# 2025 Outlook: Ongoing Economic Expansion, But Lower Returns And Greater Volatility

- The economic outlook is supportive of risk assets, but expect lower returns on global equities and balanced portfolios in 2025 after this year's strong gains. A moderate pro-growth portfolio tilt is appropriate.
- Heightened policy uncertainty will prevail in the first part of 2025 as the next Trump Administration settles in, but we assume he will not jeopardize U.S. or global economic growth.
- Another upleg in global bond yields will develop next year given sticky inflation, increased policy uncertainty and fewer interest rate cuts than currently anticipated. We expect the U.S. 10-year yield to re-test the 5% level in 2025 and are underweight bonds in a multi-asset portfolio. Remain overweight credit within a fixed-income portfolio.
- A continuing rise in corporate earnings should sustain the equity uptrend, albeit at a much more muted and volatile pace than in 2024. Risks will rise as bond yields eventually re-test 2023 highs.
- We expect the risk-reward to shift in favor of select non-U.S. markets as next year progresses and recommend overweight exposure to emerging market, Japanese and euro area equities, and a slight underweight on the overextended U.S. market.
- Diverging fundamentals and starting points among key constituents warrant neutral exposure to commodities within a multi-asset portfolio. The U.S. dollar will be well supported in the near term, but it will subsequently soften as economic growth firms outside the U.S.
- ***MRB Tradebook:*** Closing our short U.S. Treasury position with a 3% gain.

Risk assets will have tailwinds in early-2025 against a backdrop of ongoing global economic expansion and supportive monetary policy. In the U.S., incoming President Trump's pro-growth promises of fresh tax cuts and deregulation reinforce the risk-on climate in the near term given the already strong U.S. economy. Conversely, his apparent preference for broad-based trade tariffs and mass deportations are potentially highly disruptive to



## Table 1 MRB Asset Allocation Recommendations[1] (6-12 month horizon)

### Overall Asset Allocation

| Overall Asset Allocation | – | N | + |
|---|---|---|---|
| **Equities** | | ■ | |
| **Fixed Income** | ■ | | |
| **Cash** | | | ■ |
| **Commodities** | | ■ | |

### Regional Equities[2]

| | – | N | + |
|---|---|---|---|
| Australia | ■ | | |
| Canada | ■ | | |
| EM Markets | | | ■ |
| Euro Area | | | ■ |
| Japan | | | ■ |
| Sweden | | ■ | |
| Switzerland | | ■ | |
| U.K. | | ■ | |
| U.S. | ■ | | |

### U.S. Equity Sectors[3]

| | – | N | + |
|---|---|---|---|
| Consumer Discretionary | ■ | | |
| Communication Services | | ■ | |
| Consumer Staples | | ■ | |
| Energy | | | ■ |
| Financials | | | ■ |
| Health Care | | | ■ |
| Industrials | | ■ | |
| Information Technology | ■ | | |
| Materials | | ■ | |
| Real Estate | | ■ | |
| Utilities | | ■ | |

### Emerging Market Equities[4]

| | – | N | + |
|---|---|---|---|
| Brazil | | | ■ |
| China | | ■ | |
| India | | | ■ |
| Indonesia | | ■ | |
| Korea | | | ■ |
| Mexico | ■ | | |
| Saudi Arabia | ■ | | |
| South Africa | | ■ | |
| Taiwan | | | ■ |

1 6-12 month horizon
2 Relative to common currency global equity benchmark
3 Relative to common currency U.S. equity benchmark
4 Relative to common currency emerging markets equity benchmark
5 + = Steepener and - = Flattener
6 Relative to hedged global fixed income benchmark

Note: Apart from the Asset Allocation section, recommendations are within asset classes; + = overweight, N = neutral and – = underweight

### Fixed Income

| | | – | N | + |
|---|---|---|---|---|
| Duration | | ■ | | |
| Government Bonds | | ■ | | |
| Yield Curve[5] | | | | ■ |
| Inflation Protection | | | | ■ |
| Corporate Bonds[6]: | Investment-Grade | | ■ | |
| | High-Yield | | | ■ |
| EM Sovereign: | USD Debt | | ■ | |
| | Local Currency Debt | | | ■ |

### DM Government Bonds[6] (Currency Hedged)

| | – | N | + |
|---|---|---|---|
| Australia | | | ■ |
| Canada | | | ■ |
| Euro Area | | ■ | |
| Japan | ■ | | |
| New Zealand | | | ■ |
| Norway | | | ■ |
| Sweden | | | ■ |
| Switzerland | | ■ | |
| U.K. | | | ■ |
| U.S. | ■ | | |

### Currencies (vs US$)

| | – | N | + |
|---|---|---|---|
| Australia | ■ | | |
| Canada | ■ | | |
| Euro Area | | | ■ |
| Japan | | | ■ |
| New Zealand | ■ | | |
| Norway | ■ | | |
| Singapore | | | ■ |
| Sweden | | ■ | |
| Switzerland | | ■ | |
| U.K. | ■ | | |
| Emerging Markets | | | ■ |
| U.S. (DXY) | ■ | | |

### Emerging Market Currencies (vs EM Basket)

| | – | N | + |
|---|---|---|---|
| Brazil | | | ■ |
| China | ■ | | |
| India | | | ■ |
| Indonesia | | | ■ |
| Korea | | | ■ |
| Mexico | | ■ | |
| South Africa | | | ■ |
| Taiwan | | | ■ |
| Turkey | | | ■ |

the U.S. and global economy. How things play out in 2025 will hinge to a considerable extent on whether, how and when Trump's policy proposals translate into action[1].

More broadly, several macro themes underpin our investment outlook for 2025 and recommended asset allocation:

- Much of Trump's tariff talk is a negotiating stance and ***he will not jeopardize U.S. growth***. Implicit in this assumption is that U.S. tariffs will be applied only selectively, such that the overall effective U.S. tariff rate rises only modestly. Nonetheless, a more disruptive outcome is possible and in the interim policy-related uncertainty and volatility will persist.

- The global economic expansion will continue and gradually broaden, with the euro area, Japan and Asia gradually gaining traction and global manufacturing and trade strengthening.

- Inflation in the G7 economies remains sticky, especially in services and most importantly in the U.S.

- The Fed and other central banks cut interest rates less than currently discounted.

- G7 bond yields rise to fresh cyclical highs in response to ongoing economic expansion, sticky inflation and the partial unwinding of central bank rate cut expectations.

- U.S. exceptionalism gradually wanes as an investment thesis as growth in Europe and Asia improves.

***The global economic expansion will continue and gradually broaden***

While the global growth backdrop should remain supportive, global balanced portfolio returns are set to be lower next year after very strong returns in 2024. Global, and primarily U.S., equities are also increasingly vulnerable to corrections in 2025 given elevated valuations and earnings expectations. Even so, the growth and policy mix warrant a moderate tilt in favor of global stocks versus G7 government bonds, although we express that through a neutral overall weighting on equities and an underweight on bonds within a multi-asset portfolio.

***We continue to recommend overweight exposure to cash***

We continue to recommend overweight exposure to cash, particularly for U.S. dollar portfolios. We view commodities as a mixed bag that justifies neutral exposure. See **table 1** for our complete asset allocation recommendations[2].

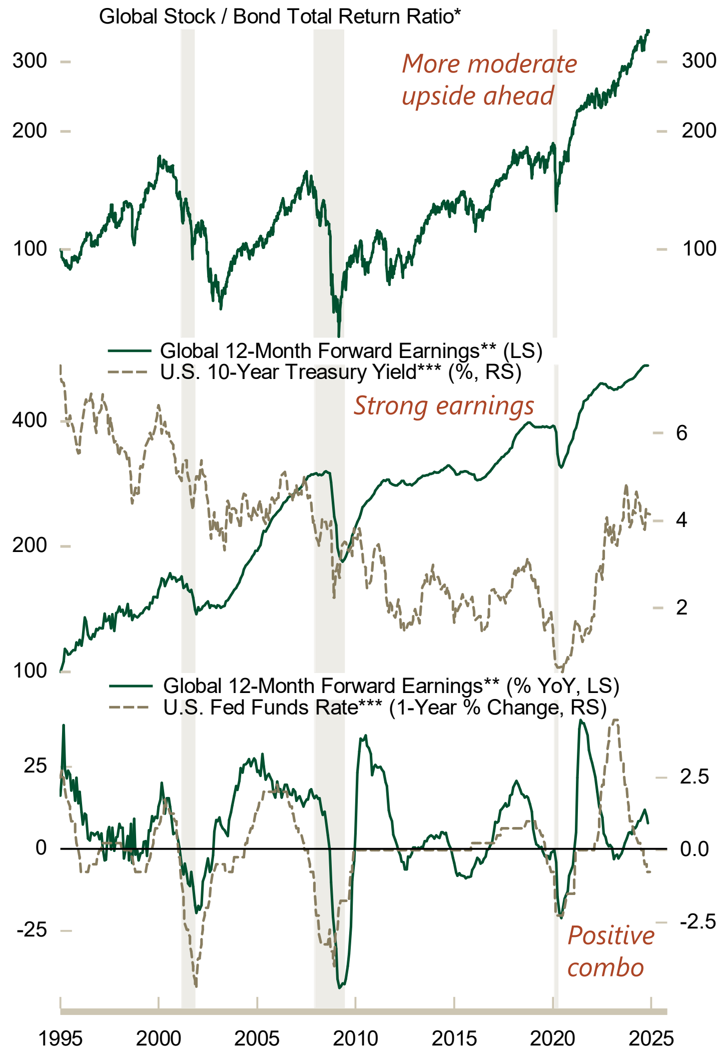
Politics is ordinarily a secondary concern for markets, but they are likely to inject significant volatility over the course of the coming year. Even beyond some of the

[1] **MRB:** "*Positioning For The New Fat Tail U.S. Economy*", November 20, 2024

[2] **MRB Asset Allocation Strategy:** "*Temptation Is One Thing Investors Can't Resist*", November 1, 2024

uncertainties associated with Trump's policies, the global political landscape is a source of potential market risk. There is a worrisome lack of effective leadership in France, Germany and Japan, for example, to address structural economic challenges. China is sturdier than many believe, but investor emphasis on downside risks will persist at least until President Xi embraces more aggressive pro-growth economic policies. And while both the Ukraine and Middle East wars appear to be in their late stages, there is still scope for negative surprises that could rile European energy and/or global oil markets as well as economic sentiment.

Chart 1 The Macro Outlook Warrants Overweighting Stocks Vs Bonds




* Global MSCI stock market total return index divided by G7 10-year government Bond total return index; local currency; rebased
** Local currency; rebased; shown in log scale
*** Source: Bloomberg
Note: Shaded for NBER-designated U.S. recessions

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## Stock/Bond Allocation And Investment Strategy

The overarching macro backdrop points to further upside for the global stock-to-bond (S/B) total return ratio (**chart 1**). The S/B ratio normally trends higher during global economic expansions on the back of rising stock prices, albeit with periodic consolidation or correction phases. Corporate earnings are a key driver of the global S/B ratio since stock prices and earnings are positively correlated.

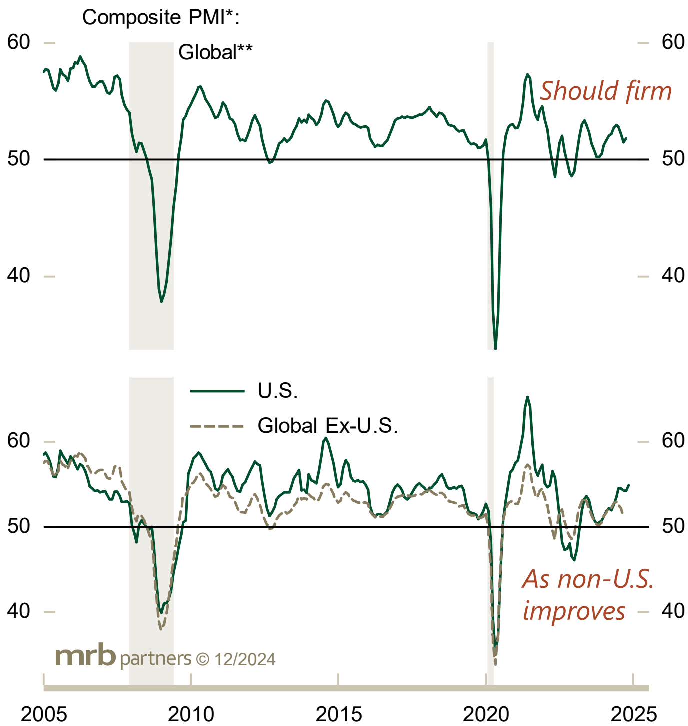
Thus, the ongoing rise in global 12-month forward earnings, which we expect to continue, is a positive harbinger for global stock prices and the S/B ratio. So too is the Fed's current policy easing, which is occurring even as global 12-month forward earnings growth momentum is improving. This combination is atypical as past Fed rate-cutting cycles have occurred when global earnings momentum was weak and/or weakening and is inherently bullish for stocks and the global S/B ratio.

*Politics are likely to inject significant volatility in the coming year*

One clear threat to both stocks and the global S/B ratio would be a rise in the U.S. 10-year Treasury yield toward or above the 5% peak hit in October 2023. We expect the latter to occur in the year ahead, as strong U.S. economic growth coincides with sticky inflation and mounting fiscal concerns and eventually forces the Fed to the sidelines.

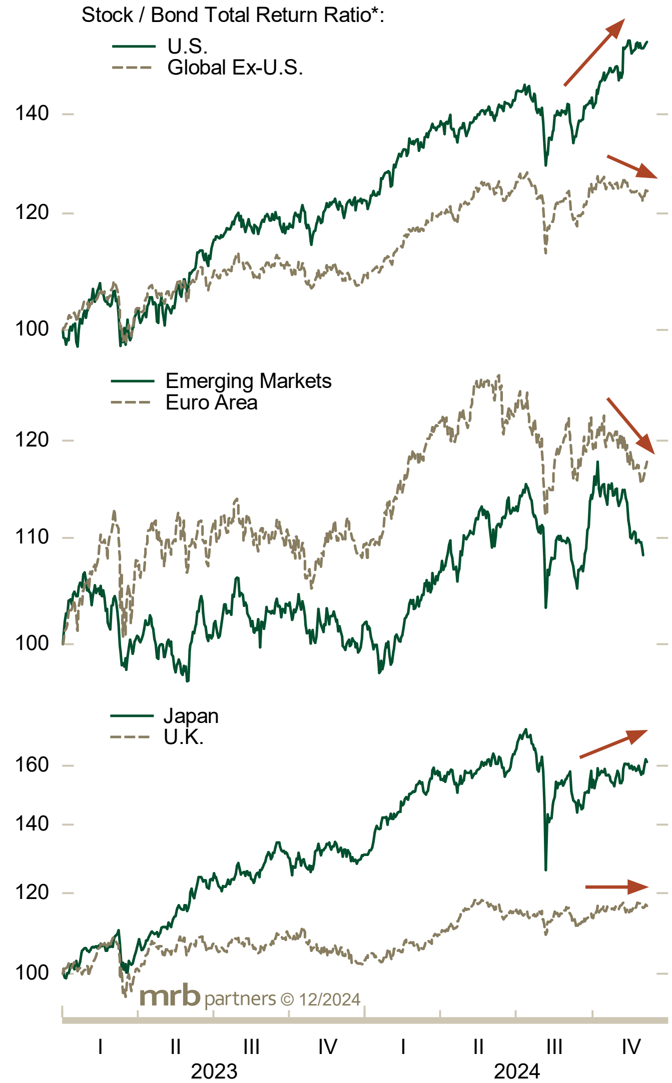
Composite PMIs highlight diverging economic momentum within the global economy.

Chart 2 **Global Economy: Expansion Mode Led By The U.S.**




* Smoothed; source: S&P Global
Note: Shaded for NBER-designated U.S. recessions

Chart 3 **Diverging Stock/Bond Trends Across Markets**




* Equity benchmark divided by a 10-year government bond; local currency; source: MSCI and Bloomberg; shown in log scale

The global composite measure is in solid expansion territory, but robust U.S. economic momentum is in contrast to the much soggier performance in the global ex-U.S. measure (**chart 2**). Such a divergence is also historically unusual and is unlikely to persist. Our base-case scenario is that global ex-U.S. growth momentum will firm in the year ahead, but more evidence will likely be needed to persuade investors that it is safe to increase risk exposures outside the U.S. economy and markets[3].

While the macro backdrop implies a further rise in the global S/B ratio, domestic S/B ratios (domestic stock returns relative to domestic bond returns) exhibit contrasting trends that are broadly consistent with comparative domestic economic growth performance. The U.S. S/B ratio is near a cyclical high, while that for the global ex-U.S. aggregate has rolled over in recent months (**chart 3**). The latter, in turn, primarily reflects weakness in the S/B ratios in the emerging markets and euro area, as stocks have corrected materially over the past two months. The Japanese and U.K. S/B ratios have been steadier over this period, but are also off this year's highs.

***Global ex-U.S. growth momentum will firm***

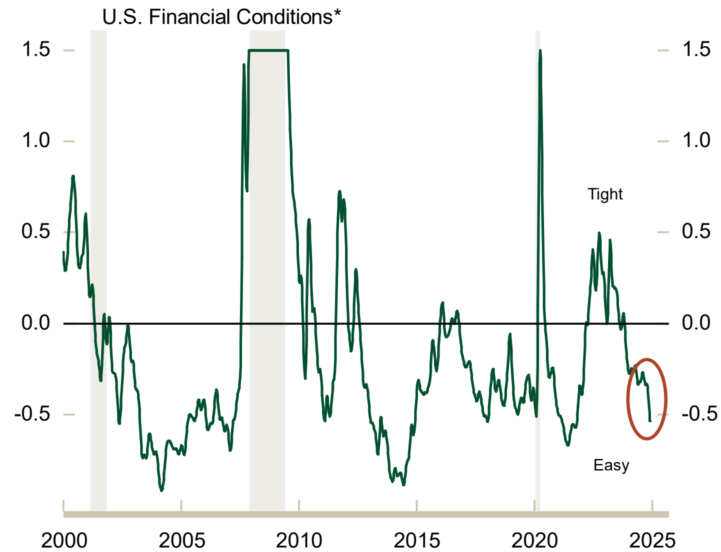
[3] **MRB:** "*Watch The French Consumer To Gauge The Euro Area Economy*", December 5, 2024
**MRB:** "*China's Feel-Good Fiscal Non-Stimulus*", November 11, 2024

Easy financial conditions also bode positively for the global S/B ratio. U.S. financial conditions are extremely easy, based on the Chicago Fed measure, indeed easier than prior to the start of the Fed's tightening cycle (**chart 4**). Such easy financial conditions do not preclude corrections in risk asset prices or the global S/B ratio, but they imply that any weakness will be limited in magnitude and duration, and represent potentially attractive entry points.

The global S/B ratio may have further upside in 2025, but investors should expect lower returns on balanced portfolios after this year's big gains (**chart 5**). A 60/40 global equity/G7 10-year government bond portfolio in local-currency terms is up approximately 20% in the past year, which is at the upper-end of the historical range. Equities have delivered an unsustainable 25%+ nominal return, while G7 10-year government bonds have generated a modest 4% return. We expect ***global*** equities to deliver moderate returns, and G7 government bonds similar-to-slightly lower returns than in the past year.

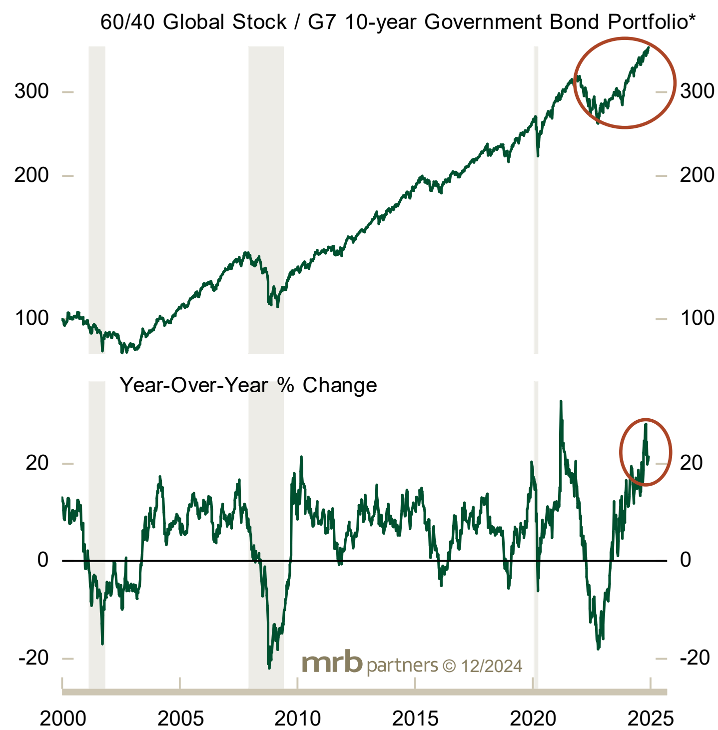
**Final Word**: *The ongoing global economic expansion should enable global stocks to outperform bonds in 2025, albeit by a much narrower margin than this year. Similarly, a 60/40 equity/bond portfolio should deliver positive, but significantly lower, returns next year compared with this year. A moderately pro-growth portfolio posture across and within asset classes is still appropriate. There is ample scope for negative policy surprises, especially from the U.S. (with tariffs the most threatening), but our base-case scenario is that incoming President Trump's policy bark will be worse than his bite. Our forecast that U.S. Treasury yields will eventually punch to a cyclical high will also pose a danger to equities and other risk assets, albeit down the road.*

Chart 4 **Very Easy U.S. Financial Conditions Support Risk Assets**




* Re-standardized; truncated; source: Chicago Federal Reseerve
Note: Shaded for NBER-designated recessions

Chart 5 **Lower Returns Ahead For Balanced Portfolios**




* Local currency; rebased; sources: MSCI and Bloomberg
Note: Shaded for NBER-designated U.S. recessions; panel 1 shown in log scale

## Fixed Income

Bond yields will be in consolidation mode in the near term, but another upleg looms over the course of 2025 to reflect steady economic growth, above-target inflation and concerns about the G7 fiscal outlook[4].

The bellwether U.S. 10-year Treasury yield has retreated modestly in recent weeks after a sharp rise from mid-September to mid-November (**chart 6**). Both the earlier rise and current retreat correspond with movements in the expected Fed policy rate in the year ahead.

The Fed has walked back some of the dovishness expressed by Chair Powell at Jackson Hole in August given the U.S. economy's persistent strength, and buoyant equity and credit markets. Markets are pricing in a likely 25 bps Fed rate hike this month (which we also expect), but a more gradual pace of cuts in 2025, with the fed funds rate ending next year at 3.5-3.75% (the lower and upper bounds, respectively).

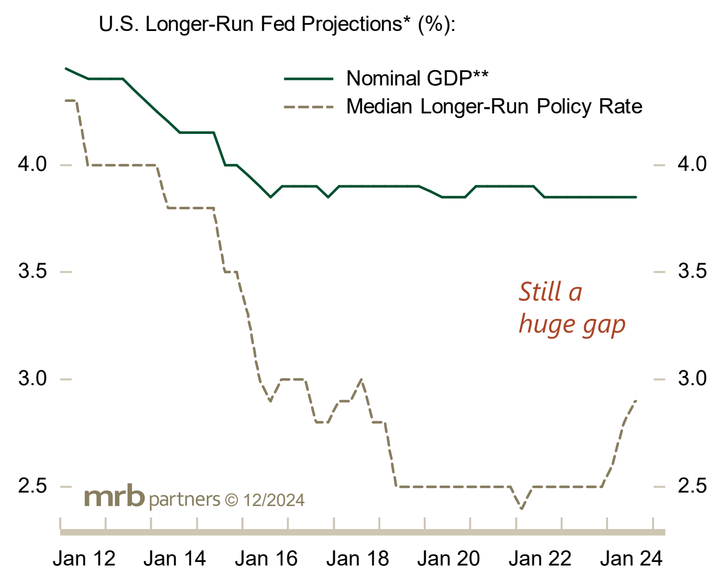
The Fed is unlikely to deliver on market expectations since there is no evidence that policy is still restrictive overall, and the underlying trend of inflation remains meaningfully above target. Moreover, with the economy both operating and growing above potential, inflation risks are to the upside (trade tariffs would add to upside risks).

We have long argued that the equilibrium policy rate (the nominal r*) for the U.S., that is, the rate that would be neither stimulative nor restrictive, is about 4.5% or around the current fed funds level. That contrasts with the long-run equilibrium policy rate of 2.9% in the Fed's latest *Summary of Economic Projections*, although we expect that to be raised further when the December edition is published (**chart 7**). There is considerable debate within the Fed about r*, with Dallas Fed President Logan stating

Chart 6 Fed Rate Expectations Still Driving Treasury Yields


* Source: Bloomberg

Chart 7 Fed's R* Estimate Headed Higher In 2025




* Source: Federal Reserve
** Midpoint of central tendency plus 2% inflation; median omitted for shorter forecast history

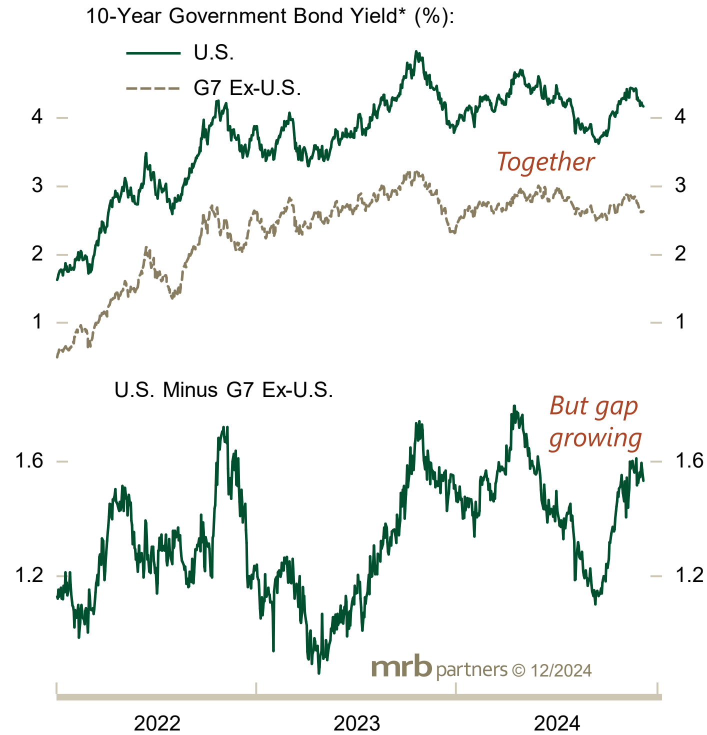
[4] **MRB:** "*Trump 2.0: What It Means For The Fixed Income Market*", November 13, 2024

that it may be at the current level, as we argue (of course, with a positive output gap and above-target inflation, a Taylor Rule framework would indicate that Fed policy should become more rather than less restrictive).

Looking ahead, we expect the Fed to raise its nominal neutral or r* estimate further in 2025 given our economic forecast, which ***will put upward pressure on the U.S. 10-year Treasury yield***[5]. The burgeoning U.S. budget deficit and associated increasing Treasury issuance, combined with an expected rise in the term premium to compensate investors for greater prospective policy uncertainty will also add to upside risks on Treasury yields over time.

Our base-case scenario is that the U.S. 10-year Treasury yield will re-test its October 2023 high of 5% within the next year[6]. Thus, a 10-year Treasury is likely to generate a mildly negative nominal total return on a 6-12 month horizon.

Chart 8 **G7 Yields Moving Together, But Big Gap Between U.S. And Others**




* Source: Bloomberg

While yields across the G7 are moving directionally together (less so in Japan), the gap between the U.S. and G7 ex-U.S. 10-year yield has increased, reflecting central bank rate expectations and underlying economic growth (**chart 8**). We expect the gap to increase further in 2025, albeit with G7 ex-U.S. yields also moving higher alongside that of the U.S.

***Total returns on bonds will be negligible to mildly negative next year***

Overall, we expect total returns on G7 ex-U.S. 10-year bonds will be negligible to mildly negative next year.

We have the following expectations and recommendations for fixed-income assets in 2025:

- **Duration (Underweight):** Our forecast that the U.S. and G7 10-year government bond yields will trend higher next year corresponds with our underweight stance on duration and overweight on cash (**chart 9**). While both the U.S. 2- and 10-year Treasury have produced modest positive absolute returns this year, the 10-year return has been much more volatile, which we expect to be repeated in 2025. On balance, underweight duration is appropriate across most of the G7 markets.

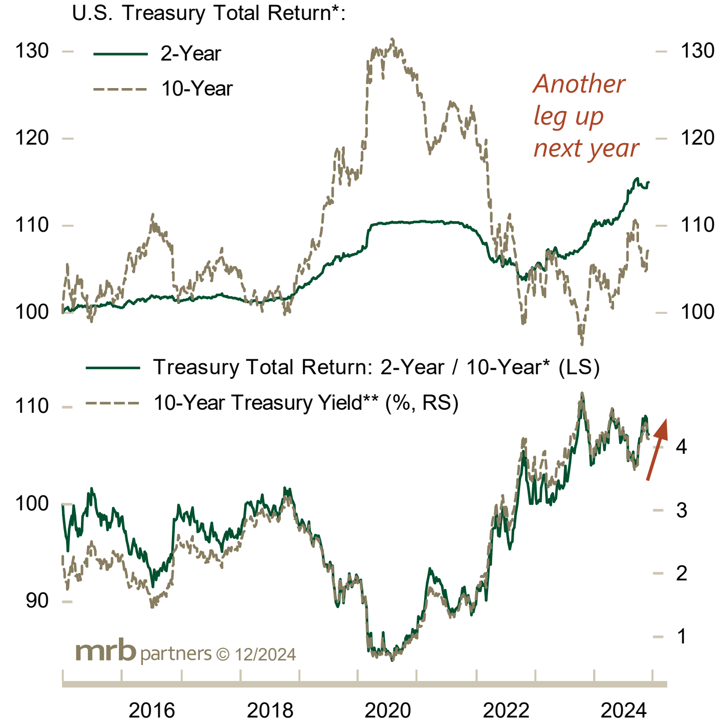
[5] **MRB:** "*The Fed Is (Predictably) Talking Up The Neutral Rate*", November 18, 2024
[6] **MRB:** "*U.S. Treasurys: The Calm Before Another Storm*", November 25, 2024

❍ **Yield Curve (Steepener):** We expect G7 yield curves to steepen in 2025, most notably in the U.S. The long-end of the U.S. curve is anchored by the Fed's excessively low long-run equilibrium policy rate, but a normalization of the curve should develop as U.S. (and G7) 10-year yields rise. For perspective, the median U.S. 2/10 spread over the past 40 years is 90 bps, compared with near zero today (**chart 10**). The curve should steepen even if the Fed fails to fulfill rate cut expectations next year.

❍ **Inflation Protection (Overweight):** Inflation breakevens and CPI swap rates are priced for perfection, i.e. that central banks will comfortably achieve their 2% target inflation rates in the decade ahead. We expect inflation to be sustainably higher both for structural reasons (less disinflationary pressure from goods prices as globalization unwinds/stalls and weakening fiscal conditions), and because central banks will accept moderately higher inflation to promote economic growth. At a minimum, we expect investors to demand greater compensation for upside inflation risk given the weak fiscal outlook for G7 economies.

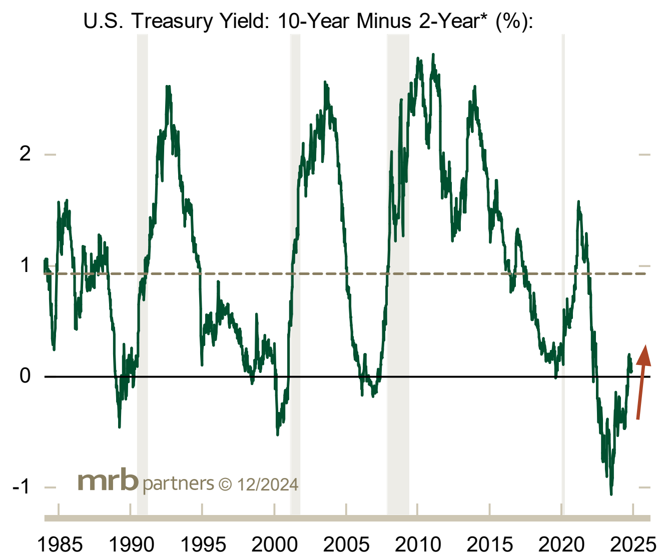
❍ **Corporate Bonds (Overweight):** We continue to recommend overweight exposure to corporate bonds against a backdrop of ongoing economic expansion and rising corporate earnings. That said, spreads are historically tight and meaningful further tightening is unsustainable (**chart 11**)[7]. High-yield issues have greater spread cushion than their investment-grade counterparts, which should ensure outperformance given low expected default risk next year, but returns will be much lower following stellar gains in 2024. Investment-grade corporate bonds are vulnerable to total return losses as government bond yields trend higher in 2025.

**Chart 9** Stay Short Duration As Higher Yields Loom In 2025




* Rebased; source: Bloomberg, MRB calculations
** Source: Bloomberg

**Chart 10** The Yield Curve Will Continue To Normalize




* Source: Bloomberg
Note: - - - period median; shaded for NBER-designated recessions

7 **MRB:** "*U.S. Corporate Bonds: Solid Fundamentals Will Keep Spreads Tight*", October 21, 2024

- **Emerging Market Bonds (Overweight):** EM bonds will be supported if global trade firms next year, as is our base-case scenario and assuming that Trump's tariff application is much less than the threat. Rising exports should ensure that spreads versus U.S. Treasurys remain historically tight, although the absence of sustainable downside implies modest total return potential. We continue to favor local-currency bonds, predicated on our forecast that an EM currency basket should appreciate moderately versus the U.S. dollar in the year ahead. However, absolute and relative return outperformance will be backloaded until the tariff threat diminishes, and will in any case be more modest than in the recent past given tight spreads.

Chart 11 **Tight Spreads Spell Lower Returns For High-Yield Bonds**


* Source: ICE Data Indices, LLC
Note: - - - period median; shaded for NBER-designated U.S. recessions

**Final Word**: *We remain cautious toward fixed-income assets overall, expecting G7 and U.S. government bond yields to rise over the next year. Longer-dated G7 government bonds are forecast to produce very low or even negative total returns. Credit will fare better given a supportive global economy and limited default risk, but tight spreads imply lower returns than this year. Favor high-yield over investment -grade issues among corporate bond exposures. EM bonds, most notably local currency, should outperform U.S. government bonds as global trade gradually broadens and strengthens.*

## Equities

***Global stock prices should climb further next year***

Global stock prices should climb further next year (albeit by much less than this year), underpinned by rising corporate earnings. We expect the yawning performance gap between U.S. and global ex-U.S. stocks to narrow, with select non-U.S. markets eventually outperforming the global benchmark. U.S. tariff policy is a big risk factor, and stocks will become increasingly vulnerable if bond yields rise to new cyclical highs, as we expect.

Global equities have had a stellar year, with the benchmark up some 20% year-to-date in both local-currency and U.S.-dollar terms (**chart 12**). The U.S. has led decisively, gaining 28% while the global ex-U.S. index is up a more sedate 12% and 7% in local-currency terms and U.S. dollar terms, respectively. U.S. stocks recently have punched to an all-time high, while global ex-U.S. equities have been very choppy since mid-year.

The divergence in stock price performance between the U.S. and global ex-U.S. benchmarks in recent months reflects both superior U.S. earnings and a decisive relative re-rating (**chart 13**). Both U.S. and global ex-U.S. 12-month forward earnings are trending higher, but more strongly for the U.S.[8] More strikingly is the divergence between the relative forward P/E ratios. The global ex-U.S. forward P/E ratio is little changed YTD at an undemanding 13, while the U.S. ratio has risen sharply to a stiff 23. In fact, the rise in the P/E ratio has accounted for slightly more of the U.S. share price gain YTD than forward earnings.

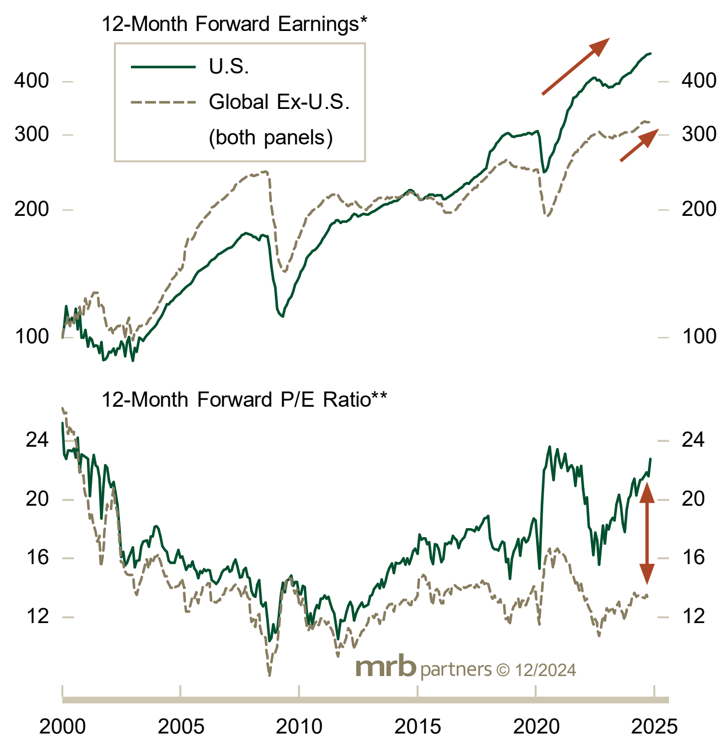
There have been significant recent stock price divergences between the U.S. and the rest of the world, which only partly reflect shifts in underlying macro conditions (**chart 14**). The U.S. equal-weighted stock price index is gaining positive momentum, while that of the global ex-U.S. benchmark is languishing. The same holds for both technology and non-technology stocks, which conflicts with the pattern that broadly held from the beginning of 2022 until the middle of this year. While forward earnings expectations are also favoring the U.S. market, these price divergences suggest that investors have fully embraced the U.S. exceptionalism" thesis.

Despite the supportive macro backdrop, regional equity allocation is complicated by the distorted country and sector structure of the global benchmark, and the pronounced divergence between U.S. and non-U.S. valuations and earnings. U.S. stocks account for 2/3rds of global market capitalization and are richly priced, especially given

Chart 12 **U.S. Stocks Driving The Global Benchmark**


* Local currency; rebased; shown in log scale; source: MSCI
Note: - - - 40-week moving average in panel 1; the vertical line is December 31, 2023

Chart 13 **Earnings Yes, But A Big P/E Expansion In The U.S.**




* Local currency; rebased; shown in log scale; source: MSCI
** Source: MSCI

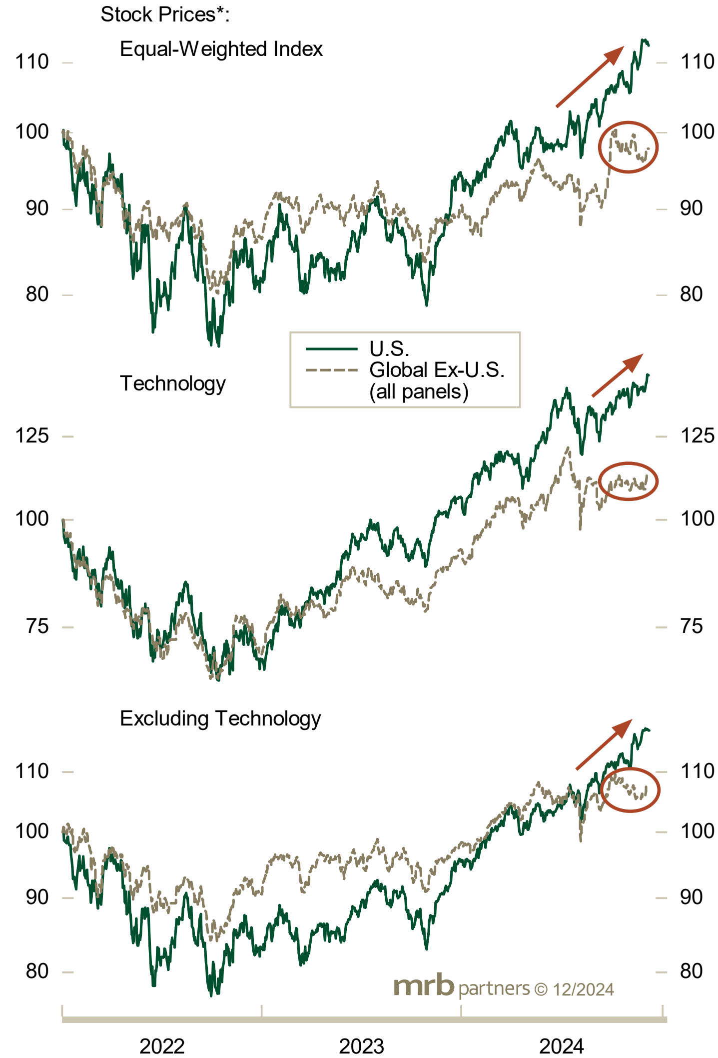
[8] **MRB U.S. Equities:** "*Q3 2024 Earnings Review And Outlook: Continued Expansion*", November 21, 2024;
**MRB U.S. Equities:** "*The Implications Of A Red Sweep*", November 14, 2024

elevated earnings and profit margins. Moreover, the outsized weight of technology and A.I. related stocks within the U.S. market and the huge premium of tech/A.I. stocks to the overall U.S. market compound the challenge of regional allocation.

As we indicated earlier, among our key themes for next year is that expectations for economic growth outside the U.S. will gradually firm, which in turn would benefit global ex-U.S. earnings. A caveat is that historically improving growth momentum outside the U.S. has also coincided with strengthening global trade, with the latter closely correlated with earnings momentum for non-U.S. equity markets (**chart 15**).

Our base-case scenario is that such an upturn is likely assuming that new U.S. tariffs are selective and non-punitive. Indeed, in past cycles, global trade expanded at 20% YoY or more, underscoring that there is substantial upside potential in the year ahead, with similar upside for global ex-U.S. earnings. Global ex-U.S. relative earnings could also benefit from a continuing and more broad-based semiconductor upcycle. Narrowing the relative earnings gap between the U.S. and the rest of the world would be an important contributor to bolstering global ex-U.S. overall relative equity performance.

Chart 14 **Big Recent Divergence Between U.S. & Global Ex-U.S. Stocks**




* Local currency; rebased; source: MSCI
Note: All panels shown in log scale

A combination of firmer economic growth and global trade, an acceleration in earnings growth and comparatively attractive valuations, implies scope for non-U.S. equities to play catch-up to the U.S. market in the year ahead, albeit on a selective basis. That said, our constructive scenario for non-U.S. stocks will likely play out only gradually.

***There is scope for non-U.S. equities to play catch-up in 2025***

Our forecast of another meaningful upleg in U.S. long-term Treasury yields next year will also likely be a headwind for U.S. tech stocks. The latter have had a huge run-up in the past year and now trade at a 12-month forward P/E ratio of nearly 30. The sector is vulnerable to a de-rating as bond yields rise if earnings fail to meet already highly optimistic expectations.

Overall, we continue to believe that the risk-reward relationship justifies slight underweight exposure to the U.S. versus the global benchmark, countered by moderate overweight exposures to the other three major markets, namely emerging markets, Japan and the euro area[9]. Moreover, U.S. stocks are overbought in relative terms, indicating that even near-term opportunities increasingly favor augmenting non-U.S. exposure (**chart 16**). Many investors have been reluctant to add exposure to non-U.S. markets given structural concerns, but even the latter will fade if cyclical economic conditions slowly improve, as we expect.

**Final Word**: *The ongoing economic and earnings expansion points to higher global stock prices in 2025, albeit with more muted gains than this year. That is especially the case after this year's blistering gains by the U.S. market. Our base-case scenario is that economic conditions outside the U.S. will gradually improve over the next year, which should support non-U.S. earnings and enable a period of outperformance for selective non-U.S. markets. Accordingly, we recommend a modest underweight on the U.S. market within a global equity portfolio, complemented by overweight exposure to emerging markets, Japan and the euro area.*

## Commodities & Currencies

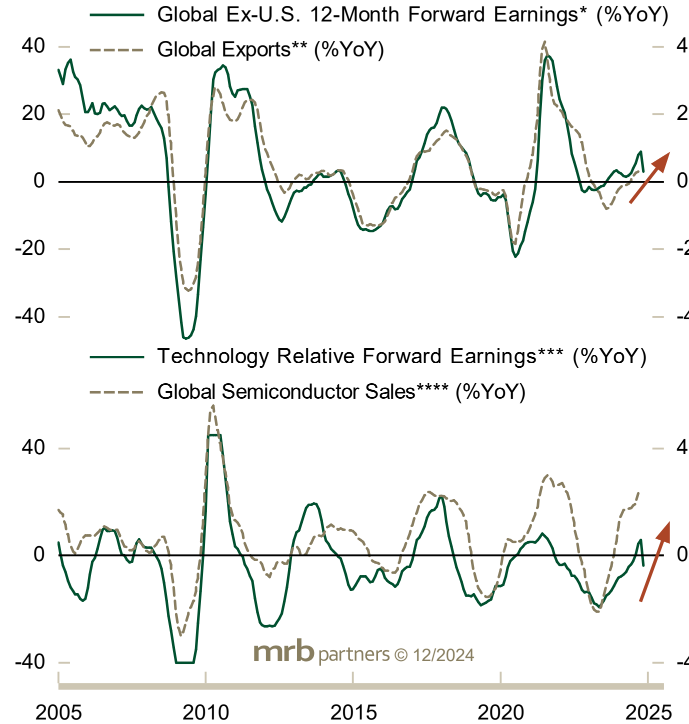
### *Commodities*

Commodity prices continue to languish, trading in a narrow range in recent months and lagging other risk assets (**chart 17**). A broad index of commodity prices has sharply underperformed global equities this year and has been flat against a U.S. 2-year Treasury and underperformed cash.

There have been substantial divergences between key commodity prices, with gold near cyclical

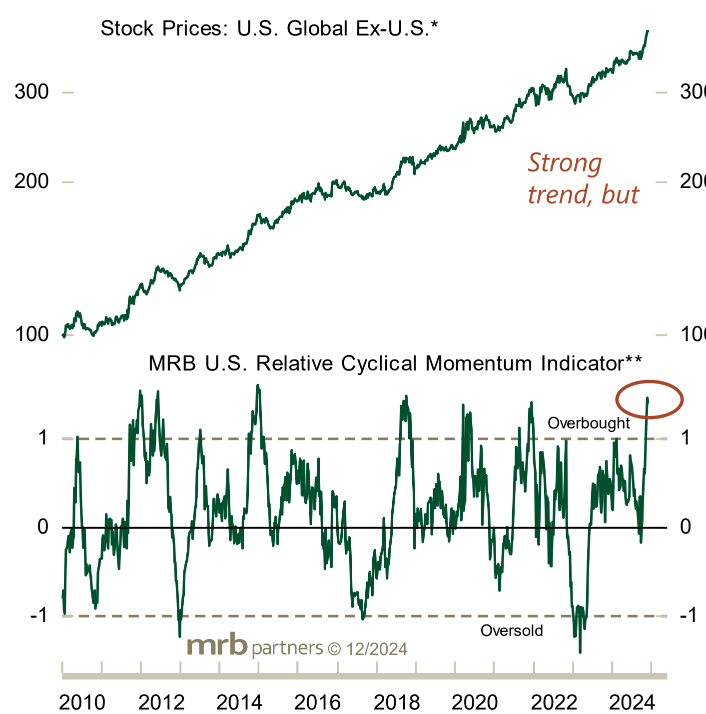
[9] **MRB:** "***Euro Area: Member Divergences Provide Opportunities***", October 23 2024

**Chart 15** **Positive Drivers For Global Ex-U.S. Earnings Momentum**




* U.S. dollars; source: MSCI
** U.S. dollars; source: Netherlands CPB
*** Global ex-U.S. 12-month forward earnings versus U.S. technology; truncated above 45 and below -40; U.S. dollars; smoothed; source: MSCI
**** Source: Semiconductor Industry Association

**Chart 16** **U.S. Equities: Overbought Vs RoW**




* U.S. dollars; rebased; shown in log scale; source: MSCI
** Versus global ex-U.S. benchmark; standardized

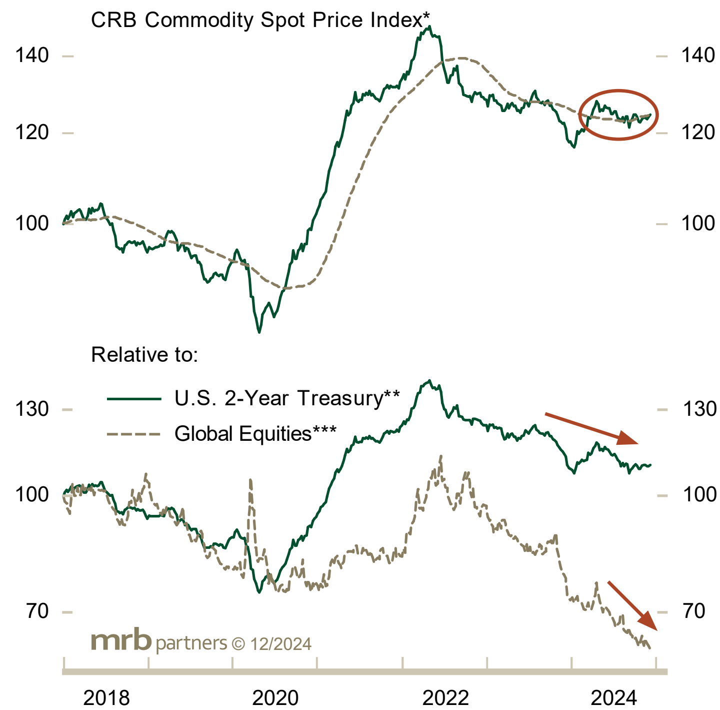
highs, oil weak, and base metals range-bound. The latter reflects the underlying tepid activity in global manufacturing, with the global manufacturing PMI hovering around the 50 boom/bust line over the past two years (**chart 18**). Such a prolonged period of soft manufacturing activity is unusual and to a significant extent represents the unwinding of the pandemic goods boom that should now be in its late stages. An expected upturn, even if only modest, should provide some lift to base metal prices.

Gold's strong performance YTD is consistent with easy global liquidity conditions and the shift in the Fed's policy stance earlier this year. Central banks have been accumulating gold as a diversifier for their international reserves, which is likely to persist given incoming President Trump's nationalistic foreign policy bias. While there is no immediate catalyst for a reversal in the underlying uptrend, gold is overbought and looks ripe for a consolidation phase given elevated sentiment readings and historically high net long exposure among speculators[10].

Moreover, our forecast that bond yields will have another material upleg in 2025 indicates that a threat to the underlying gold bull market could emerge down the road. We would hold onto but not increase exposure to gold, while preparing for downward pressure as 2025 unfolds and the U.S. 10-year Treasury yield re-tests the 5% level.

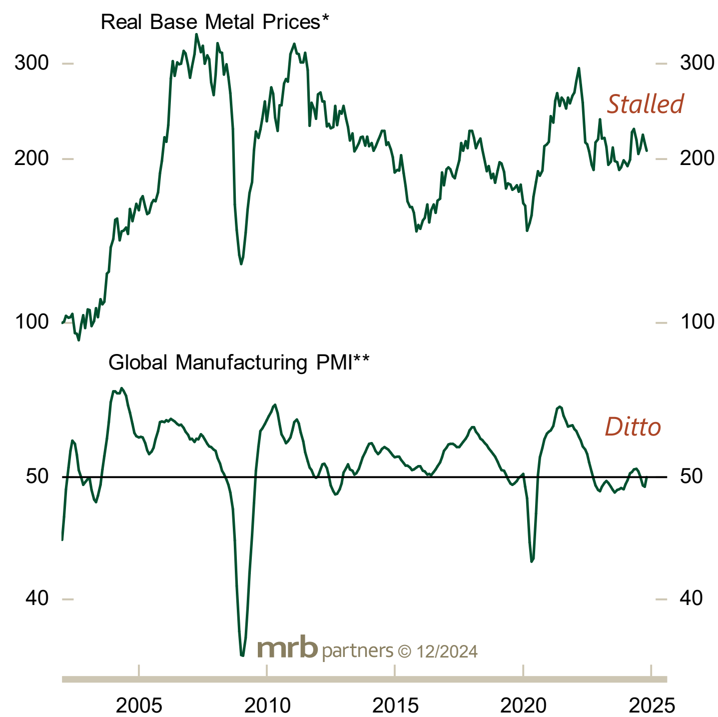
Our macro outlook points to an improving demand backdrop for crude oil prices, but concerns about a supply overhang will persist until well into 2025. OPEC+ has postponed raising its output target given the current weak crude prices, but its ultimate intention to do so will keep a cap on prices at least until confidence about demand solidifies. Trump's proposed U.S. Treasury Secretary Bessent is touting

Chart 17 **Commodity Prices Are Languishing**




* - - - 40-week moving average; rebased; source: Bloomberg
** Total return; rebased; source: Bloomberg
*** Total return; U.S. dollars; rebased; source: MSCI
Note: All panels are in log form

Chart 18 **Base Metal Prices Await A Rebound In Global Manufacturing**




* Deflated by U.S. CPI; rebasedd; sources: London Metral Exchange and U.S. Bureau Of Economic Analysis
** Smoothed; source: S&P Global
Note: Panel 1 is in log form

10 **MRB:** "***Gold Is Primed For A Consolidation***", November 8, 2024

his intention to boost U.S. oil & gas output by the equivalent of 3 mbd, which, even if overstated, adds to the risk of a lingering oversupply condition. Our bias is for oil prices to rise modestly in the year ahead, but the outlooks is complicated by a number of policy unknowns.

Overall, we expect commodity prices to drift higher in 2025, partly reflecting a slightly weaker U.S. dollar, but to only perform in line with other risk assets. We recommend neutral exposure to commodities within a multi-asset portfolio.

Chart 19 Relative Interest Rates Are Driving The U.S. Dollar


* Shown in log scale; source: Bloomberg
** Other majors based on the DXY weights
Note: - - - 40-week moving average in panel 1

## *Currencies*

The U.S. trade-weighted dollar index (DXY) continues to move to the rhythm of relative interest rates (**chart 19**). In the past month, the DXY poked its head above the trading range that has prevailed over the past two years, but has since lost steam. The strong run-up starting in late-September coincided with a pronounced unwinding of Fed rate-cut expectations and sharp increase in the dollar's relative interest rate advantage versus other major currencies.

***The dollar already discounts "U.S. exceptionalism"***

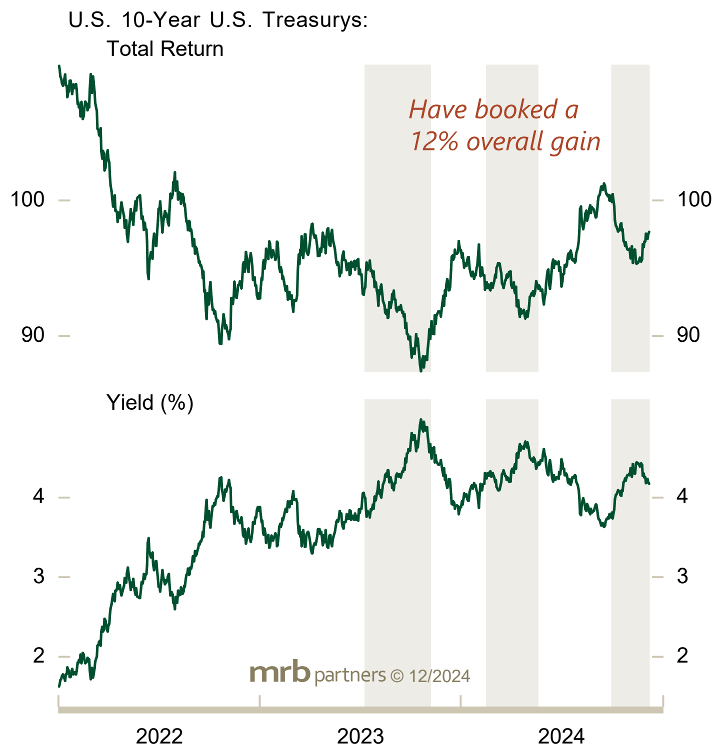
With relative interest rates having significantly re-set and likely to stabilize for the near term, we expect the dollar to be in consolidation mode through early-2025. That will be reinforced as investors try to gauge how policy under the incoming Trump administration will evolve, especially on tariffs. For now, the market, and we, expect tariff policy will be less harsh than Trump's recent rhetoric implies.

Beyond the near run, and given our tariff assumptions, the dollar is likely to be driven by competing forces. Interest rate differentials will remain in the dollar's favor, especially as we believe the markets will further trim expected Fed rate cuts next year, albeit only modestly. However, we expect the dollar's growth advantage to diminish as growth outside the U.S. gradually firms. The latter should bolster investor confidence in the euro, yen and other major currencies given their depressed starting point (with the elevated U.S. real trade-weighted dollar as the corollary).

The dollar, like U.S. stocks, already discounts "U.S. exceptionalism" to a significant degree. We do not rule out further dollar upside in the near term as Trump takes power, but stress that sustained meaningful gains would depend on deteriorating economic conditions outside the U.S., which we do not anticipate in the year ahead.

**Final Word**: *Diverging underlying fundamentals and starting points justify a neutral weighting on commodities within a multi-asset portfolio. We expect the U.S. dollar to be in consolidation mode in the near term following its recent run-up; however, given its elevated current level, we expect the dollar to eventually soften on a trade-weighted basis over the course of 2025 as economic growth firms outside the U.S.*

**Chart 20** MRB TradeBook: Booking Profits




Note: Total return rebased at initiation of trade; shading denotes when MRB held trade

## MRB *TradeBook Update*

### Short U.S. Treasurys

This position was stopped out this week with a 3% gain as U.S. Treasurys have started to consolidate their previous losses (**chart 20**). However, we expect the benchmark 10-year U.S. Treasury yield to eventually retest its October 2023 high of roughly 5%[11]. The Fed may go on an extended pause which would lift rate expectations further, but much of the rise in bond yields will be driven by higher inflation expectations (rather than improving economic growth), a greater term premium, and an ongoing upward adjustment in the projected nominal neutral fed funds rate. In turn, we are adding a 3% stop-short on the U.S. 10-year Treasury to capture the next backup in bond yields.

**Peter Perkins**
Partner, Global Strategy

***Please see the following pages for highlights of this week's research***

[11] **MRB:** "*U.S. Treasurys: The Calm Before Another Storm*", November 25, 2024

# This Week's Research

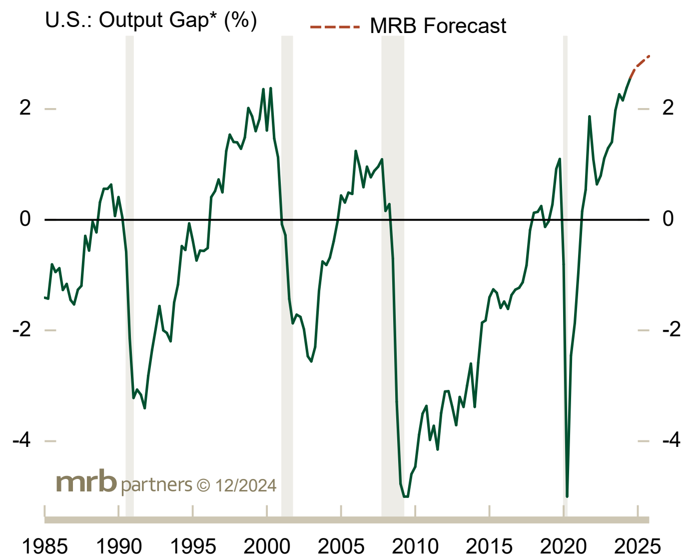

## U.S. 2025 Economic Outlook: The Cycle Should Trump Policy Hurdles

The election outcome has fattened the tail risk for the U.S. economy, but MRB's base-case view is that the economy is likely to once again grow at an above-consensus and above-potential rate in 2025, as sound macro fundamentals and strong growth momentum should be able to outweigh policy hurdles. Inflation risks are tilted to the upside given the lack of economic slack and potential policy shocks. The Fed is in easing mode now but will be forced to dial down its dovish intent next year.

Highlights included:

- Barring extreme policy choices, strong macro fundamentals and solid economic momentum will drive continued above-potential U.S. economic growth in 2025.
- While job creation will slow next year, aggregate labor income growth will remain historically solid, supporting continued healthy consumption growth.
- The lack of economic slack combined with solid growth and the potential for policy shocks imply a meaningful upside risk to inflation (**chart 21**).
- Resilient growth, sticky inflation, and upside risks to the latter will force the Fed to dial down its policy easing plans next year.
- The Fed will raise its neutral rate estimate further over the coming months, supporting an earlier halting of the easing cycle than it had previously signaled.
- The prospects for expansionary fiscal policy, policy uncertainty and the Fed's acceptance of a higher neutral rate imply upside for long-term bond yields.

Chart 21 Above-Potential Growth Will Continue In 2025




* GDP as a percent of potential GDP; truncated below -5; sources: Bureau of Economic Analysis and Congressional Budget Office
Note: Shaded for NBER-designated U.S. recessions

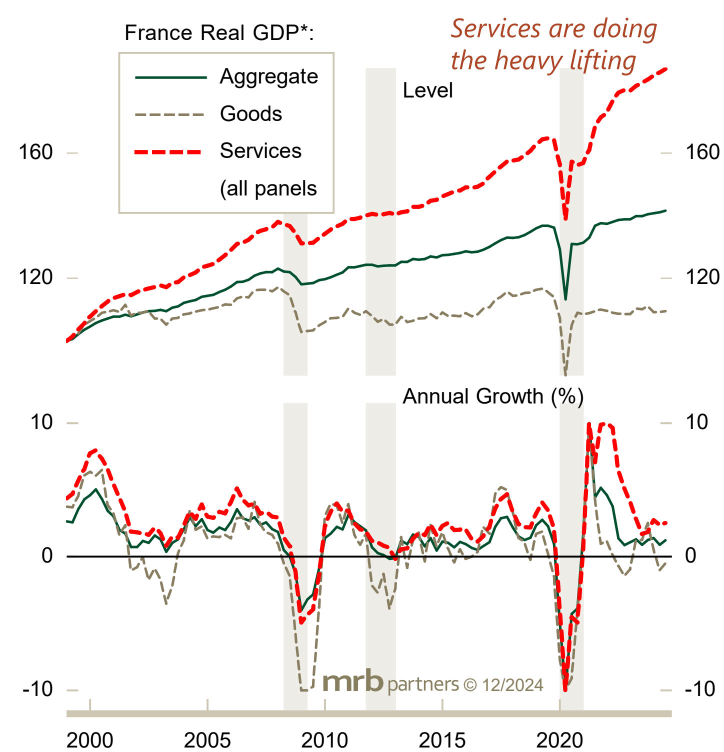
# Watch The French Consumer To Gauge The Euro Area Economy

France provides a much better bellwether for the aggregate euro area than Germany, which investors have traditionally fixated on. Indeed, the French consumer sector (rather than German manufacturing) is likely to provide the key in terms of signaling the direction of the entire regional economic growth profile. Today's report focuses on the French economy, and its consumer sector more specifically, to gauge when the euro currency and regional equity market might outperform.

Highlights included:

❍ Global investors have soured on the euro area and need a solid catalyst in order to to return. The most likely positive spark would be an improvement in the French economy, specifically the consumer sector.

Chart 22 France: The Tale Of Two Economies




* Source: Eurostat
Note: Shaded for Center for Economic Policy Research-designated euro area recessions

❍ France is the second largest euro area economy, and we find it serves as a better proxy for the aggregate euro area economic landscape compared to the presumed bellwether – Germany.

❍ Manufacturing has been the weak spot of the French economy, but demand for services has held up. Investors should place a greater emphasis on the latter, since services is a much larger part of the aggregate economy and employment (**chart 22**).

❍ France's economy is driven by consumer spending, which has been sluggish over the past year, albeit largely due to very weak auto demand. However, there are green shoots starting to appear, with real consumer spending on services now growing at an annual rate of 2.4%, compared to mildly negative for goods.

❍ Moreover, retail sales volumes ***excluding*** all motor vehicle sales are now expanding at a 4% year-over-year rate and point a recovery in final household consumption growth ahead.

❍ France has decent wage growth and households have large excess savings, which provide underlying support for overall consumer spending. An offset is that political uncertainty could weigh on business and consumer sentiment in the near run, something that needs to be monitored.

- Finally, France is more interest rate sensitive compared to other euro area members that have deleveraged over the past decade. While this represents a risk, it also means that French consumers and the economy could respond more positively to ongoing ECB rate cuts.

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