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Will tech continue its exceptional run?

US equities have had another stellar year, extending their 2023 ‘bull run’. As was the case last year, however, gains proved highly concentrated, as big tech benefited from strong demand and AI optimism (F1). Bullish risk sentiment, in contrast, drove a further rotation away from high quality bonds, which in real terms continue to trade at 2022 lows.

In this special edition of our *US Macro Strategist*, we present our US investment outlook for 2025. The views build on the macro themes showcased in our year-end *US Macro Perspectives*. We first explore the broad equity outlook and the risk-reward profile by style, sectors and size. We then shift to fixed income and portfolio strategy, focusing on whether Treasuries can finally rally back to life, or if investors should keep favouring riskier asset classes.

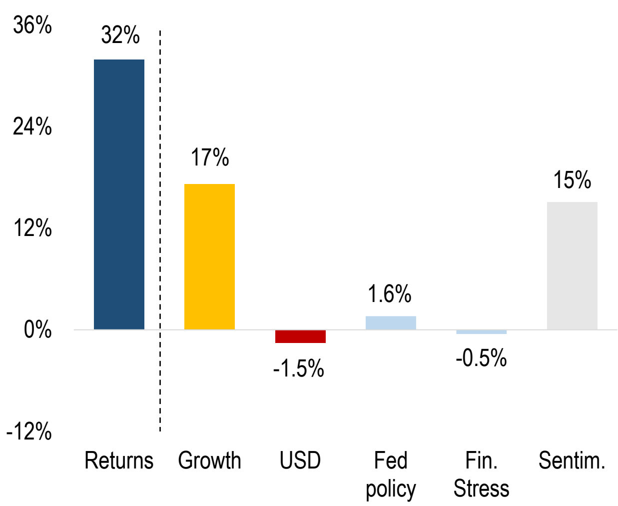
While left-tail risk on equities remains contained, it is unlikely that earnings will live up to Wall Street’s lofty expectations in 2025. This exposes expensive tech stocks to a reversal in sentiment, even when Fed easing usually favours growth over value (F2). We also expect weaker activity to lower yields in 2025, suggesting a more cautious portfolio stance.

We hope you find the research interesting, and we wish you a wonderful holiday season!

Joaquin Kritz Lara
Chief Economist & Strategist

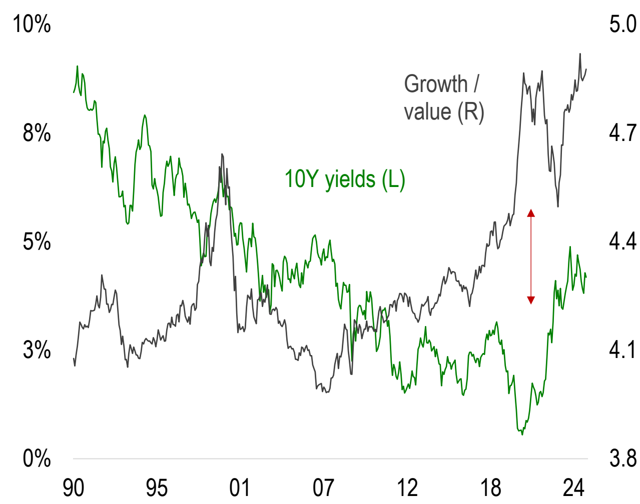
Charts of the month

F1: Another exceptional year for big tech
Drivers decomposition - S&P IT (11M 2024)



Note: Bars isolate the estimated contribution of selected macro factors to real returns on S&P 500 IT stocks through Nov. 2024. Source: Numera Analytics.

F2: Will Fed cuts extend tech dominance?
S&P growth / value vs. 10Y Treasury yields



Note: Chart compares the relative performance of growth to value stocks (in logs) to the 10Y Treasury yield. Source: Standard & Poor's, Department of Treasury.

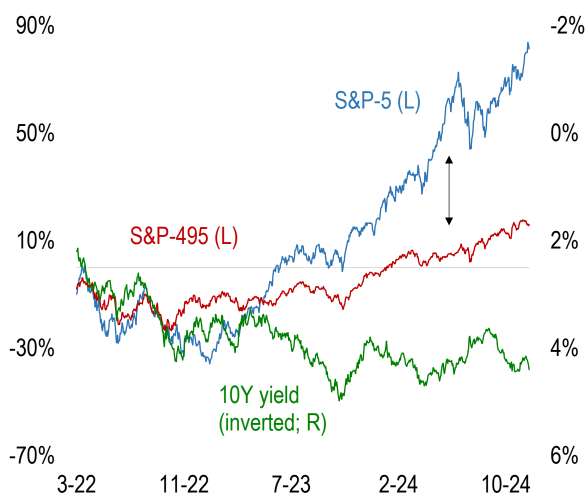
Is it time for tech to take a back seat?

In this special edition, we present our views on US markets for 2025. We first discuss the US investment outlook, and then cover optimal portfolio positioning – including alternative strategies for potential shifts in monetary policy.

AI alpha, again – As was the case in 2023, the S&P has had an exceptional year, posting real returns of 25%. Strong returns reflect improved growth expectations, as consumption and investment proved resilient to high borrowing costs. This, in turn, fueled 'soft landing' optimism, encouraging a further rotation towards risky assets.

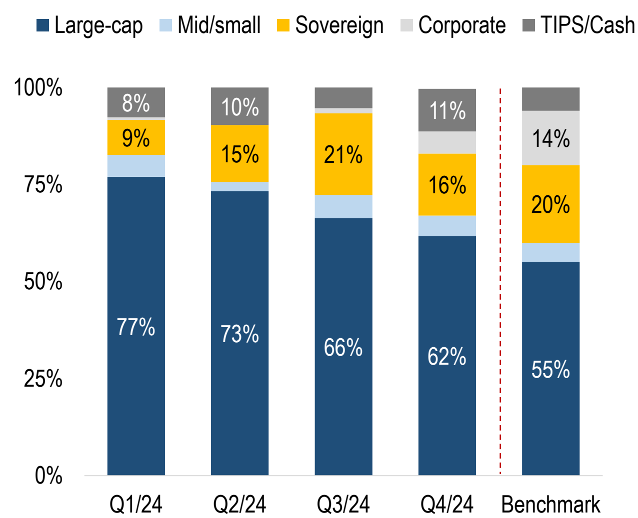
Yet much like last year, **gains were highly concentrated**, with mega-cap tech outpacing the rest of the market (F3). Besides macro optimism, tech is benefiting from AI adoption and rapid growth in software investment (F1). While market breadth improved in H2, tech rotation resulted in large gaps in performance across factors: Growth more than doubled value, cyclicals tripled defensives, and large-cap outperformed small/mid-cap by 10 points YTD.

F3: Returns remain highly concentrated
S&P 500 returns by size vs. 10Y yields



Note: Total returns on the S&P 500 by size (5 largest vs. others) against 10Y US Treasury yields. Source: Numera Analytics, S&P, Department of Treasury.

F4: We've favoured an aggressive stance
Suggested positioning across US assets



Note: Bars show suggested weights for the current macro context, as published in Numera's US Asset Allocation reports in 2024. Source: Numera Analytics.

Far from highlights, bonds continue to struggle, posting weaker returns than last year despite Fed cuts. The key drag has been expectations of 'higher-for-longer' Fed policy as growth fears dissipated. More recently, **Trump's win lifted yields by rekindling inflation worries** and widening the term premium, amid concerns that his policies will widen the fiscal deficit. Corporate debt fared better than Treasuries, as strong balance sheets lowered liquidity risks.

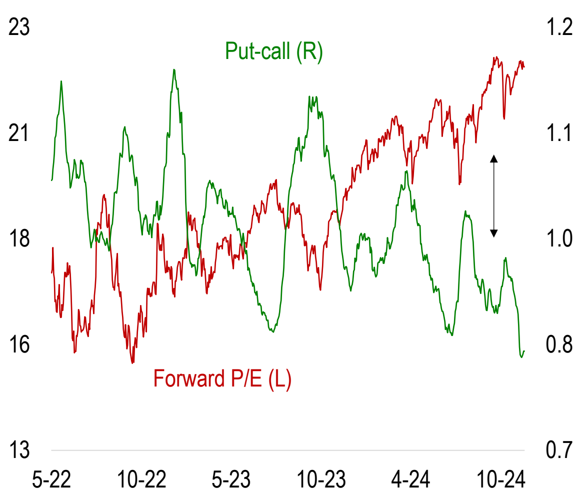
Against this backdrop, we have favoured an aggressive stance (F4), although we toned down our large-cap tilt in H2 as breadth improved and the Fed pivoted. In positioning for 2025, should investors continue to bet on big tech, or do high valuations call for further diversification? And will bonds act as an effective hedge amid uncertainty?

Excessive optimism – Split by source, this year's equity 'bull run' reflects strong profit growth and multiples expansion, with 12M forward P/Es climbing 15% to 22X. In the case of earnings, the market clearly benefited from its tech tilt, as spending on technology far outpaced demand for other goods and services. As for valuations, higher multiples reflect risk taking in response to soft landing optimism, and favourable growth and earnings surprises (F5).

Wall Street expects this upswing to continue, predicting double-digit S&P returns in 2025 (most banks have year-end targets in the 6500-7000 range). Underscoring this bullish view is even stronger earnings growth, aided by strong final demand, further AI investments, Fed easing, and tax cuts by the incoming administration.

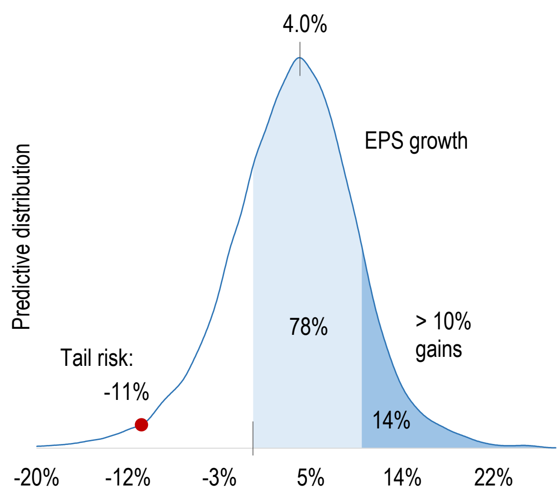
F6 shows our updated EPS outlook. We identify a 78% probability of real profit growth, 10-points higher than average. This reflects moderate recession risks, given low household and corporate debt. Yet as we argued in our year-end *US Macro Perspectives*, spending should slow as consumers deplete their excess savings, and businesses refinance at higher interest rates. **This makes the consensus view of very strong profit growth an unlikely outcome**.

F5: Multiples at risk of sentiment reversal
S&P forward P/E vs. equity put-call ratio



Note: Chart compares the 12M forward P/E ratio for the S&P 500 against the ratio of puts and calls on US equity options. Source: S&P, CBOE.

F6: Market overly optimistic around profits
Real S&P 500 EPS outlook - 2025 (%)



Note: There is a 78% probability that real earnings per share for S&P 500 firms grow next year, but only a 14% chance of double-digit EPS gains. Should earnings fall, the worst potential outcome is an 11% decline. Source: Numera Analytics.

If growth disappoints, this would dent investor sentiment, weighing on valuations. The most likely outcome is for for ward P/Es to move sideways, with a 2% chance they rise at a similar pace than in 2024. The outlook is sensitive to rates: Should yields keep rising, the likelihood of a compression in multiples increases 15 points to over 60%.

What does this mean for market returns? Low valuation upside reduces the likelihood of the S&P trading above 6500 by year-end. In particular, **we find a two-in-three chance that the S&P rises less than consensus**, with real total returns of around 5% (T1). However, left-tail risk remains low by historical standards: Should the market undergo a correction, the worst potential outcome is a 16% drawdown, compared to 30-40% losses during deep recessions.

T1: S&P 500 outlook Probability forecast	2025 returns by source: Real returns	Real earnings	Valuations	Dividends
Expected returns	5.3%	4.0%	-0.1%	1.4%
> 2024 returns (%)	3%	28%	2%	22%
Left-tail risk	-16%	-11%	-19%	0.8%

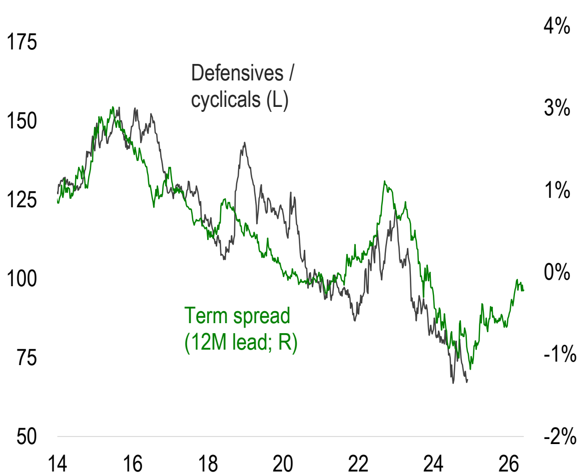
Note: Table shows projected returns by source for the S&P 500 in 2025. Rows compare real expected returns, the likelihood of stronger returns than this year, and left-tail risk by S&P component. Source: Numera Analytics.

Time to downsize? – Beyond the overall equity outlook, an important question in setting portfolio strategy is whether returns will broaden, or remain highly concentrated in big tech. Three important elements to consider, in this respect, are sensitivity to Fed cuts, the impact of negative growth surprises, and the role of speculation in fueling returns.

Historically, higher rate sensitivity gives tech-heavy **growth stocks an edge during Fed easing cycles**. Since the mid-80s, growth has posted average returns of 16% in the year after a pivot, compared to 8% for value. But if valuations are out of sync with fundamentals, this caps upside risk. The dot-com bubble serves as an example, when overstretched valuations caused growth to trail value by double digits despite aggressive Fed easing.

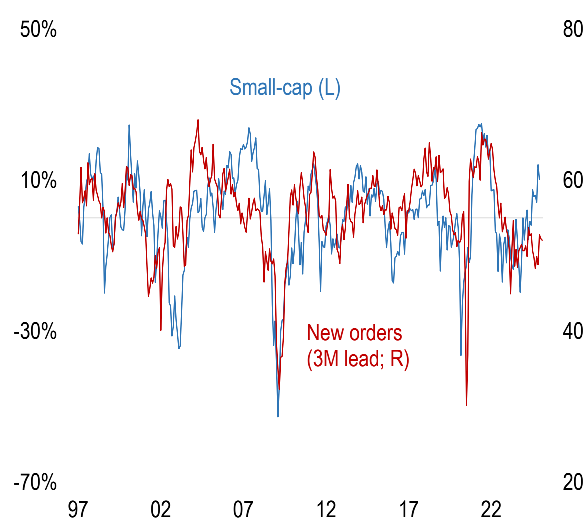
To be sure, today's market conditions are less concerning than in 2000, when outright euphoria caused tech to detach from fundamentals. However, we find that bullish investor sentiment has pushed tech well above 'fair value', while many non-tech sectors are trading at a discount. As growth slows, this calls for a gradual rotation to value, with **our models currently identifying a 62% chance that value outperforms** next year as market returns broaden.

F7: Defensives could regain edge in 2025
S&P defensives / cyclicals vs. term spread



Note: Chart compares the ratio of defensive to cyclical stocks in the S&P 500 against the 10Y minus 2Y Treasury yield (with a 12M lead). Source: Numera Analytics, Department of Treasury.

F8: Small caps tied to US business cycle
Small-cap stocks vs. ISM new orders



Note: Cyclical fluctuations in the Russell 2000 against 3-month prior changes in the ISM new orders composite (m'fg + services) index. Source: Russell Group, ISM.

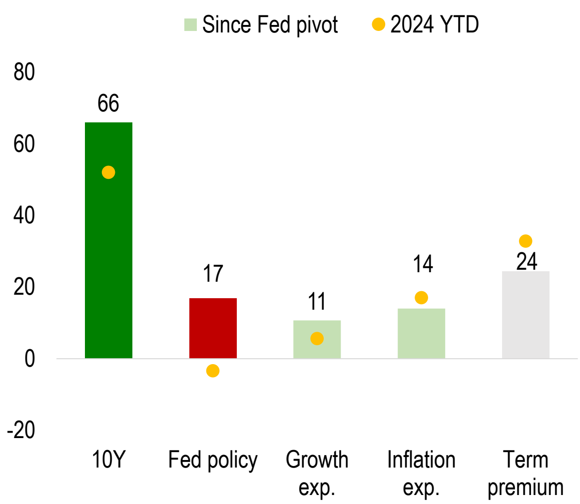
Within the non-tech space, negative growth surprises boost the relative appeal of defensives after two years of clear underperformance (F7, T4). And what about size? Small-caps fared poorly in H1, partly due to their limited tech weight. More recently, however, returns improved on the back of Fed cuts and Trump's pro-US business agenda.

Indeed, small business optimism in November spiked to its highest level since mid-2021, a dynamic that (if sustained) could allow small caps to outperform next year. One limitation, however, is that **their performance is closely linked to the US business cycle** (F8). This becomes problematic beyond the near term, as spending loses momentum. This erodes their relative appeal at 12M holdings, suggesting a gradual rotation in favour of quality and size (see T3).

A little caution – Long-term yields have increased noticeably since the Fed pivot, as markets priced in less cuts and greater inflation risks, and demanded extra compensation to a challenging fiscal stance (F9). The wider term premium has pushed 10Y yields 1% above 'fair' value, making for an attractive entry point as activity slows.

F9: 'Higher for longer' holding up yields

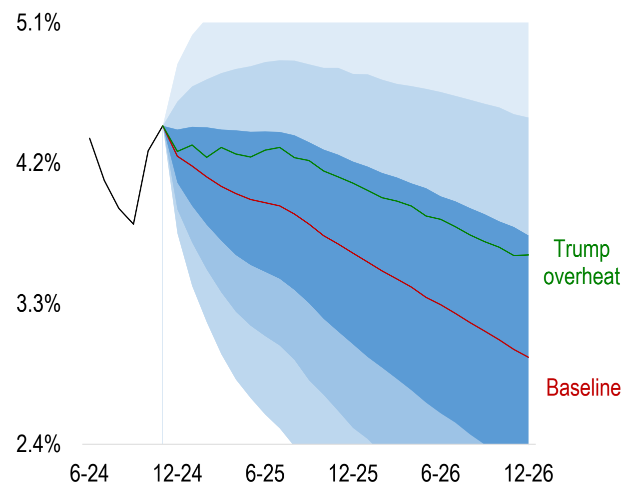
10Y yield term premium decomposition



Note: Chart isolates the contribution of changes in Fed policy, growth and inflation expectations to the observed change in 10Y yields since the Fed pivot, and so far this year. Source: Numera Analytics.

F10: Yields should fall as activity slows

10Y yield outook with Trump overheating



Note: Probability forecast for 10Y Treasury yields. Shade area denotes 50 / 80 / 95% prediction intervals. Green line is an alternative scenario assuming all of Trump's policy proposals are immediately implemented. Source: Numera Analytics.

More specifically, we find a high probability that the FOMC will lower rates by more than markets anticipate. Alongside a downgrade in growth expectations, this should cause yields to weaken, especially if demand for safe assets picks up as growth disappoints. We find a near 80% chance that 10Y yields will trade below current levels by this time next year, improving the upside on rate-sensitive high duration bonds (trading 50% below their 2022 peak).

What would happen if the new administration fully enact its policy agenda? As we have argued, a shift in trade and immigration policy increases the likelihood of overheating. Assuming immediate implementation, the most likely outcome is that Fed cuts twice next year, versus four in our baseline scenario. Even if this were the case, the policy shift would not prevent activity from slowing, which still translates into a two-in-three chance of lower yields (F10).

T2: Fed policy sensitivity Optimal portfolio weights (12M)	Growth	Value	Small-mid	Sovereign	Corporate IG	High yield
Numera optimal	*12%*	*38%*	*3%*	*43%*	*3%*	*1%*
Hawkish Fed (6 cuts)	*27%*	*44%*	*3%*	*22%*	*3%*	*1%*
Dovish Fed (10 cuts)	*7%*	*30%*	*3%*	*44%*	*14%*	*1%*

Note: Table compares optimal portfolio weights for alternative Fed policy scenarios. Second row conditions on a scenario in which the Fed cuts rates 6 times by December 2025, whereas the third row considers positioning under a 10 rate cut scenario. Sovereign includes TIPS and money market securities. Source: Numera

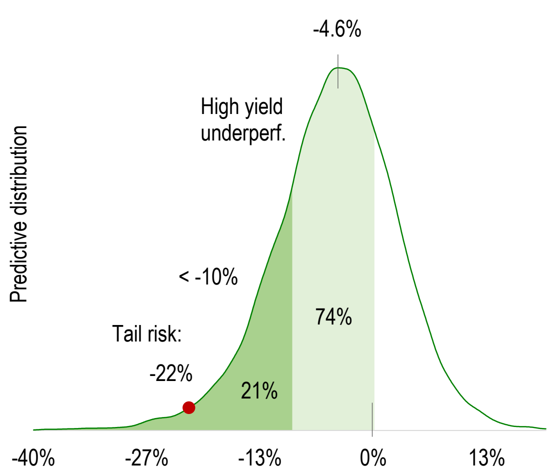
Yes, but corporate bond issuance has been super strong too amidst higher rates

What about corporate debt? High yield have benefited from low liquidity risk since they refinanced at rock bottom rates in 2020/21. Many debtors, however, will **face a maturity wall in 2025-26**, increasing the likelihood of wider spread in a context of slowing revenue growth. Here, it is likely that riskier bonds will underperform in 2025 (F11).

T3 shows updated results from our USAA framework, which finds optimal weights for a US portfolio at various holding periods. While the macro context calls for a mild OW on stocks, a prudent **45 / 55 split maximizes risk-adjusted returns 12M out**, with a preference for value over growth, and sovereign over corporate debt. This is consistent with past easing cycles and moderate inflation risks, when the equity return premium typically narrows (F12).

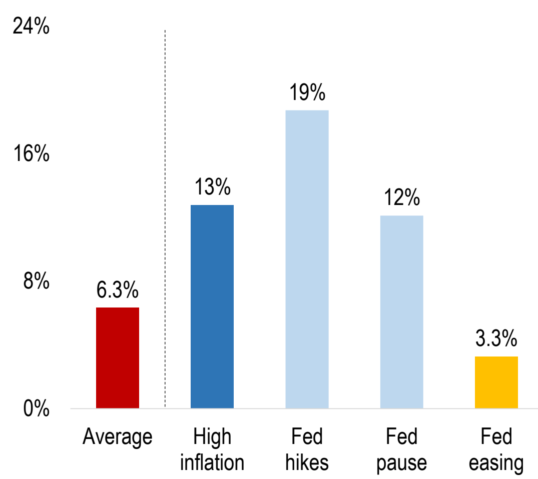
Importantly, our modeling approach allows us to evaluate positioning under alternative scenarios. T2 outlines how to alter the asset mix in the event of a more dovish or hawkish Fed. If inflation and growth surprise on the upside under Trump, this would call for a **significantly lower bond exposure**, and a less aggressive value tilt. Conversely, if the Fed cut aggressively as unemployment spikes, investors should replace riskier equity holdings for safer IG debt.

F11: Higher liquidity risks would hurt HY
High yield / 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.

F12: Quality, duration have greater upside
S&P / sovereign bond returns by regime

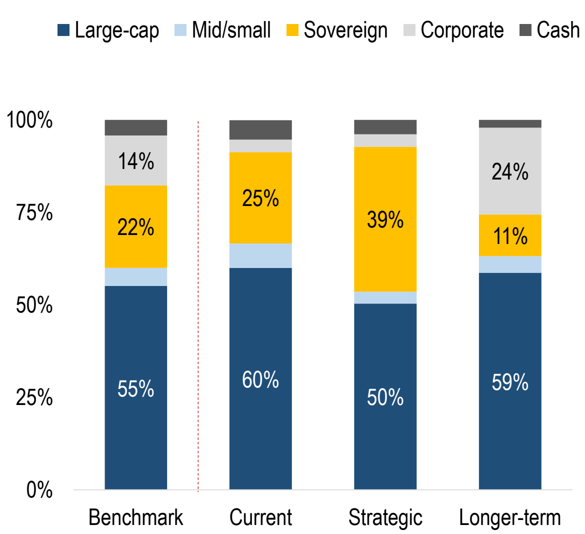


Note: Average excess returns on US stocks versus Treasury bonds by macro regime since 1984. Blue bars isolate returns during periods of high inflation, and when high inflation coincides with Fed hikes, pauses and easing. Source: Numera Analytics.

T3: Asset allocation Optimal weights (%)	Benchmark	Positioning[a] Current	 Strategic	 Longer-term
Large-cap stocks	55%	60%	50%	59%
Growth	30%	44%	16%	26%
Value	25%	16%	34%	32%
Mid-cap stocks	3%	3%	2%	2%
Small-cap stocks	2%	3%	1%	3%
Sovereign bonds	20%	20%	34%	10%
Corporate bonds	14%	3%	3%	24%
Investment-grade	11%	3%	3%	23%
High yield	2%	1%	1%	1%
Inflation-linked bonds	3%	4%	5%	1%
Money market	4%	5%	4%	2%
Stocks	60%	67%	54%	63%
Bonds	40%	33%	46%	37%

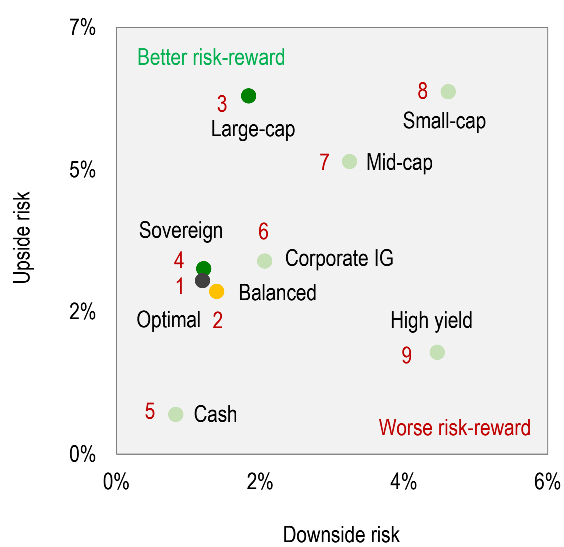
a. Optimal weights maximize risk-adjusted portfolio returns across stocks and bonds for the current US and global macro context, over the next 12M (strategic), and over the next 5 years (longer-term).

F13: Numera suggested positioning
Optimal weights by investment horizon



Note: Optimal weights maximize risk-adjusted returns for the current macro context, over the next 12M, and over the next 5 years. Source: Numera Analytics.

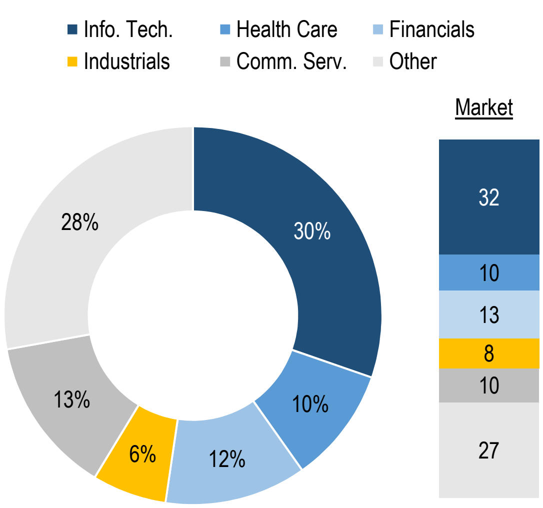
F14: Strategic US asset allocation
Risk-reward comparison by asset class



Note: Chart compares ratio of upside to downside risk across US stocks and bonds over a 12-month holding period. Source: Numera Analytics.

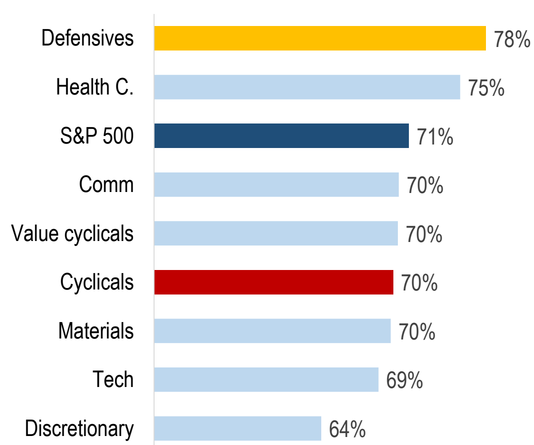
T4: Strategic allocation Positioning by sector	Strategic rotation	Change (vs. Nov.)	Sector view and key macro factors
Information Technology	●	–	Continued AI enthusiasm and lower projected yields remain two important sources of 'alpha'. We favour software, more resilient to a US slowdown.
Health Care	●	–	Neutral overall, but major differences by sub-sector. We are OW on services and equipment, but UW on big pharma as we expect investment to slow.
Financials	●	–	We are neutral since a wider term spread and a normalization in lending standards improves bank appeal. Regionals stand to gain from deregulation.
Consumer Discret.	●	–	High borrowing costs and falling credit volumes should hurt the profitability of consumer durables producers next year as wealth effects dissipate.
Industrials	●	–	As a deep cyclical, industrials are vulnerable to negative growth surprises in 2025. However, downside contain by likely pick-up in domestic manufacturing.
Communication Serv.	●	▼	Downgrading since bullish investor sentiment has pushed online media well above 'fair' value. Lower projected yields contain downside risk.
Consumer Staples	●	–	Improving volume growth, and expenditure share to rise as consumers deplete savings. FMCG producers also benefit from resilient mark-ups.
Energy	●	–	We continue to find that oil trades at a significant discount given a tight balance. We also expect crack spreads to widen as trader sentiment normalizes.
Materials	●	▼	USD strength worsens near-term appeal. Energy is a more effective inflation hedge, partly because higher oil prices would hurt chemical margins.
Utilities	●	–	Fed easing and AI-driven power demand boost their risk-reward profile. As a defensive sector, it also offers a hedge against a likely slowdown in H2/25.
Real estate	●	–	CRE prices are picking up, increasing upside for a sector that still trades at a deep discount. Fed cuts also help, especially given a low risk of a deep recession.

F15: Optimal vs. market sector weights
Strategic portfolio weights (12M holdings)



Note: Optimal versus market weights for Numera strategic portfolio. Optimal weights are constrained to +/- 50% of their market caps. Source: Numera Analytics, S&P.

F16: Probability of positive real returns
Likelihood by GICS sector - 2025 (%)



Note: Chart compares the probability of positive real returns on selected equity sectors and styles over a 12M holding period. Source: Numera Analytics.

Top Conviction Calls & Scorecard

US Investment Ideas Top Conviction Calls	Action	Open date	Recently closed	Trailing stop-loss[1]	P&L	Report
US utilities	Long	22-Aug-24	4-Nov-24	4.1%	4.1%	PDF
US small-cap stocks	Long	26-Aug-24	9-Sep-24	5.0%	5.0%	PDF
Fed fund rate futures	Put option	9-Sep-24	27-Nov-24	70.0%	70.0%	PDF
US small-cap stocks	Long	16-Sep-24	-	6.2%	8.2%	PDF
US energy stocks	OW	18-Sep-24	4-Dec-24	2.0%	2.0%	PDF
Materials stocks	Long	3-Oct-24	-	-8.0%	-7.2%	PDF
Real estate stocks	Long	21-Oct-24	-	-9.0%	-3.6%	PDF
S&P equal weighted	Long	30-Oct-24	-	-9.0%	1.1%	PDF
Regional banks	Long	6-Nov-24	11-Dec-24	7.1%	7.1%	PDF
US aerospace & defense	Long	6-Nov-24	-	-4.0%	-1.5%	PDF
US refiners / E&P	OW	6-Nov-24	-	-8.0%	-1.9%	PDF
US diesel	Call option	20-Nov-24	-	-70.0%	-8.5%	PDF
US gasoline	Call option	20-Nov-24	-	-60.0%	-7.0%	PDF
US semiconductors	OW	11-Dec-24	-	-3.0%	1.2%	PDF

1. Stop-loss threshold matches the expected loss over the remaining holding period, relative to the current P&L.

Benchmarks

- **Stocks**: Large-cap: S&P 500 by GICS sector; Mid-cap: S&P midCap 400; Small-cap: Russell 2000
- **Bonds**: ICE BofAML US Treasury, US Corporate and US High Yield, US TIPS; Money market: 3-month T-bill