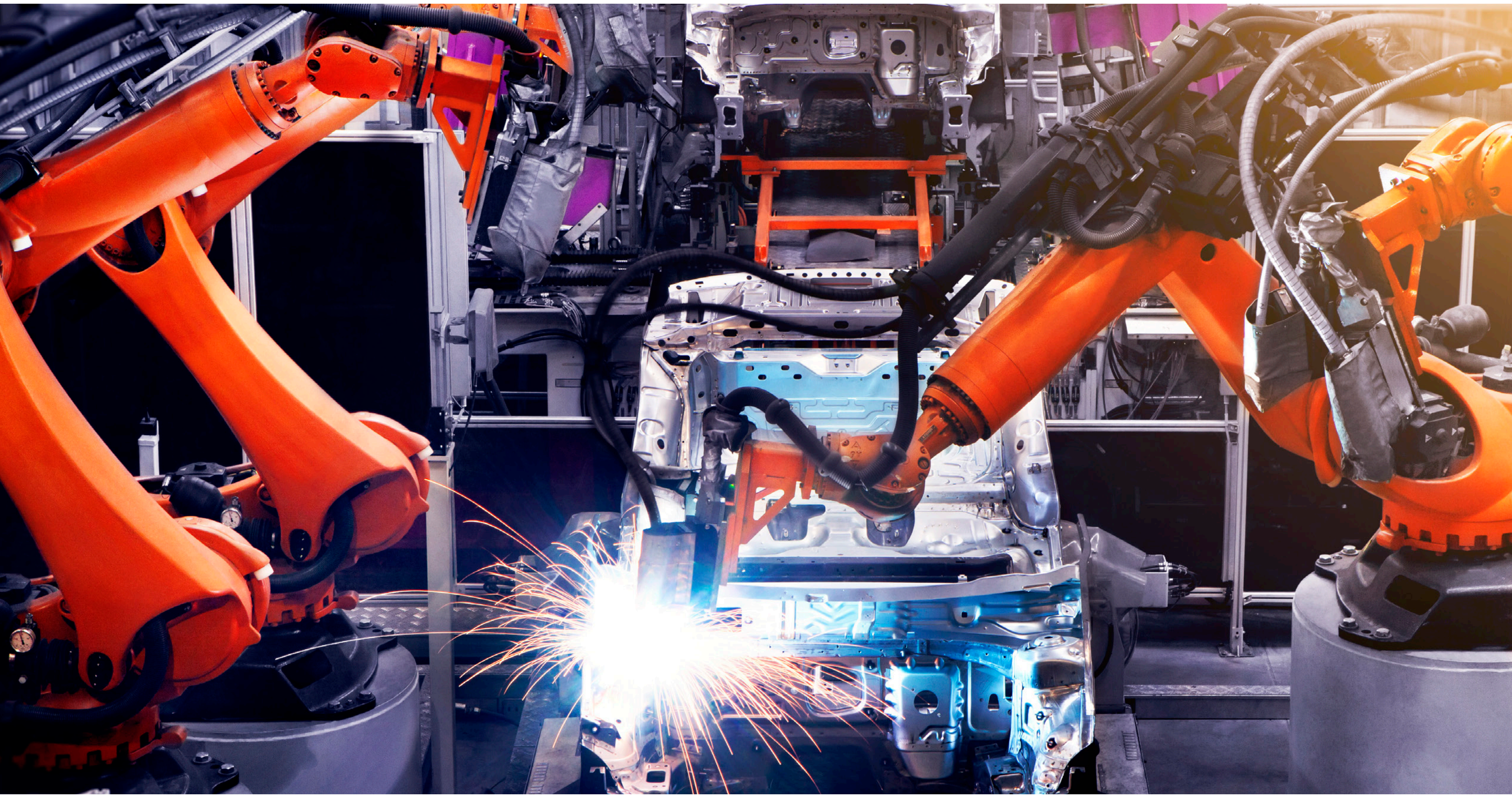

RAHEEL SIDDIQUI
Senior Research Analyst, Global Equity Research

NEUBERGER BERMAN

Equity Market Outlook 1Q 2025

We believe a strong economy, rebounding industrial activity, improving liquidity and rising animal spirits should continue to support corporate earnings growth and a broadening of the U.S. equity market in the coming year.

- We expect mergers and acquisitions (M&A) are set for a big comeback, thanks to a mix of supportive economic and financial conditions, as well as a more favorable regulatory regime. In our view, investors looking to capitalize on increased M&A should consider Event Driven Merger Arbitrage hedge funds in their portfolio mix.
- Recent data suggests to us that global industrial activity will gain momentum and the manufacturing recession will end in 2025, potentially spurring an increase in capital expenditures (capex) and market broadening in favor of value stocks and small caps.
- Stimulative financial conditions and fiscal policy could also add to growth in 2025, in our view. Global central banks remain highly coordinated in easing monetary policy: Of the 61 central banks we track, only four are increasing interest rates.
- We believe key risks in the U.S. include market concentration, rich valuations and stretched equity positioning.

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Investment Themes and Views[1]

We have retooled the methodology behind our equity recommendations to provide more actionable guidance for active asset allocators and portfolio managers. Our methodology is designed to assess developing risk and opportunity cycles at the index and sub-component levels (countries, sectors, regions and styles) and be more responsive to changes in market sentiment. The targeted investment horizon for these recommendations is approximately 12 months, but we expect more frequent adjustments at the sub-index level.

USA	1Q'25	Δ[1]
Communication Services	Overweight	⇑
Consumer Discretionary	Overweight	⇑
Consumer Staples	Overweight	
Energy	Underweight	⇓
Financials	Overweight	
Health Care	Market Weight	⇓
Industrials	Overweight	
Information Technology	Underweight	
Materials	Overweight	
Utilities	Overweight	

EQUITY STYLES	1Q'25	Δ[1]
Russell 1000 Growth vs. Value	Underweight	
Russell 2000 vs Russell 1000	Overweight	

REGIONS	1Q'25	
EAFE	Market Weight	
EM	Market Weight	
Europe	Market Weight	
US	Market Weight	
Japan	Market Weight	
China	Overweight	
India	Underweight	⇓

[1] Changes Relative to Previous Quarter.

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The Economy Looks Strong As We Enter 2025

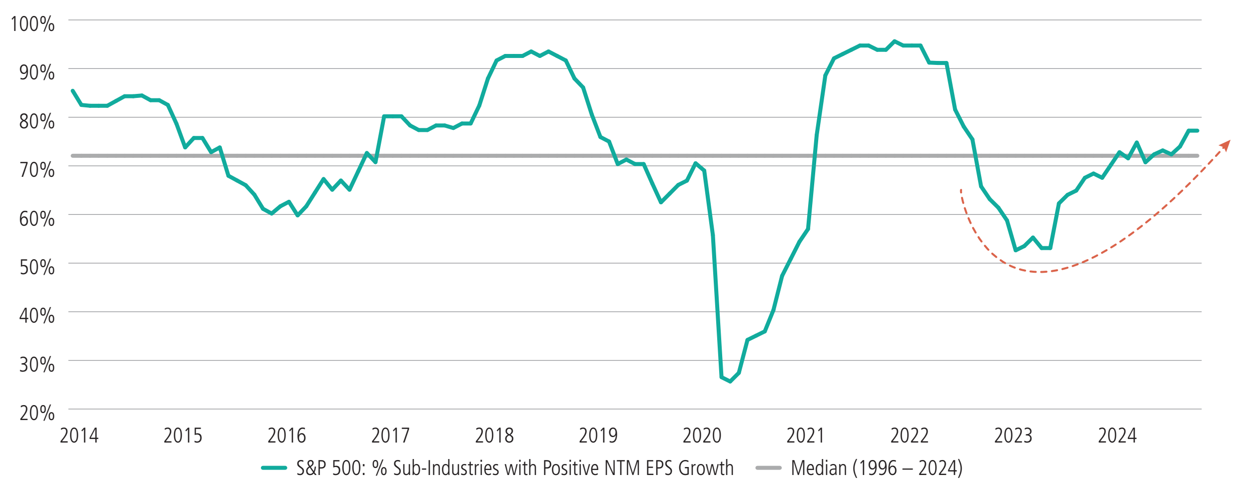
As we approach 2025, we believe several important economic indicators point to a robust economy and broadening earnings growth.

U.S. GDP is expected to grow at a 3.2% annualized pace in Q4 2024.[1] The consumer spending outlook remains strong and is well supported by accelerating real disposable income growth.[2] In addition, U.S. household net worth increased by $13 trillion in just the first nine months of 2024, likely encouraging consumers to spend more in 2025 because of the wealth effect.[3]

Stimulative financial conditions and fiscal policy could also add to growth in 2025, in our view. Global central banks remain highly coordinated in easing monetary policy: Of the 61 central banks we track, only four are increasing interest rates; in our view, this is the most market-friendly backdrop outside of recessions in three decades.[4] Additionally, we believe potential fiscal easing in China and Europe,[5] rebounding capex, inventory restocking, the likely ending of a two-year-long global industrial recession, and rising animal spirits in the U.S. could provide a solid backdrop for broadening earnings growth (see figure 1).

This setup continues to support our overall investment thesis (discussed in last quarter's report), and is a far cry from 2022 – 2023, when the specter of recession loomed large.

FIGURE 1: THE NUMBER OF SUB-INDUSTRIES EXPECTED TO POST POSITIVE EARNINGS GROWTH IS INCREASING



Source: Neuberger Berman research and FactSet. Data as of November 30, 2024. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. **Past performance is not indicative of future results.**

[1] Source: Atlanta Fed GDP Nowcast. Data as of December 18, 2024.
[2] Source: Neuberger Berman research and FactSet. Data as of October 31, 2024.
[3] Source: Neuberger Berman research and FactSet. Data as of September 30, 2024.
[4] Source: Neuberger Berman research and FactSet. Data as of November 30, 2024.
[5] Source: Goldman Sachs, Neuberger Berman research and FactSet. Data as of November 30, 2024.

M&A Activity: A Surge in Sight

We believe mergers and acquisitions (M&A) are set for a big comeback, thanks to a mix of supportive economic and financial conditions, as well as a more favorable regulatory regime.

Historically, M&A activity tends to rise during the 12 months after an equity bull run (with a correlation of +68% from 1998 to 2024).[6] With the S&P 500 having delivered 20%-plus returns for two straight years,[7] we expect a meaningful boost in M&A activity in 2025.

Several positive M&A drivers have been aligning: Interest rates are stabilizing; corporate bond spreads are narrowing; M&A-related bond issuance is on the rise; and the ISM Manufacturing Index is recovering.[8] Typically, as financial conditions ease and industrial activity strengthens, dealmaking tends to pick up.

On the regulatory front, we believe market-friendly policies could also boost M&A. Over the last four years, M&A activity has dropped by a third compared to the previous four years, largely due to strict regulatory and anti-trust measures under the Biden administration.[9] We believe this has created significant pent-up demand for corporate M&A.

We expect business-friendly leadership at the SEC and FTC next year, likely leading to fewer investigations, a slower pace of new regulations and subsequently increasing M&A activity. Increased M&A activity could boost confidence among CEOs and CFOs; encourage more corporate and investor risk-taking; energize deal-making and underwriting; and enhance American companies' long-term dynamism and competitiveness. Indeed, we believe this trend has already begun, as M&A premiums have been on the rise.[10]

Finally, we note that the multi-strategy "event-driven" category of hedge funds, which focus on deep-value exposures and speculate on potential M&A deals, has been among the top-performing hedge funds since October.[11] We believe this trend has room to run and that investors should consider including Event Driven Merger Arbitrage hedge funds in their portfolio mix.

[6] Source: Neuberger Berman research and FactSet. Data as of November 30, 2024.
[7] Ibid.
[8] Source: BofA, Neuberger Berman research and FactSet. Data as of November 30, 2024.
[9] Source: BofA. Data as of November 14, 2024.
[10] Source: BofA. Data as of November 14, 2024.
[11] Source: Neuberger Berman research and FactSet. Data as of November 30, 2024.

The Capex Outlook Gets Brighter

The representation of service-based companies in global stock markets has grown significantly with rapid growth in the social media and technology sectors. However, manufacturing continues to be a crucial driver for goods-oriented sectors, which tend to dominate value and small-cap indices.

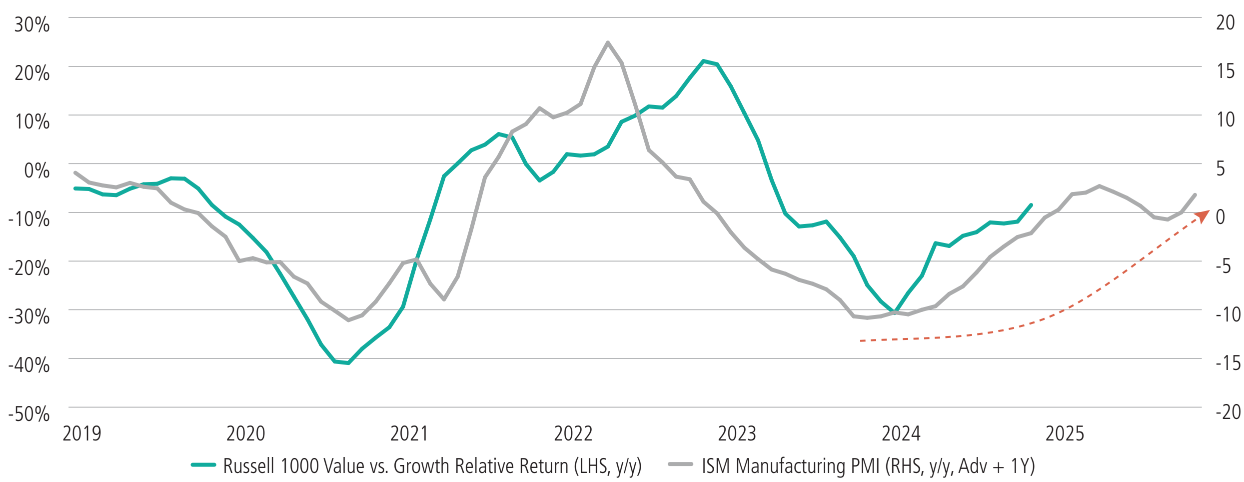
Global industrial activity has been on a downswing for more than two years, a trend that has favored growth-oriented and large-cap stocks, both of which are inherently less sensitive to industrial activity.[12] But recent data suggest to us that global industrial activity will gain momentum and the manufacturing recession will end in 2025, giving way to a multiyear industrial recovery, a potential tailwind for value stocks and small caps.

We believe there are fundamental reasons to expect strengthening industrial production; for example, the corporate restocking cycle (highlighted in our 4Q 2024 Equity Market Outlook) remains robust as companies continue to replenish inventories, further boosting industrial activity. We also think that strong retail sales, potentially improving demand in mainland China, and a rise in imports (following U.S. port strikes and weather disruptions) should continue to support industrial activity in the near term.

Improving corporate capex, a major component of industrial production, has the potential to sustain this trend. Historically, capex has lagged behind earnings growth and business confidence by about nine months;[13] both have recently moved higher, which is supportive of future capex spending. As uncertainty surrounding the U.S. presidential election has faded and policy direction has clarified, companies appear increasingly comfortable about committing funds to capex: Goldman Sachs forecasts capex growth to accelerate next year and grow 2.6 times faster than U.S. GDP.[14]

To us, these collective observations suggest early signs of a return to the traditional manufacturing economy—a shift that we believe favors a rotation from growth stocks into value stocks, and large caps into small caps (see figure 2).

FIGURE 2: A POTENTIAL RISE IN MANUFACTURING ACTIVITY AND CAPEX COULD PROVIDE A TAILWIND FOR VALUE INVESTING



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[12] Ibid.
[13] Source: Neuberger Berman research and FactSet. Data as of November 30, 2024.
[14] Source: Goldman Sachs, Neuberger Berman research, FactSet, and Bloomberg. Data as of November 11, 2024.

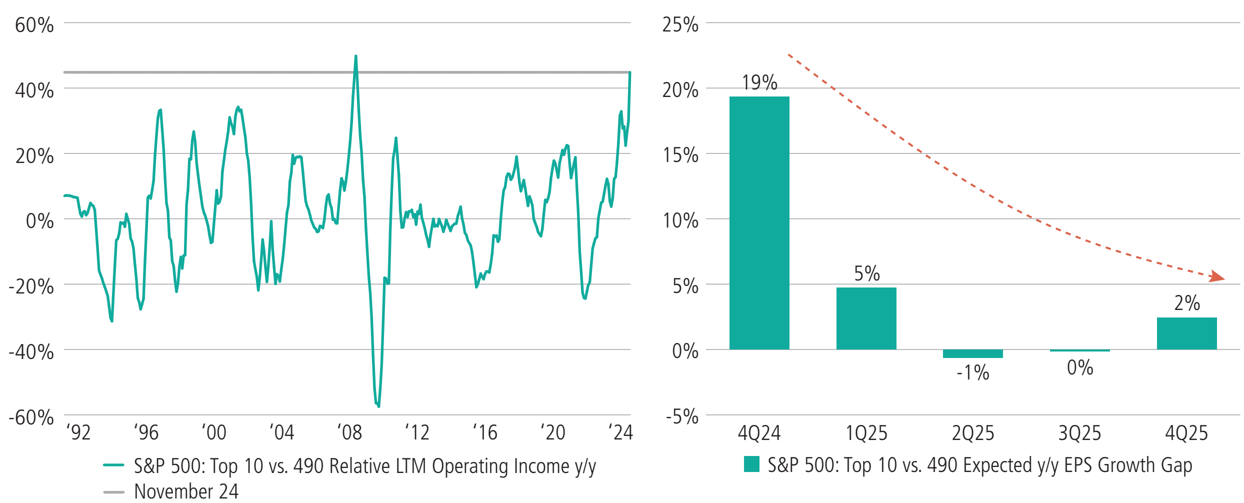
Risks to the Market and Our Recommendations

While we remain optimistic about U.S. equities in 2025, we acknowledge several underlying risks that could challenge the market's overall performance, as well as our style, size and sector recommendations.

Stalling Rebounds in Earnings Breadth and Capex Growth

Even as earnings growth has begun to broaden across the equity market, many investors are still enamored of the mega caps. The gap in reported earnings growth between the 10 largest stocks in the S&P 500 Index and the other 490 has recently expanded to nearly 40%—a level exceeded only once in four decades (see the left side of figure 3).[15]

FIGURE 3: WILL MEGA-CAP EARNINGS SLOW FROM ELEVATED LEVELS?



Source: BofA, Neuberger Berman Research and FactSet. Data as of November 30, 2024. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical result. **Past performance is not indicative of future results.**

Our base-case scenario assumes that the extraordinary growth gap between the top 10 stocks and the rest will diminish to more typical levels in 2025 as industrial activity accelerates and economic growth broadens (see the right side of figure 3). However, if earnings are late to broaden or global capex expenditures are late to pick up, we fear the growth gap could remain elevated, potentially posing a significant risk to our recommended tilt toward value stocks and small caps over growth stocks and large caps.

Stretched Equity Positioning

U.S. households currently have a higher proportion of their net worth allocated to equities relative to cash than at any time since records began in 1951, except one quarter at the peak of the dot-com bubble.[16] At these elevated allocations, we fear the stock market could be more sensitive to negative corporate and geopolitical news surprises in 2025 than is normally the case.

At the sector level, Technology, which now accounts for 32% of the S&P 500 by market cap, has a beta of 1.6—the highest among all sectors.[17] Compounding this risk: discretionary managers' positioning in Technology is now at a bullish 93rd percentile, meaning their relative exposure to that specific sector has been higher only 7% of the time since 2010.[18]

[15] Ibid.
[16] Source: Neuberger Berman research and FactSet. Data as of September 30, 2024.
[17] Ibid.
[18] Source: Deutsche Bank. Data as of December 13, 2024.

In terms of style, the protracted outperformance of high-quality stocks relative to value stocks is reaching a level not observed in 26 years.[19] We fear this shift has introduced a subtle risk: High-quality stocks—traditionally considered safer than the broader market—now have a beta exceeding 1.0, making them riskier than the overall S&P 500 Index.[20]

We worry these trends have made the broader equity market particularly vulnerable to a shift in investor sentiment away from growth stocks, potentially caused by earnings disappointments in the tech sector or a broadening of economic growth.

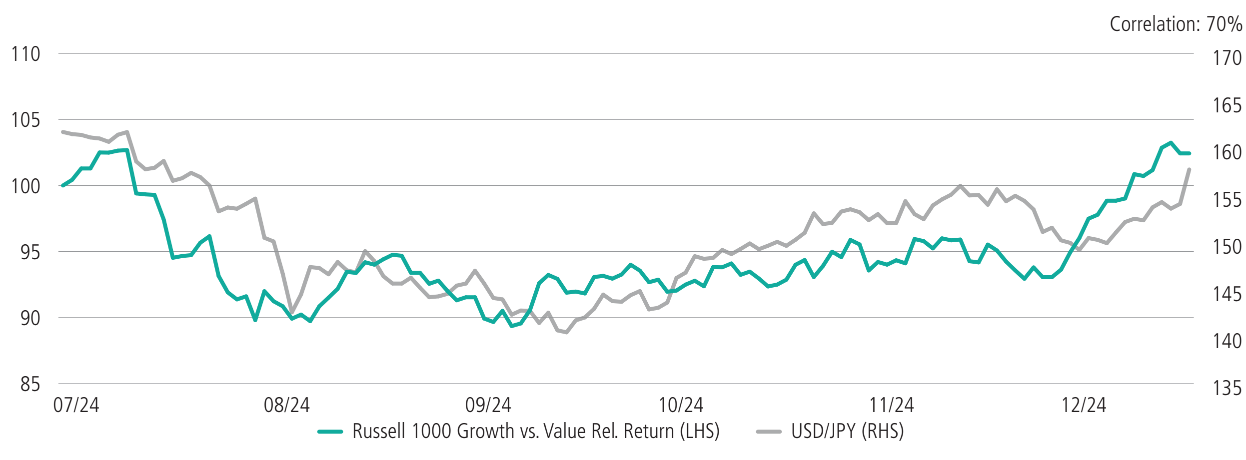
An Unwinding of the Yen Carry Trade Is a Risk to Growth Stocks

The significant divergence in real interest rates across the developed world has made carry trades particularly lucrative over the past three years. Carry trades involve borrowing in a low-yielding currency, such as the yen and Swiss franc, and investing in a higher-yielding currency or even global growth stocks, thereby capturing a spread.

Consider the current differential between the USD and JPY policy rates, as shown in figure 4: As the Fed looks to ease while the BoJ aims to hike, we expect the Japanese 2-year rates to rise relative to those in the U.S. This would make the carry trade increasingly unattractive.[21]

The yen carry trade has been a significant contributor to the exceptional performance of mega-cap growth stocks and remained a significant support for the NASDAQ 100 in the second half of 2024.[22] The reversal of carry trade, in our view, could pressure growth stocks and create volatility across the broader stock market.

FIGURE 4: THE YEN CARRY TRADE MAY SOON START LOOKING UNATTRACTIVE



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There is precedent for this: The yen rose against the USD in early July, prompting a rapid unwinding of the carry trade. Investors sold growth stocks and bought yen, which resulted in a swift 13% correction in the Russell 1000 Growth index within a three-week period.[23] In short, we suggest investors monitor developments in the carry trade over the course of 2025.

[19] Source: J.P. Morgan. Data as of November 30, 2024.
[20] Ibid.
[21] Source: Neuberger Berman research and FactSet. Data as of November 30, 2024.
[22] Source: Neuberger Berman research, FactSet and Bloomberg. Data as of December 9, 2024.
[23] Source: Neuberger Berman research and FactSet. Data as of November 30, 2024.

Portfolio Considerations

While our investment style recommendations remain the same from last quarter (see our 4Q 2024 Equity Market Outlook), we have slightly adjusted our sector and regional allocations.

Sector Tilts
Communication Services and Consumer Discretionary: Upgrading to Overweight

Healthcare: Downgrading to Neutral

Energy: Downgrading to Underweight

We believe the recovery in corporate and consumer spending should drive demand for goods and services, including media, telecom and entertainment, while lingering policy uncertainty could pressure the energy and health sectors.

Regional Tilts
India: Downgrading to Underweight

We believe signs point to a shift in sentiment to China from India. Improving corporate profitability and greater dissaving among Chinese consumers have made us increasingly constructive on Chinese equities. In India, by contrast, the pace of earnings downgrades is increasing and macro momentum slowing, while valuations remain stratospheric and allocations elevated.[24]

For detailed recommendations across sectors, factors, styles and geographies, see the section titled "Investment Themes and Views."

[24] Source: Neuberger Berman research and FactSet. Data as of November 30, 2024.

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Index Definitions

The S&P 500 Index consists of 500 U.S. stocks chosen for market size, liquidity and industry group representation. It is a market value-weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term (2-year) growth and higher sales per share historical growth (5 years).

The Russell 1000® Value Index measures the performance of the largecap value segment of the U.S. equity universe. It includes those Russell 1000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2-year) growth and lower sales per share historical growth (5 years).

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New York
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