*Outperforming the market requires accurately estimating opportunities and risks: it's about identifying favourable odds through probability analysis. **Percentage Play** offers high conviction calls based on our cutting-edge probability forecast models.*

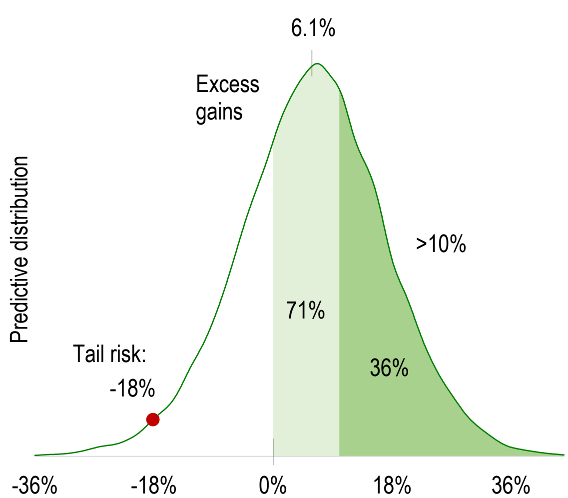
SPECIAL EDITION: TEN CONTRARIAN CALLS FOR 2025

Contrarian alpha: In this special edition of *Percentage Play*, we discuss ten 'out-of-consensus' global and US ideas for 2025. These contrarian calls build on the macro and investment themes featured in our year-end publications. None of these trades are overly tactical, as they are based on dynamics that should materialize over the course of the year.

1) OW EM stocks – EM stocks have trailed DM equities by 6% per year over the post-GFC period. Their poor showing reflects a combination of slowing growth in China, a lower tech exposure, and a strong US dollar. This trend should reverse next year, with our models signaling a 71% chance that EMs will outperform DM stocks (F1).

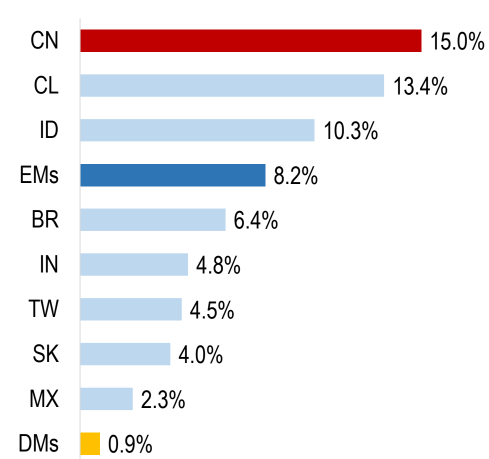
Unlike DMs, most EM equity markets are trading below 'fair' value, improving their relative appeal. In addition, we expect EMs to benefit from greater-than-anticipated Fed easing, which should allow the USD to normalize. Macro stimulus by Beijing al-

F1: EMs have significant 'alpha' potential
EM / DM equities - 12M probability forecast



Note: There is a 71% probability that EM equities outperform DM stocks in 2025, and a 36% chance of excess gains of 10%+. Red dot (left-tail risk) indicates the maximum potential loss on a spread trade over this period. Source: Numera Analytics.

F2: Stimulus *much* more beneficial to EMs
12M equity impact of CN credit impulse



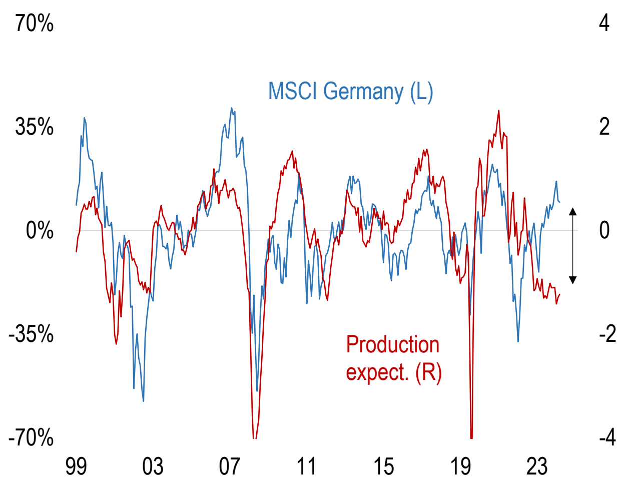
Note: Chart shows simulated impact of a 10% increase in China's credit impulse on 12M real expected returns on selected EM stocks. Results derived from our workhorse structural model of China's economy. Source: Numera Analytics.

so improves their risk-reward profile. We estimate that EM stocks are eight times more reactive to China's credit cycle than DMs (F2), so greater liquidity support increases the likelihood of outperformance.

2) UW Germany – This one is less of a contrarian call than a puzzling phenomenon. The DAX outperformed other offshore markets by 7% last year, despite dismal business sentiment, weak consumption in China (a major export market), and a deep political crisis (F3). One reason for its strong showing is that it features one of two major tech firms in the EZ (SAP), giving it an inherent advantage over competing markets amid continued AI enthusiasm.

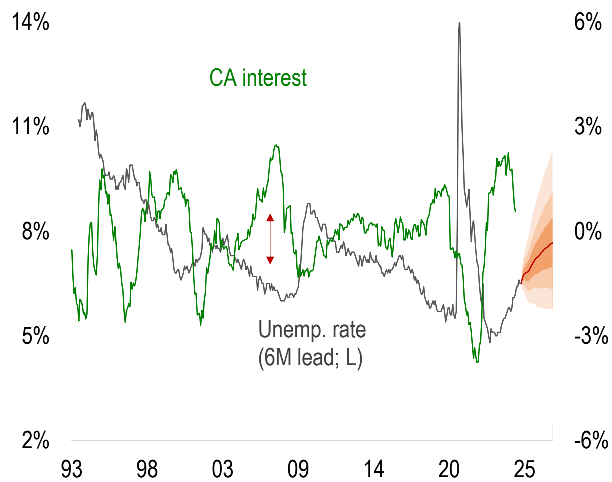
Yet even after stripping tech from the DAX, our structural models suggest that DE stocks are trading well above 'fair' value. Overstretched valuations are vulnerable to a normalization in global risk appetite, while earnings also face a number of headwinds. For example, profits should remain under pressure as automakers keep losing market share to CN producers. We currently find only a 40% chance that DE stocks outperform other DMs 12M out.

F3: DAX unfazed by Germany's struggles
MSCI Germany vs. production expectations



Note: Chart compares cyclical changes in the MSCI Germany against production expectations by German factories. Source: Numera Analytics, MSCI, Eurostat.

F4: BOC still hawkish for level of activity
CA real interest rate gap vs. unemployment



Note: The interest rate gap is the spread between real short-term rates and the estimated 'neutral' rate (R*) for Canada. Fan chart for unemployment indicates 50 / 80 / 95% prediction intervals. Source: Numera Analytics.

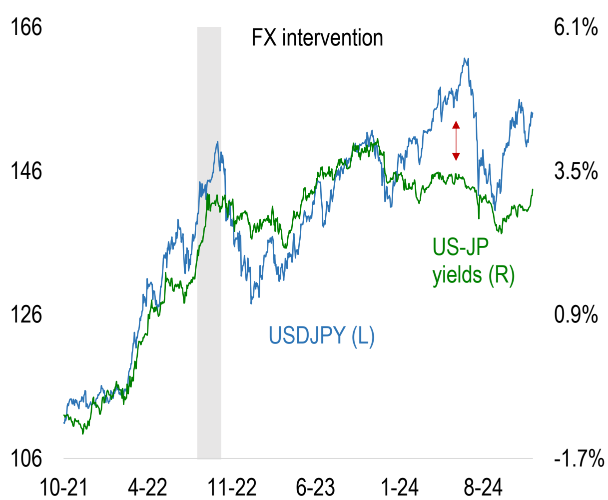
3) Long CA bonds – While stagnant activity and BOC cuts weighed heavily on the loonie in Q4, sovereign yields are up slightly as investors priced in a higher terminal rate. Although markets anticipate further cuts in 2025, we expect an even more aggressive response amid muted inflation risks and even higher unemployment.

Lower rates and a reduction in immigration quotas should lower inflation via lower rental and mortgage costs (absent these components, CPI is up 0.2% YoY). Layoffs should also rise in a context of weak demand and falling vacancies. This should encourage further policy normalization, since real rates remain well above neutral (F4). This translates into an 80% chance that CA 10Y yields will weaken in 2025, the highest such probability across the G10.

4) Long JPY – The yen is the worst performing G10 currency since DM central banks started raising policy rates in early 2022. Expectations of rapid Fed easing during Q3 unwound speculative bets against the yen, but this dynamic has again reversed as markets priced in 'higher-for-longer' Fed policy. While US-JPY yield spreads widened in Q4, the interest rate gap implies a much lower USDJPY than the current spot rate (F5).

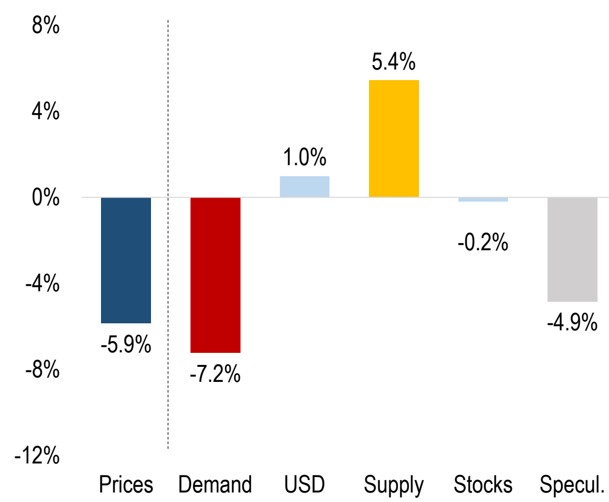
The fact that the yen is trading at a steep discount should encourage net long speculative positions, especially given an acceleration in nominal wage growth (keeping inflation elevated and supporting domestic demand). In combination with a high probability of lower US yields in 2025, this translates into a 65% chance that the yen appreciates against the greenback, a higher likelihood than for other major DM currencies.

F5: Yen again trading at a hefty discount
USDJPY vs. US-JP real yield spread



Note: Chart plots the USDJPY exchange rate against the spread between real (inflation-linked) US and JP bond yields. Source: Macrobond, ICE BofAML.

F6: Weak demand, speculation hurting oil
Drivers decomposition - Real oil prices (2024)



Note: Bars isolate the relative contribution of selected market drivers to real changes in crude oil prices in 2024. Source: Numera Analytics.

5) Long crude oil – Real oil prices weakened this year, hurt by very weak demand (particularly weak usage in China; F6). Markets expect this dynamic to continue, with the Brent forward curve still exhibiting backwardation. In contrast, we find a high probability that oil prices pick up in 2025, owing both to economy-wide and industry-specific factors.

One important source of support should be stronger household spending in China, boosting consumption via stronger road traffic. On the supply-side, production should rise as OPEC+ phases out voluntary cuts, but by less than market expectations. One important reason is Saudi Arabia's very high fiscal breakeven price. We also expect higher perceived inflation risks to lift demand for petro assets, further increasing the likelihood of higher prices.

6) OW defensives – Value stocks – and defensives in particular – have vastly underperformed the S&P over the past two years. As we have argued in recent publications, this reflects a combination of favourable growth surprises, very strong demand for technology, and 'soft landing' and AI optimism.

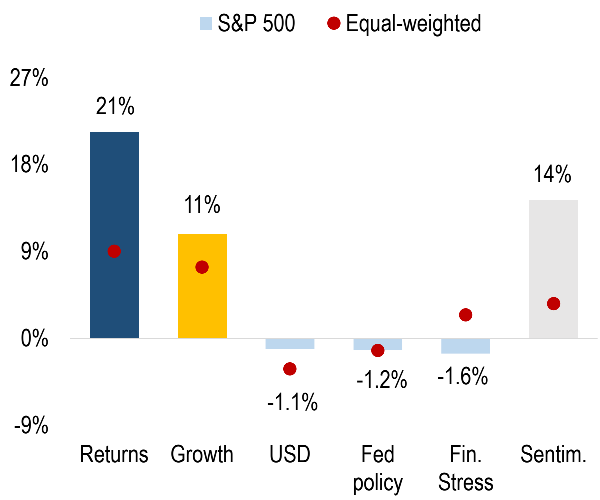
Next year, markets expect strong earnings growth to continue, which alongside Fed easing would call for OW positions on cyclicals. However, we find a high probability that earnings growth will disappoint, as consumers run out of sources of support. This should encourage a rotation towards defensives, many of which are trading well below 'fair' value. We particularly like staples, which stand to gain from a shift in spending patterns.

On the contrary, staples are losing pricing power

7) OW market breadth – The dominance of mega-cap tech has resulted in exceptional concentration in US stocks. This allowed the market-cap weighted (MCW) S&P to deliver far stronger returns than competing benchmarks, including not just small / mid-cap indices but even the equal weighed (EW) version of the S&P.

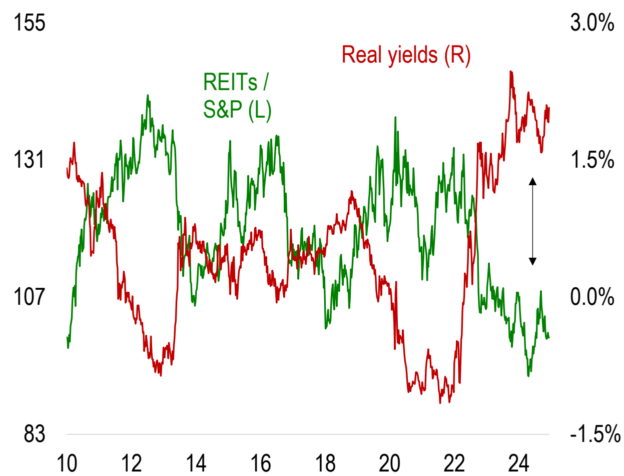
From a macro standpoint, the MCW has disproportionately benefited from resilient growth, including strong demand for technology. However, we find that most of the premium is speculative in nature, as AI enthusiasm keeps driving liquidity flows towards big tech (F7). This makes the MCW more exposed to a reversal in sentiment. Historically, when the MCW – EW gap is as wide as today, the EW index outperforms by 9% 12M out.

F7: Bullish sentiment amplified S&P gains
Drivers decomp. - S&P 500 returns (2024)



Note: Contribution of selected drivers to real returns on the S&P 500 market-cap and equal-weighted indices in 2024. Policy captures actual and expected changes in poicy rates. Sourco: Numera Analytics.

F8: Lower yields would directly help REITs
REITs / value stocks v. real 10Y yields

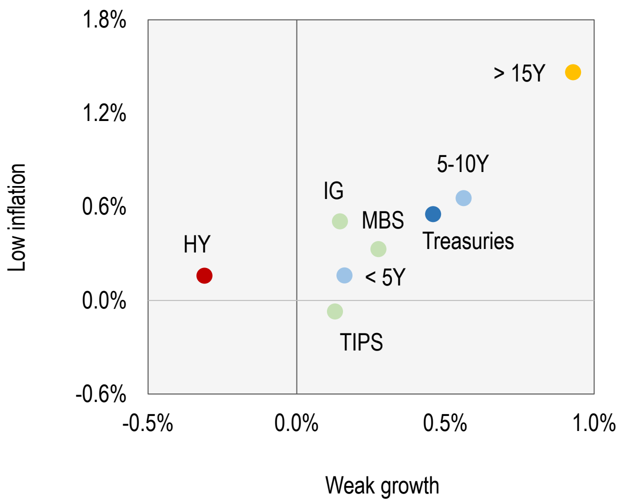


Note: Chart compares the relative performance of REITs to overall value stocks in the S&P 500 against 10Y real yields. Source: S&P, Department of Treasury.

8) OW real estate – Even if we generally favour defensives, there are some cyclical categories with considerable 'alpha' potential. One such industry is real estate, the only GICS sector that has yet to recover its 2022 losses. Their dismal performance reflects a combination of plunging CRE prices and high borrowing costs.

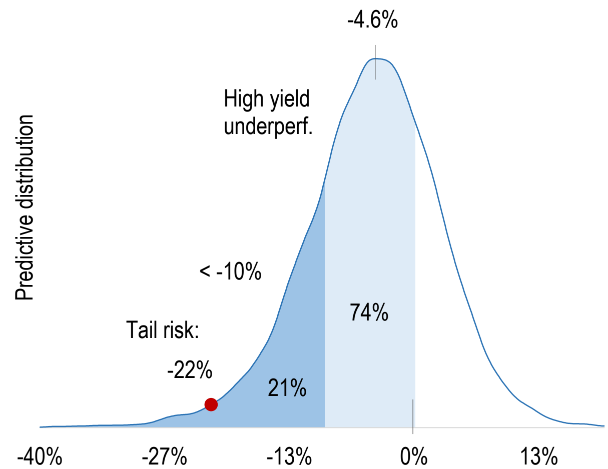
In an encouraging sign, real CRE prices have started to pick up in recent months. While office should remain under pressure as pre-COVID leases expire, other sectors have significant upside. Multi-family, for instance, should benefit from high home prices, favouring renting over buying. This should compensate for a slowdown in broad US growth. Since REITs are highly rate-sensitive, they should also benefit from a decline in yields (F8).

F9: Cyclical slowdown favours duration
US bond response to inflation, growth shocks



Note: Chart compares the estimated impact of typical inflation and growth shocks on 12M expected total bond returns by type. Source: Numera Analytics.

F10: High yield at risk of slowing activity
HY bonds / Treasury returns - 12M ahead (%)



Note: There is a 74% probability that high yield bonds will underperform Treasuries in 2025, and a 21% chance of a 10%+ returns differential. Source: Numera Analytics.

9) Long duration – No asset class has been as impacted by high rates as long duration Treasuries, down 50% in real terms since 2021. Long-dated bonds are hugely sensitive to policy expectations and to growth and inflation surprises (F9). Resilient activity and perceptions of 'higher for longer' Fed policy are therefore preventing a recovery.

US macro conditions next year should result in more rate cuts than the market anticipates. In particular, slower final demand should cause layoffs to rise, driving up unemployment and containing inflation risks via weaker wage growth. This should cause investors to downgrade their terminal rate expectations, and rotate to cheap safe haven assets.

10) UW high yield – Unlike Treasuries, high yield debt has delivered strong returns since 2023, due to a sharp compression in spreads (at 300 bps over 10Y yields, spreads are near an all-time low). Narrow spreads reflect strong corporate balance sheets, due to strong revenue growth, higher asset prices, and a low interest burden (F10). Many HY borrowers, however, will hit their maturity wall this year, increasing liquidity risks in a context of slowing revenue growth. In this context, we find a 74% chance that HY debt trails Treasuries after two years of clear gains.

In case you missed it ...

- **Global Macro Strategist** (17/12): Positioning for uncertainty: Global markets in 2025
- **US Macro Strategist** (19/12): Will tech outperformance continue?

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