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Positioning for uncertainty: Global markets in 2025

In our year-end *Global Macro Perspectives*, we examined the key themes driving the global economic outlook in 2025. We now shift our focus to financial markets, discussing how these factors shape the risk-reward profile of global assets. DM stocks have had another stellar year, propped up by resilient US growth and 'soft landing' optimism (F1). We explore whether stocks will retain their current momentum, and if investors should continue to OW US assets in global portfolios.

After two years of exceptional returns, we expect the US equity premium to narrow in 2025, opening the door for further diversification. DM bonds, in particular, should finally experience stronger returns as G10 central banks continue cutting policy rates, and US growth slows (F2). Weaker US activity also suggest greater regional rotation, particularly to EMs.

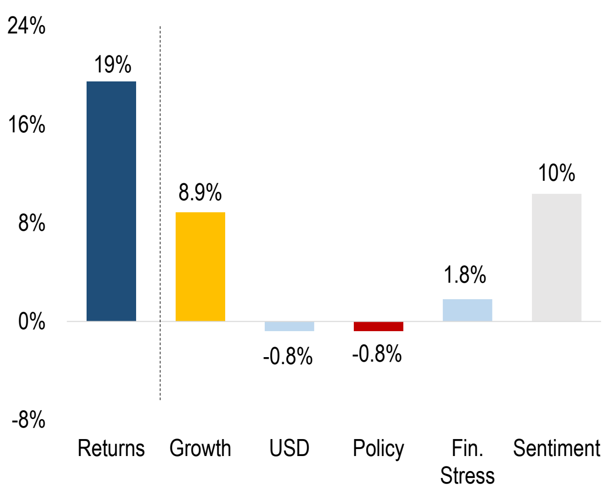
In the following pages, we present our views on global asset classes, and our suggested portfolio mix. We also discuss alternative positioning if protectionist US policies limit Fed easing and keep the dollar elevated. Later this week, we will publish an equivalent report for US markets, delving deeper into equity styles, and fixed income by quality and duration.

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

Joaquin Kritz Lara
Chief Economist & Strategist

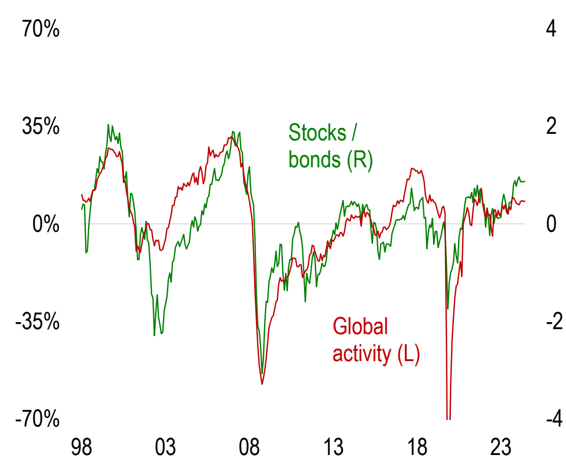
Charts of the month

F1: Macro optimism fueled stocks in 2024
Drivers decomp. - MSCI World (2024 YTD)



Note: Contribution of selected drivers to real returns on the MSCI World between Dec. 2023 and June 2024. Policy captures actual and expected changes in policy rates, money supply and corporate policy (for Japan). Source: Numera Analytics.

F2: Global context still favouring stocks
Stocks / bonds vs. Numera activity index



Note: Chart plots the relative performance of stocks to bonds against Numera's global activity index, a high frequency proxy of the global business cycle. Both series shown as deviations from trend. Source: Numera Analytics.

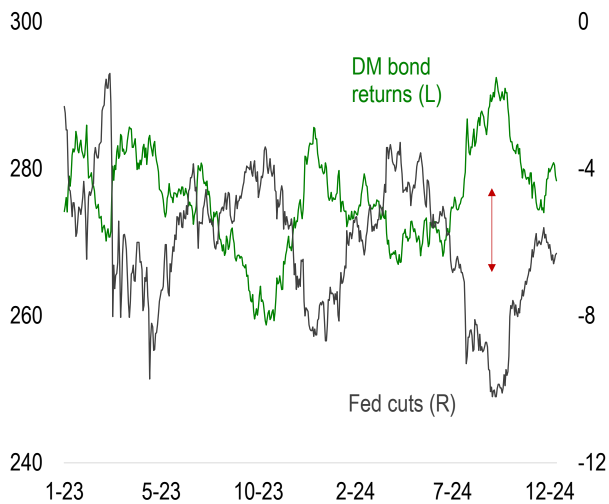
Should investors keep betting on US exceptionalism?

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

A year of contrast – As was the case last year, 2024 proved an **outstanding year for equity investments**. DM stocks are up 19% YTD, benefiting from resilient US activity and improving growth expectations. In addition, US 'soft landing' and AI optimism fueled risk appetite, compensating for still tight monetary policy and a strong dollar (F1).

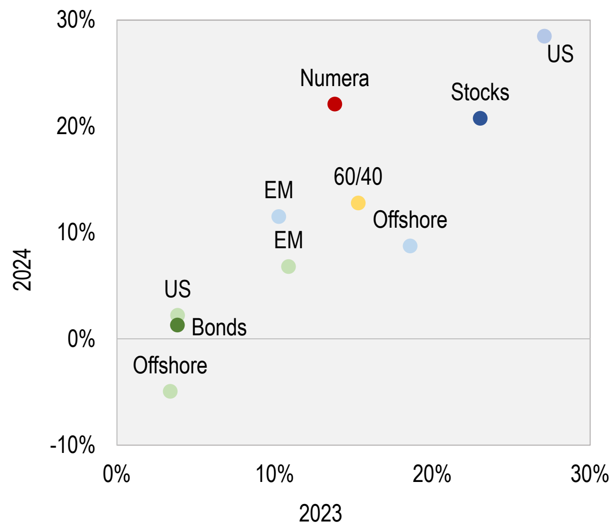
Nevertheless, strong returns hide **significant dispersion across regions**. While rapid growth in demand for tech goods and services fueled S&P earnings, offshore markets faced multiple headwinds (F3). EZ stocks, for instance, are up 3% YTD in real terms, hampered by subdued activity in Germany, limited tech exposure, and a string of political crises. EM equities fared better, but still faced pressure from USD strength and weak growth in China.

F3: 'Higher for longer' hurting bonds
DM bond returns vs. Fed cut expectations



Note: Chart compares total USD returns Treasury bonds against expected number of Fed cuts by Dec. 2025. Source: ICE BofAML, CBOT; Numera calculations.

F4: US stocks tilt proved right call in 2024
Global asset returns and portfolios



Note: Chart compares total USD returns on global asset classes and portfolios in 2023 and 2024. Green dots represent bonds and blue points stocks. Source: MSCI, ICE BofAML, Numera Analytics

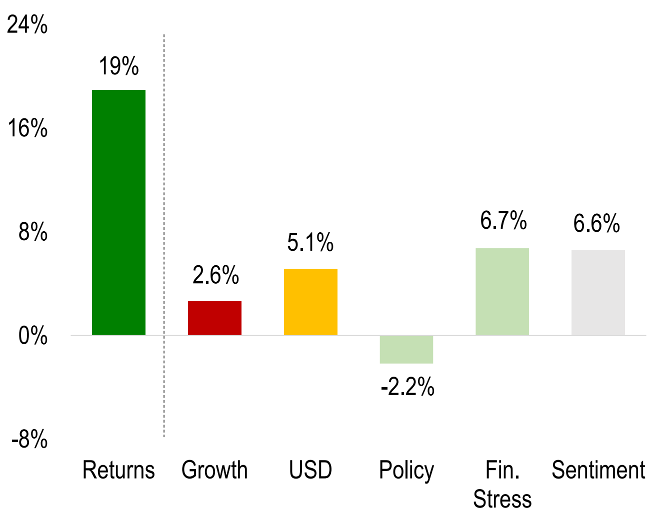
Bond investments had an even more challenging year, delivering flat returns despite the start of the DM easing cycle. The key drag was expectations of 'higher-for-longer' Fed policy, lifting Treasury yields and weighing on offshore bonds via a stronger dollar (F4). As we expected, EM debt maintained an edge, as macro optimism narrowed spreads.

Our global investment views fared strongly against this backdrop. In the case of multi-asset strategy, our GAA modeling framework far outpaced a 60/40 benchmark (F4). This reflected an accurate read of two key topics: A continuous OW of stocks over bonds, as macro optimism fueled a rotation to riskier assets, and large OW positions on US over offshore stocks, as the US growth premium kept widening (see F5).

Similarly, our top conviction calls had a strong showing. This year we opened 91 trades. An equal-weighted portfolio of these ideas is **up 42% YTD, doubling the MSCI World**. One important source of 'alpha' was our assessment of the late cycle. While investors expected a synchronized easing cycle this year, we argued that varying macro conditions would create differences in policy stance across the G10, opening up FICC opportunities.

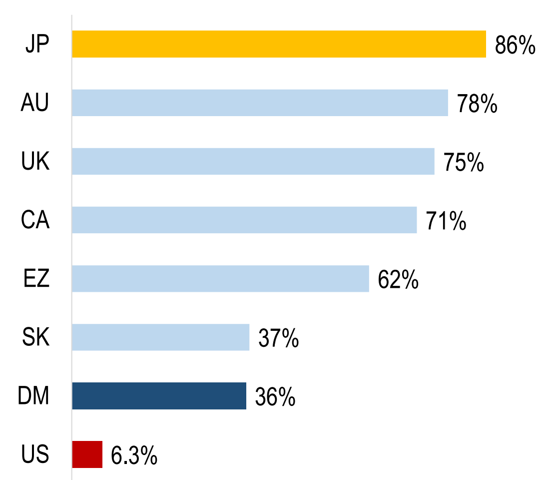
Time to diversify? – Investors face a number of important questions for 2025. Will US equities continue to dominate, or is the market at risk of a correction? Will bonds finally pick up as central banks cut rates further, or will growth and inflation surprises keep yields elevated? Will China's stimulus efforts finally give EMs an edge?

F5: Multiple factors favouring US equities
Drivers decomp. - US / offshore stocks (2024)



Note: Contribution of selected drivers to real returns on the MSCI World between Dec. 2023 and June 2024. Policy captures actual and expected changes in policy rates, money supply and corporate policy (for Japan). Source: Numera Analytics.

F6: US growth premium will likely narrow
Likelihood that growth picks up in 2025 (%)



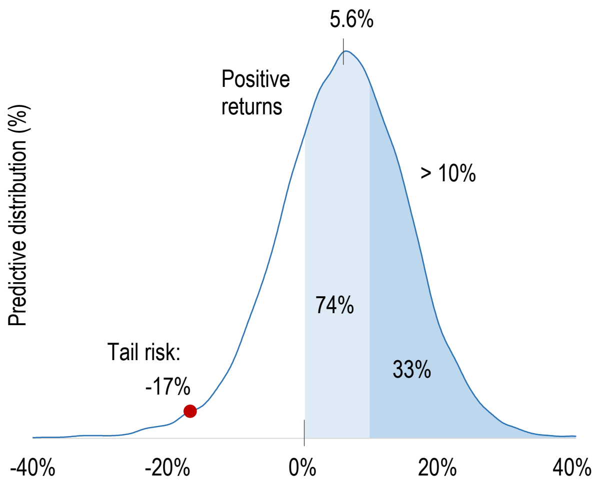
Note: Chart compares the likelihood that real GDP in major DMs grows faster next year than in full-year 2024 . Source: Numera Analytics.

On the equity side, **US outperformance remains the name of the game**. This year the S&P delivered an almost unprecedented 19% returns premium over offshore stocks. As we can see in F5, this reflects much stronger activity, USD gains, and favourable financial conditions. Yet as we have argued recently, excessive concentration and bullish earnings expectations limit their upside versus earlier in the cycle – opening the door to diversification.

To be sure, we are not overly concerned of an outright correction, as robust household and corporate balance sheets should prevent a recession. The main risk, in our view, is that profit growth fails to meet Wall Street's lofty expectations as spending decelerates. **This would likely dent investor sentiment**, weighing on valuations despite Fed cuts.

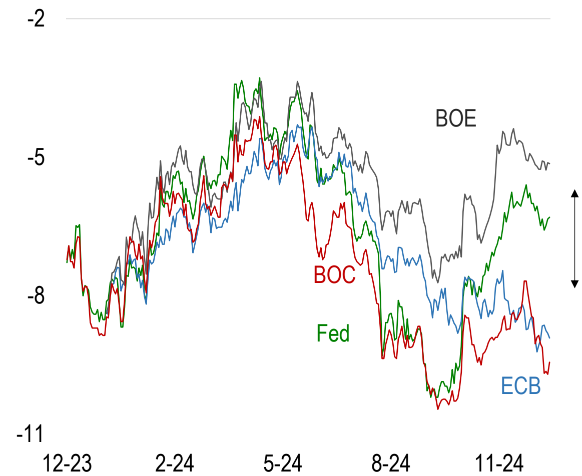
In contrast, we find a higher probability that activity in other DMs picks up in 2025 (F6), as stronger real wages boost consumer confidence. Alongside further Fed easing, a narrower US growth premium should cause the dollar to lose some ground next year. Taken together, these factors translate into a **48% chance that offshore stocks beat the S&P** (this is 35-points higher than the post-GFC average, and high enough to justify a neutral relative stance).

F7: Stocks should continue to rise in 2025
MSCI World - 12M probability forecast (%)



Note: There is a 74% probability that DM equities deliver positive real returns in 2025, and a 33% chance of double-digit gains. Red dot (left-tail risk) indicates the maximum potential drawdown over this period. Source: Numera Analytics.

F8: Rate cut expectations have decoupled
Expected number of rate cuts by Dec. 2025



Note: Expected number of cuts by G7 central banks by December 2025 based on futures prices. Source: Macrobond; Numera calculations.

What does this mean for DM stocks overall? We find a 74% chance that the MSCI World keeps climbing in 2025 (F7), matching its historical average. In addition, left-tail risk is well within its normal range, with a maximum drawdown of -17%, versus 30-40% losses during deep recessions. Yet the S&P's limited valuation upside curbs the extent of future gains: For example, we find **only a 34% chance of double-digit returns**, a common outcome since 2010.

Ready for launch – What about fixed income? Unlike stocks, **bonds are far from recovering their 2022 losses**, when inflation and rate hikes raised yields well above their post-GFC levels. In real terms, IG debt is still 32% below its 2021 peak, with a 50% shortfall in rate-sensitive long duration sovereign bonds. This makes for an attractive entry point, considering that most DM central banks have now started their easing cycle.

The risk-reward profile of high quality bonds depends macro factors. One important element is whether markets are properly pricing in future cuts. In contrast to H1/24, **bond investors today anticipate unsynchronized easing**, expecting multiple rate cuts by the ECB and the BOC, and 'higher-for-longer' monetary policy in other DMs (F8).

T1: DM policy rate outlook Expected cuts by Dec. 2025	Fed	ECB	BOE	BOC	SNB
Numera baseline	*8*	*7*	*6*	*11*	*5*
Futures markets	*6*	*9*	*5*	*9*	*7*
< futures probability (%)	*71%*	*34%*	*56%*	*66%*	*22%*

Note: Table compares the likelihood that policy rates in selected G10 economies fall more than what the bond market is currently pricing over a given holding period. Source: Numera Analytics against FFR, ESTR, SONIA, CORRA and SARON futures.

T1 shows our updated DM policy rate forecasts for 2025, versus market expectations. While limited inflation risks and rising unemployment should result in aggressive BOC easing, we find a 34% chance the ECB lowers rates by less than priced in by markets. This reflects ongoing pressures, and tight job market conditions. Finally, **investors are underestimating future Fed cuts**, as slowing activity should cause higher layoffs and weaker wage growth.

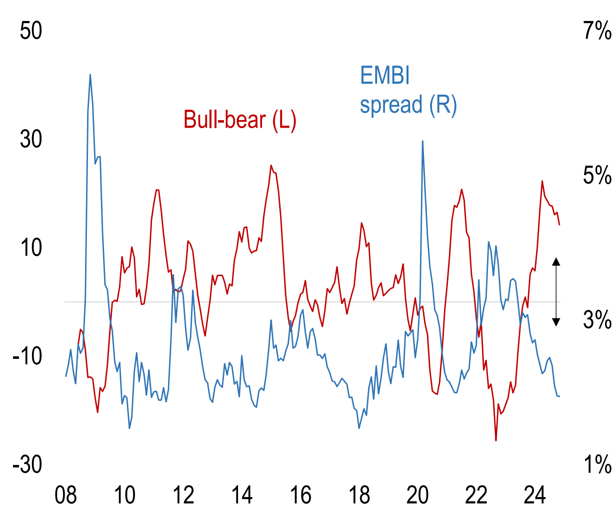
This has major implications for the bonds. While a US recession remains unlikely, the combination of negative growth surprises and faster Fed easing should directly lower Treasury yields. In addition, notice from F9 that US yields are trading 1% above the level consistent with macro fundamentals, as optimism discourages demand for safe haven assets. If growth slows, this should compress the term premium of long-term debt, boosting bond prices.

Conversely, slower ECB easing **dents the relative appeal of offshore bonds**, which also pay much lower coupons than US. In fact, 40% of offshore government debt is made up by JGBs, subject to downside risk as JP inflation picks up and the BOJ normalizes policy. In this context, we find a 64% chance that US debt outperforms in 2025.

F9: US rates trading well above 'fair' value
10Y yields vs. expected short-term rates

Note: Chart compares 10Y US Treasury yields vs. average expected short-term interest rates over the next 10 years. Source: Macrobond, San Francisco Fed.

F10: Macro optimism has helped EM debt
EMBI spread vs. bull-bear spread



Note: Chart plots the spread between EM hard currency and 10Y US Treasury bond yields against the smoothed bull-bear spread. Source: ICE BofAML, AAII.

Emerging opportunities – Another important decision in setting strategy is whether to OW EM assets. This year, we suggested sizeable OW positions on EM stocks and bonds. While EM equities trailed the S&P, they will likely beat DM offshore stocks for only the second time since 2017. EM hard currency debt, in turn, far outpaced DM bonds, due to a combination of global macro optimism (F10), falling EM inflation, and more attractive coupon rates.

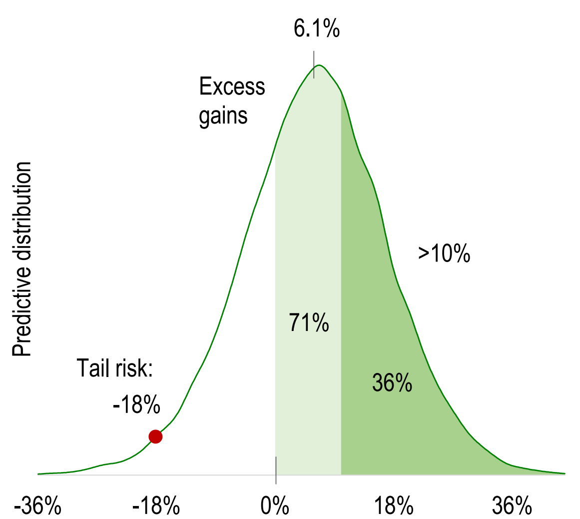
This should continue in 2025, as the global macro outlook benefits both asset classes. F11 shows our 12M probability forecast for relative returns on EM stocks. We currently find a **71% chance that EMs outperform DMs**, expecting a 6% premium. This is a very strong signal for an asset that has trailed DMs by 6% on average since 2011.

The bullish EM outlook reflects a number of key tailwinds. One important dynamic is persistent Fed easing, historically much more beneficial to EM stocks and bonds. We can see this in F12, which shows excess returns on global assets in the year after a Fed pivot. As long as US avoids a financial crisis, **Fed cuts disproportionately benefit EMs**.

One reason for this is that Fed easing usually weakens the greenback, favouring high 'dollar beta' assets. This has not been the case this year, as the market priced in a shallow Fed easing cycle. Moving forward, however, the fact that investors are underestimating future cuts increases the likelihood of EM outperformance. Our modeling work reveals that a 5% drop in the USD boosts EM equity returns by 15%, twice the multiplier for DM offshore shares.

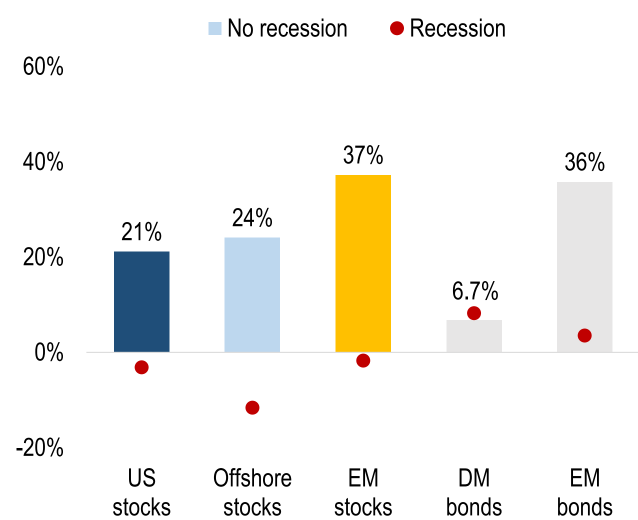
Greater policy support by Beijing also improves their risk-reward profile. China's credit impulse has weakened sharply since mid-year, but the government **has pledged policy support in 2025** after likely missing its 5% growth target. This also boosts expected gains for EM stocks, eight times more sensitive to CN policy moves than DMs. Similarly, stronger CN activity should contain any potential widening on EM bond spreads as US growth expectations normalize.

F11: EMs have enticing risk-reward profile
EM / DM stocks - 12M returns 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.

F12: EMs are very sensitive to Fed policy
12M average returns after a Fed pivot (%)

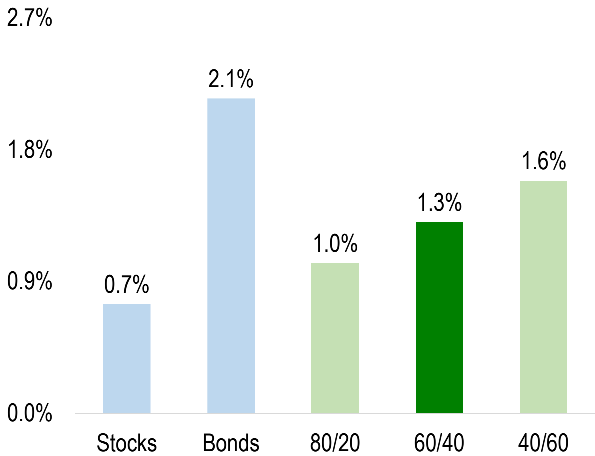


Note: Average returns by asset class in the 12M following a Fed pivot since 1986. Bars and dots split performance when the pivot coincides with a US recession (indicated by the Sahm rule breaking above 0.5%). Source: Numera Analytics.

Embracing uncertainty – How should investors position their global portfolios for 2025? T3 on p.8 shows optimal weights across major asset classes considering the above dynamics. Perhaps the most important decision is whether to continue OW stocks, or if investors should adopt a more conservative stance. In the current context, we find that equities retain an edge, but **suggest a higher bond exposure in 2025** as weaker US activity drives down yields.

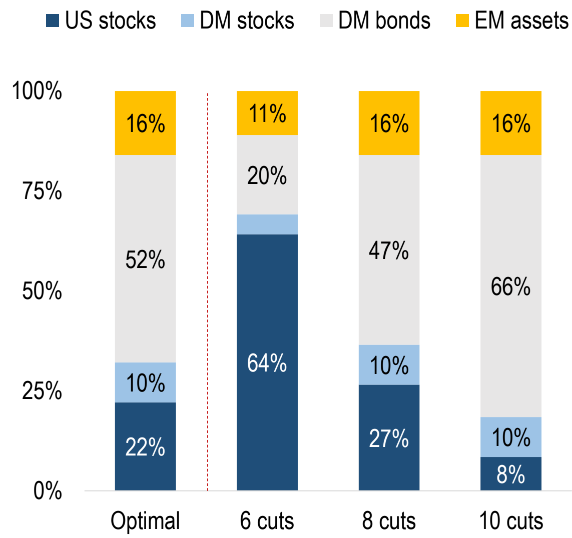
More specifically, we find that a **45/55 split maximizes risk-adjusted returns** on 12M holdings. We usually associate this asset mix to a bearish equity outlook. Yet this is not the case today. The main issue, as is often the case in a late cycle, is that Fed easing greatly improves the upside on sovereign debt, narrowing the returns differential (F13).

F13: Easing favours a conservative stance
12M excess returns following a Fed pivot



Note: Average returns versus trend for global stocks, bonds and asset allocation benchmarks in the 12M after a Fed pivot since 1986. Source: Numera Analytics.

F14: Overheating would affect positioning
Optimal weights conditional on Fed cuts



Note: Chart compares optimal weights over a 12M holding period to optimal weights conditional on a given number of Fed cuts. Source: Numera Analytics.

Our suggested positioning considers the full range of scenarios for a number of macro factors, including Fed policy and the dollar. But what if the US kept overheating in response to Trump's policy proposals? One advantage of our approach is that it allows us to assess positioning under a variety of alternative policy scenarios and macro regimes.

Assuming immediate full policy implementation, higher inflation and lower unemployment would result in **two less cuts next year** than we otherwise anticipate, for six cuts since the pivot (see our our year-end *US Perspectives* for details). F14 shows optimal portfolio weights conditional on Fed policy scenarios. This alternative outlook suggests a much higher US equity stance, as less Fed easing reduces the likelihood of bond outperformance by 15 points.

US protectionism could also keep the dollar elevated, affecting regional positioning. T2 shows optimal weights in this case conditioning on USD gains and losses. If the USD appreciated with certainty, this would lower the odds of offshore equity outperformance by 20 points, prompting a higher exposure to US assets. This scenario would also call for a higher equity exposure, since a strong dollar is associated with less Fed easing and stronger US growth.

T2: US dollar sensitivity	Stocks			Bonds		
Optimal portfolio weights (12M)	US	Offshore	EM	US	Offshore	EM
Numera	*22%*	*10%*	*13%*	*48%*	*4%*	*3%*
USD gains	*46%*	*0%*	*10%*	*44%*	*0%*	*0%*
USD losses	*3%*	*18%*	*13%*	*58%*	*5%*	*3%*

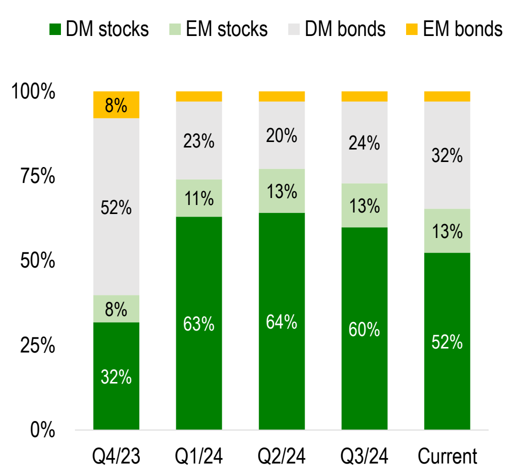
Note: Table compares optimal portfolio weights across DM and EM stocks and bonds for alternative USD scenarios. The second row conditions only on scenarios in which the USD appreciates in 2025, whereas the final row considers only scenarios in which the USD weakens. Source: Numera Analytics.

T3: Asset allocation Optimal weights (%)	Benchmark[a]	Positioning[b]		
		Current	Strategic	Longer-term
DM stocks	54%	52%	32%	44%
United States	36%	38%	22%	34%
DM ex. US	18%	14%	10%	10%
EM stocks	6%	13%	13%	13%
DM bonds	38%	32%	52%	40%
United States	33%	27%	48%	33%
DM ex. US	5%	5%	4%	6%
EM bonds	1%	3%	3%	3%
Stocks	60%	65%	45%	57%
Bonds	40%	35%	55%	43%
United States	69%	65%	70%	68%
DM ex. US	23%	19%	14%	16%
EMs	7%	16%	16%	16%

a. Benchmark weights match the iShares core growth asset allocation ETF (AOR), a balanced global stock-bond portfolio.

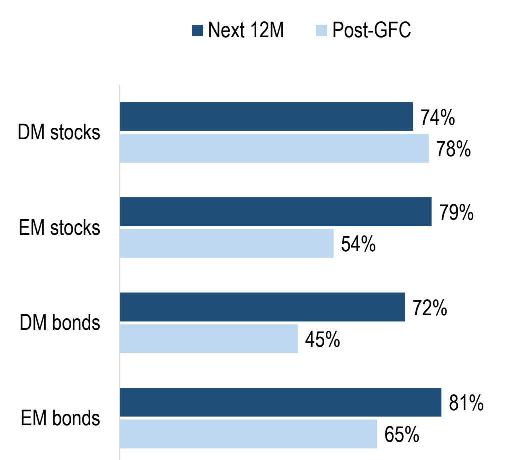
b. Weights maximize risk-adjusted returns for current macro context, over the next 12M, and over the next 5 years.

F15: Numera suggested positioning
Optimal portfolio weights over time



Note: Weights chosen to maximize risk-adjusted portfolio returns for the current global macro environment (see T3 for details). Source: Numera Analytics.

F16: Positive returns probability by asset
12M comparison versus post-GFC average



Note: Bars compare likelihood that major global asset classes deliver positive real USD returns over the next 12M. Source: Numera Analytics.

Strategic Asset Allocation

Strategic allocation Positioning by asset	Asset allocation[1]	Country rotation[2]	Key macro factors
DM stocks	🔴	-	Currently neutral, but reduce exposure as US growth slows
United States	🔴	🟡	Tech trading at a premium; risk of pullback as growth slows
DM ex. US	🔴	🟡	Likely pick-up in growth, stable USD, low financial stress
Australia	-	🟢	Terms of trade + AUD upside, responsive to CN stimulus
Canada	-	🟢	BOC cuts support valuations, likely bounce back in oil prices
Europe	-	🔴	Remain UW since other offshore marketsh have higher upside
Eurozone	-	🟡	Upgrade on signs of improving domestic demand, EUR upside
Switzerland	-	🔴	CHF trading at a premium, which curbs overall risk-reward
United Kingdom	-	🟡	Attractive valuations, improving activity, share buybacks
Japan	-	🟢	Improving domestic activity, likely strengthening of JPY
EM equities	🟢	-	Fed easing, weaker USD, low US growth beta, CN stimulus
EM Asia	-	🟡	We are neutral, but cross-country diversification encouraged
China	-	🔴	CN no longer trades at a discount; growth challenges remain
India	-	🟢	Growth premium + business dynamism, but expensive
South Korea	-	🟢	Corporate Value-Up program increases re-rating chances
Taiwan	-	🔴	Similar risk profile to Korea, but overstretched valuations
EM EMEA	-	🟢	Oil prices retain upside, low financial stress, USD to weaken
Latin America	-	🟢	Attractive valuations, commodity upside as Fed pivots
Brazil	-	🟢	Low valuations, further BCB easing, resilient BR economy
Mexico	-	🟢	Reduced MXN risk, valuation upside from Banxico cuts
DM bonds	🟢		Gradually increase exposure as G10 easing cycle continues
United States	🟢	-	Treasury yields should fall in 2025 as growth decelerates
DM ex. US	🟡	-	Neutral as market overestimating ECB easing cycle
EM bonds	🟢	-	Wider EM-DM growth premium, low global financial stress

1. Positioning relative to 60/40 global benchmark. See our for suggested portfolio weights and analysis.

2. OW/N/UW relative to DM and EM equity benchmarks. Positioning depends on projected risk-reward balance of individual equity

2. Top Conviction Calls & Scorecard:

Top Conviction Calls	Action	Open date	Recently closed	Trailing stop-loss[1]	P&L	Report
AU / DM ex. US stocks	OW	27-Nov-23	-	2.8%	4.3%	
EM high yield bonds	Long	28-May-24	-	9.0%	10.4%	
Thailand stocks	Long	11-Jul-24	-	14.0%	16.9%	
BRL / USD (w. carry)	Long BRL	15-Oct-24	-	-8%	-5%	
Chile stocks	Long	24-Oct-24	-	-7%	-2.6%	
AUD / GBP	Long AUD	4-Nov-24	-	-4.5%	-1.8%	
Mexico stocks	Short	4-Nov-24	-	-6.0%	0.5%	
MXN / USD	Put option	6-Nov-24	29-Nov-24	2.0%	2.0%	
US / EM stocks	OW	6-Nov-24	-	3.9%	5.5%	
Germany stocks	UW	13-Nov-24	-	-6.0%	-3.8%	
UK bonds	Long	18-Nov-24	-	-9.0%	1.4%	
CA bonds	Long	20-Nov-24	-	-8.0%	0.5%	
CORRA futures	Call option	26-Nov-24	-	20.0%	29.2%	
ECB futures	Put option	2-Dec-24	10-Dec-24	15.0%	15.0%	
Henry Hub futures	Put option	5-Dec-24	-	-60.0%	-35.5%	

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

Benchmarks:

- **Stocks**: United States: S&P 500 TR; Offshore: MSCI World excl. USA index and country breakdown; EM: MSCI emerging markets USD index and country breakdown.
- **Bonds**: United States: ICE BofAML US Treasury TR (all maturities); DM ex. US: ICE BofAML Global Government excl. US TR USD (all maturities); EM bonds: ICE BofAML EM external sovereign index TR USD.