, we were running at 4.5%. Is it possible that we get another three months within, say, commodity shock where we run at 4.5%? Yes. So that's why the hedge.

00:42:17 Ritu Vohora

Bringing you into conversation Justin, given what Seb’s talked about, you’re head of international equities.

We've seen the dominance of AI and a handful of stocks in the U.S., and it seems like U.S. exceptionalism is going to carry on. How do you see the setup for stocks and where do you see opportunities outside from the areas that Seb’s talked about?

00:42:35 Justin Thomson

Well, style-wise, I would go for value just on a relative value stance. Valuation’s your friend.

You heard Steph talk about U.S. small- and mid-caps, I think, and I think that's the case internationally as well, having underperformed for three years. Now they're at a discount to where they've been historically and in internationally, there aren't the some of the structural headwinds that U.S. small-cap faces.

I would say for inflation upside, a basket of commodities, and that's you know the fundamentals look good there as we transition to our energy needs and our energy supply, the demand for certain commodities is gonna be strong after a sustained period of under investment. So commodity prices could be strong.

I would say for the really contrarian, China, much unloved, much maligned, sickly adjusted PE of 10 times with potential stimulus coming. That's one for the contrarians.

00:43:45 Ritu Vohora

One for the brave. And a question now for you, Arif, that’s come through from the audience. In fixed income, we've seen higher bond yields, but a lot of volatility that we've talked about, credit spreads are historic lows and there's a risk of higher defaults. Have investors missed the boat on credit?

00:44:00 Arif Husain

I don't think they missed the boat. I think there's still some parts of the credit market that look really attractive. I would characterize the majority of credit buyers as yield buyers as opposed to spread buyers and still because of the backup in Treasury yields, you're still getting paid a decent amount of yield to own that credit, so I still think there's opportunities out there. For us, we would prefer shorter-dated, high quality.

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One other idea, just thinking about what Seb and Justin have both talked about, one of the things we're doing in our portfolios at the moment is actually substituting some investment grade credit and adding TIPS instead. Decent correlation in most environments and potentially a better pay off risk reward and better convexity.

00:44:52 Ritu Vohora

And do you talk there about U.S. Treasuries not being the safe bet. What about global bonds, more generally, do we see more opportunity out there?

00:44:59 Arif Husain

It's very hard to say, or it's very hard to call global bonds a safe bet, overall.

You know, the majority of global bond markets are very highly correlated to the U.S. Treasury markets, but there is certainly a ton of dispersion out there. You have a couple of central banks raising rates, Japan, Brazil, whereas the rest are cutting. But you also have a massive divergence in policy.

So I think taking a global approach, certainly some of the European markets, particularly core Germany, are differentiating themselves certainly from the U.S., so I think taking that global approach certainly gives you a better defensive posture in a, in a bond portfolio.

00:45:52 Ritu Vohora

OK. So to summarize, as income opportunities have some inflation protection and think potentially global as well.

So Seb, coming to you now, you've published a book on leadership. When I think about the opportunities we've talked about, there's a lot, but at the same time, investors can get quite nervous when there is a rapid pace of change and one of the themes in your book is about resilience. Can you give us three tips of how investors can navigate the uncertainty we're seeing?

00:46:19 Sébastien Page

Yes, #1, differentiate between luck and skill. You learn this from a variety of sources, but in particular, sports psychology, because in sports you don't always control the outcome. So, a mentor once told me there are only two types of investors: those who are talented and those who are unlucky.

Well, being self-aware enough to know that sometimes you get it wrong or sometimes you make the right decision, but you got the wrong outcome. So focusing on process is key.

#2, Identify your core beliefs. What do I mean by that? As an investor, which filters do you use to look at the world? Core beliefs are all over the place in our industry. Stocks for the long run is an example of a core belief. The trend is your friend is another one. And one that I like, the road to hell is paved with positive carry. This is a favorite of conservative fixed income investors. But just knowing your core beliefs will help you think about your process.

Third, meaning is really important in what we do, and I think with the trend towards index investing, we forgot the true meaning of active management. Every day we go to work, we want to make money for our clients and there is no functioning global capital markets without active management. There's a tremendous amount of meaning in what we do in investment management.

So those are my three takeaways.

00:36:47 Ritu Vohora

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That's very helpful. I'm sure very useful to the audience and back to your opening comments. You know, focus on the signal rather than the noise when you're navigating this change. So, almost at time. So I want to go with the speed round now. We've covered a lot of ground.

You're bullish and bearish, but if you had to pick one risk and one opportunity, what would they be? Arif.

00:37:09 Arif Husain

I would say the for the opportunity, I'm going to go opportunity first, I'd say the volatility and dispersion will create lots of active return. If you asked me to pick one asset class: TIPS.

For me, the biggest risk is, people talk about the fiscal deficits and it's almost an academic thing. People talk about bond yields being higher, also almost an academic thing. What are the knock-on effects? What are the second order effects of 10-year Treasuries getting 5, maybe 6 [%]. That is very poorly understood and very lack of imagination.

00:37:51 Ritu Vohora

OK, curious to watch. Seb.

00:37:54 Sébastien Page

Well, the risk now, just listening to Arif is I'm, I'm now very worried about the U.S. 10-year yield. I think that's a risk to watch. In terms of opportunity, we, a lot of investors globally, have dry powder, we mentioned dry powder. There is a fair amount of money sitting in cash.

Now if I give you a wonky way of saying this, I can say you want to add to risk assets on pullbacks. I think that's the opportunity for the next six months, all else equal, if I want a simpler way of saying this, be prepared to buy the dip.

00:38:33 Ritu Vohora

Well, as they say, volatility can be your friend. It's not necessarily risk. It can be opportunity. Justin?

00:38:38 Justin Thomson

I'm just going to pick up on Seb's aphorism about there being two types of investors. What I would say is that the more research and the harder work you do, the luckier you get. So there you go. But in terms of in terms of risk and opportunity, I mean, for me they're bundled into the same thing. So we've had 15 years, which have been dominated by one country, the U.S., within that one sector, technology, and within technology a handful of outstanding corporations that have dominated returns. That is both a risk in terms of index construction, in terms of how much money has those stocks have drawn other parts of the market. But it's also an opportunity because the opportunity is that markets can broaden from here, internationally, into small-cap stocks, into other parts of the market that have been starved of capital over time.

00:39:34 Ritu Vohora

Great. Well, thank you for your comments. That's been great.

And if I could summarize, we still think U.S. growth is resilient. We'll carry on from here, but the fiscal policy, the fiscal deficits, possibly means higher long-term yields, so we need to think about steepness and of course inflation. We could see it reaccelerating. So having some protection, but encouragingly a broadening opportunity set.

So I think the key message is be active and be diversified, particularly with change. So thank you for that and thank you for joining us today. We really hope you found the webinar insightful.

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Thanks again and we look forward to seeing you again soon.

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