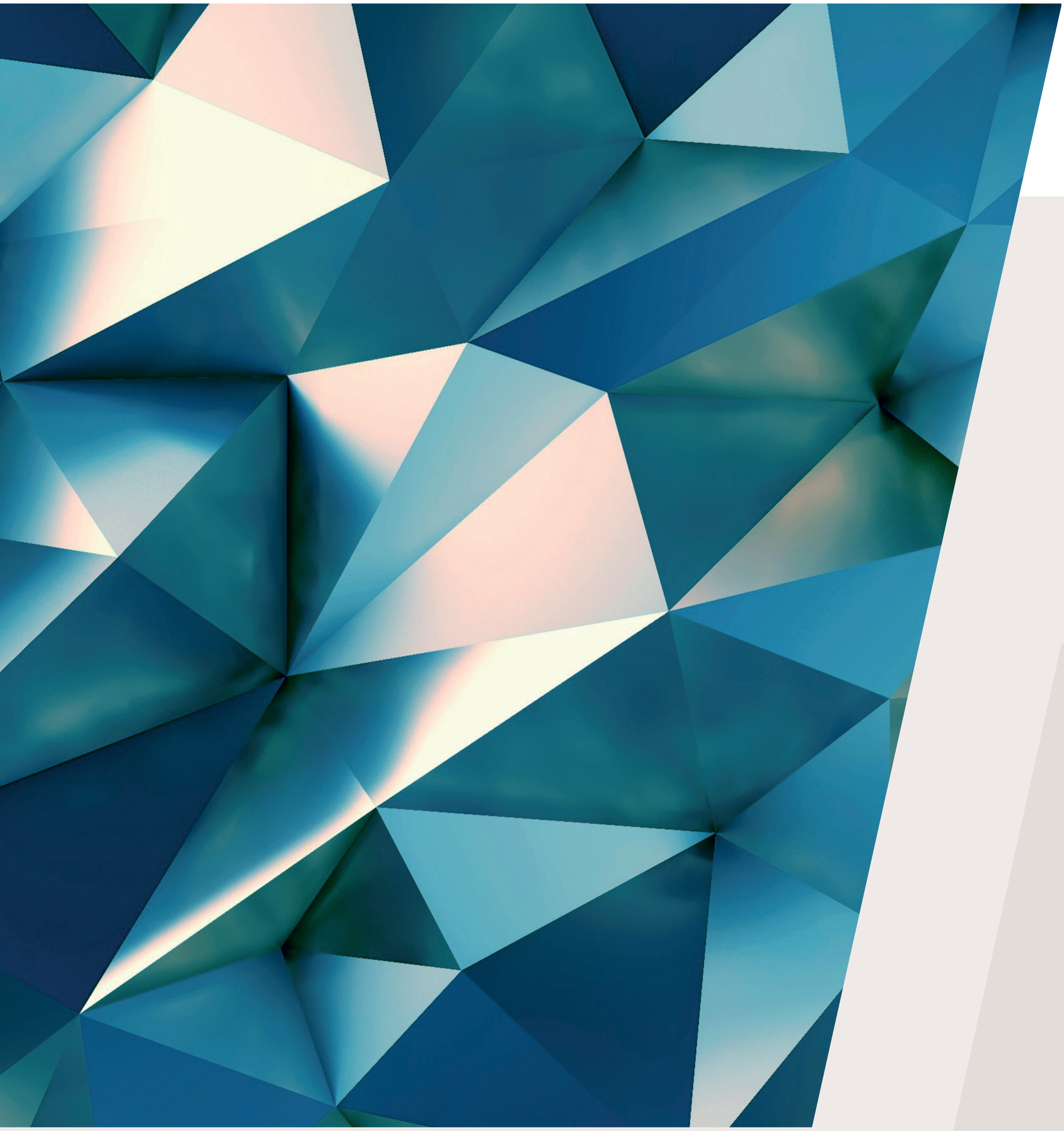
Rothschild & Co
Wealth Management



JANUARY 2025

Mosaique
Asset Allocation

Our current view

Dr. Carlos Mejia
Chief Investment Officer

Kevin Gardiner
Global Investment Strategist

KEY POINTS

- We remain open-minded about the financial impact of Trump's re-election
- Our tactical concerns relate mostly to valuations and revived inflation risk
- We stay mostly neutral on asset allocation, but in CHF portfolios now prefer cash to bonds

THE MACRO PICTURE

President-elect Trump is still putting together his administration and policies, but we think the implications for the global economy may not be as dramatic as feared. Additional tariffs, for example, may be smaller than he has suggested, and their economic effects may be partially offset or even reversed by lower taxes and deregulation. The business cycle often matters most in the narrow investment context in any case, and it continues to offer a relatively constructive backdrop of falling interest rates and healthy profitability – a backdrop that can continue for a while yet.

There are few signs of reckless excesses in the US private sector of late: savings by households and businesses are more than sufficient to finance capital outlays. The public sector's financial balance is more of a concern, and the federal deficit seems likely to rise further before it falls: tariff revenues are unlikely to pay for tax cuts. However, there is little sign that the world is reluctant to hold US Treasuries or the dollar, perhaps because America's low average tax and spending rates give it plenty of long-term room for manoeuvre. Meanwhile, US growth remains above trend, and above the growth of its G7 peers.

Elsewhere, China is using fiscal policy to support its recently faltering growth, and still enjoys the strongest trend growth of the major economies. Europe however remains firmly in the doldrums, kept there partly by a German economy whose key (manufacturing) industries remain out of global favour, and partly by ongoing structural weaknesses reiterated recently by the authoritative Draghi Report. Even there, however, growth may receive some boost from fiscal policy in 2025: France and Germany are both without governments as we write because fiscal policy has been seen as too tight to begin with.

Against this backdrop, inflation is increasingly looking to have bottomed, at least in this cycle. Unemployment remains low on both sides of the Atlantic – despite Europe's lacklustre output growth – and if budgetary policy is indeed about to become (even) more expansionary, the balance of risks may be tilting back towards higher inflation. We have always felt that inflation would prove sticky in the 2-4% range, and its stickiness has not stopped central banks cutting interest rates so far. However, as fiscal policy loosens through 2025, central banks may feel unable to cut much further – and indeed, might eventually even feel the need to consider hiking rates anew.

The outcome could still be a historically respectable growth/inflation mix, but stock prices have risen a long way in 2024. Valuations and expectations are elevated, particularly in and around the Artificial Intelligence data-processing boom, where participants are saying – and doing – some naïve things.

Meanwhile, although the new Trump administration may do less economic damage than feared, initially at least the world feels more dangerous, which could hit investors' appetite for risk assets.

As a result, in late November we tactically took profits on some of our stock holdings, closing an overweight position which had been in place since mid-2023. This left us neutral on the three main asset classes, and we remain so going into 2025 – with the exception now of Swiss franc-based portfolios, where the SNB's remarkable credibility has driven bond yields back down to negligible levels, leaving us preferring liquidity.

INVESTMENT CONCLUSION

When we cut stocks from overweight to neutral in November, we placed the funds not into bonds, which might be vulnerable to that interest rate rethink, but into cash, lifting it from underweight to neutral. This left us neutral on each of the big three assets – which we thought was appropriate at such an advanced stage of the cycle.

Portfolios will still benefit in absolute terms from any further stock gains, and for now (in dollar and euro-based portfolios) from above-inflation income from both bonds and cash. In franc-based portfolios, however, the further decline in bond yields, alongside minimal inflation risk, makes even the relatively low return on liquidity looking preferable to that on bonds, and we now move underweight bonds and overweight cash. Swiss yields have of course been significantly negative in the recent past, but not in the context of "business as usual", and we doubt they are headed there again.

Alongside the reduction in equity holdings in November we also made some changes to our regional and sectoral positions, as described below. These also had the effect of modestly reducing portfolio risk.

Asset allocation overview

Equities. Valuations are not as outlandish as in 2000, but they are nonetheless looking full, and the macro climate has been perhaps as friendly as it could be. If inflation risk does revive, interest rates will not be able to fall much further, and could even start to rise later in 2025, though we do not currently expect them to.

Within the equity market, we have favoured cyclical and secular growth sectors, with ongoing overweight positions in industrials, technology and communications. The former is perhaps particularly exposed to the threat of tariffs, and in November we cut that overweight to neutral, replacing it with an overweight in financials (the sector had already rallied, but it remains relatively inexpensive, and is a potential beneficiary of deregulation). We remained overweight in technology and communications, which have considerable momentum. Those sectors of course include some of the most expensive stocks, but our concern at exaggerated expectations for AI is addressed by the reduction in equity weightings.

Our overweight positions continue to be sustained by ongoing underweights in utilities and real estate (which perhaps both need bigger reductions in policy rates and bond yields than are in prospect to perform more strongly), and by a more recent underweight in the consumer discretionary sector. As we have seen in the last month, the latter is of course to some extent a hostage to political fortune.

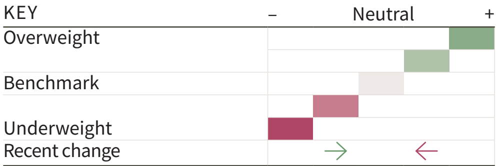
Regionally, the arguments in favour of the US seemed to have become more compelling, and we stayed overweight. Since February we had also favoured most of continental Europe too: this position disappointed, and with no reason for it to come good soon, we cut it back to neutral, raising the UK market to neutral as we did so. We remained underweight Switzerland, which we have seen as too defensive.

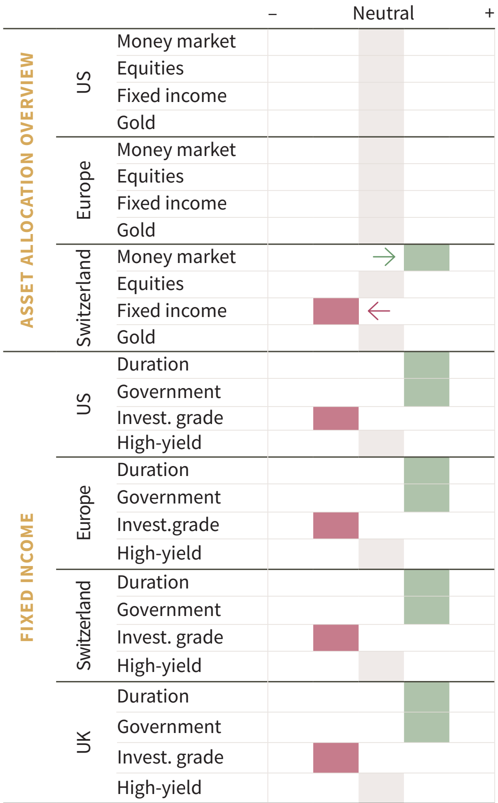
Fixed income. Our preference for longer-duration exposure has hurt in recent months, particularly in USD-based portfolios, and as noted we do think that inflation risk could revive next year. But yields remain in line with longer-term notions of neutral, and central bank policy may be more credible this time around, allowing yield curves to flatten once again.

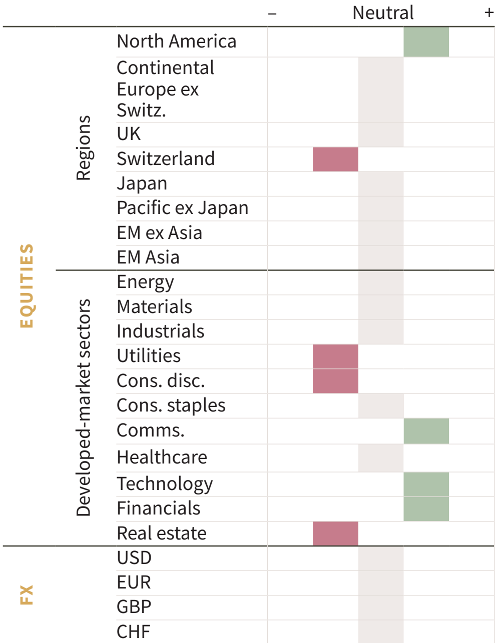
We continue to favour government bonds over credit – even in franc-based portfolios – not because we worry about corporate defaults, but on valuation grounds (the same reason we trimmed our stock weightings). Credit spreads have not been lower in the post-GFC period.

Currencies. The dollar remains well-bid on Trump's win and the prospect of enhanced global risk alongside potentially more expansionary US fiscal policy. The big bilateral cross rates nonetheless again remain inside recent trading ranges, and we prefer to express our preference for the US via stocks rather than currency selection.

Asset allocation







Wealth Insights

At the heart of Wealth Insights lies a wide set of timely and insightful publications and podcasts.

For more information please visit our page.

https://www.rothschildandco.com/en/wealth-management/switzerland/insights/