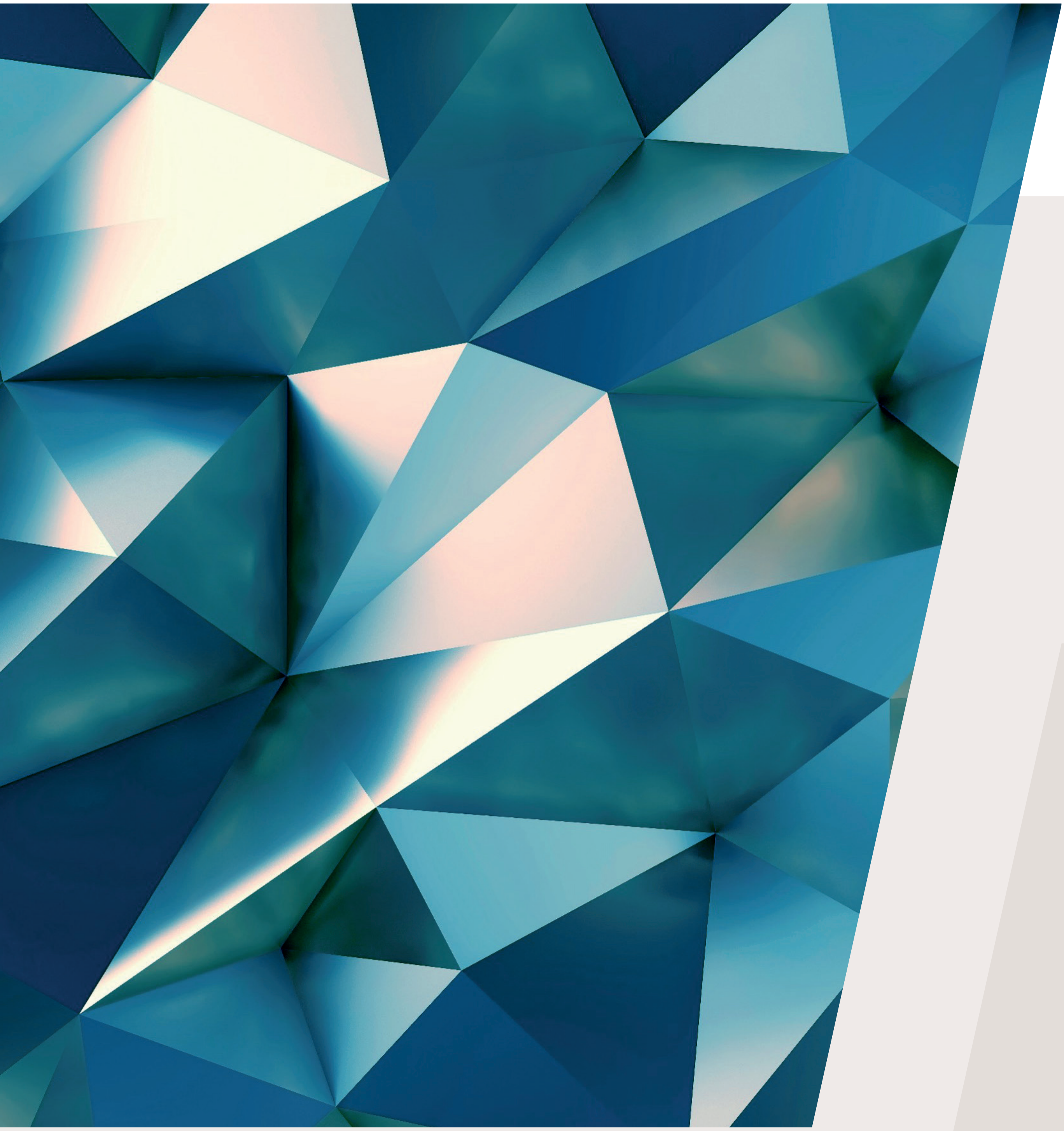


DECEMBER 2024

Mosaique Asset Allocation

Our current view

Dr. Carlos Mejia
Chief Investment Officer

Kevin Gardiner
Global Investment Strategist

KEY POINTS

- Trump re-election need not change a friendly economic backdrop
- However, stock market valuations – and investor expectations – are elevated…
- … and inflation risk may revive in 2025. We take some profits and trim risk

THE MACRO PICTURE

Trump's re-election may not have as big an effect on the global economy as feared. Tariffs may not rise as far as he has suggested, and their impact may be muted or even reversed by lower taxes and deregulation. Meanwhile, the business cycle – which often matters most in the narrow investment context – remains relatively favourable: a combination of lower inflation and ongoing growth is allowing interest rates to fall but keeping profitability healthy.

This favourable cyclical mix can continue to a while yet. Cashflow in the US private sector – households and businesses combined – is still in surplus, showing few signs of the sorts of excesses which in the past have led to retrenchment, even after a couple of years in which growth has been above trend (confounding many predictions of imminent recession). China's recent weakness (relative to its own relatively robust levels) seems to have stabilised, and while the eurozone continues to lag the other two big economies conditions there at least are getting no worse. Forward-looking business surveys continue to show the global manufacturing sector marking time, but the much larger service sector in more robust health.

It looks as if inflation may now have fallen as far as it is likely to, at least in this cycle. Stubbornly-firm service sector inflation is keeping US core inflation above 3%, while higher energy costs are promising to push headline UK and eurozone rates back above their 2% targets. This is not a surprise: we have always felt that inflation would prove sticky in the 2-4% range, and it has not stopped central banks cutting interest rates. However, as we look forward, the balance of risks may be tilting toward more, not less, inflation.

Capacity utilisation in the big economies has stayed relatively high throughout the current cycle, with unemployment rates still historically low. Now, if the Trump administration does indeed cut taxes by more than it raises tariff revenue – which looks likely – US fiscal policy will become (even) more lax. China is in the process of loosening fiscal policy substantially too, as it works through its real estate difficulties. In the UK, despite talk of fiscal pain, the recent budget delivered a clear net injection of demand in the year ahead, while in Germany, one of the outcomes of the early election there is likely to be a (modest) fiscal injection.

With both monetary and fiscal policy loosening, the stage could be set for more inflation risk than we've been expecting, and this will in due course limit – and perhaps even reverse – the room for lower interest rates. The net outcome could still be a growth/inflation mix which looks historically acceptable – but an added complication is that stock prices have now risen a long way in 2024. Valuations and expectations are elevated, particularly in and around the businesses most involved in 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 is likely to feel more dangerous, which could hit investors' appetite for risk assets this winter.

As a result, we are tactically taking profits on some of our stock holdings, closing an overweight position which has been in place since mid-2023.

INVESTMENT CONCLUSION

We move stocks from overweight to neutral. We place the funds not into bonds, which might be vulnerable to that interest rate rethink, but into cash, lifting it from underweight to neutral. This leaves us neutral on each of the big three assets – which we think is appropriate at such an advanced stage of the cycle. In absolute terms, portfolios will still benefit from any further stock gains, and from above-inflation income from both bonds and cash.

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

Asset allocation overview

Equities. Valuations have recently been at levels seen only rarely (most recently in late 2021, when interest rates were a lot lower). They 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 of late. 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 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 we have cut that overweight to neutral, replacing it with an overweight in financials (a potential beneficiary of any de-regulation, the sector has already rallied, but it remains relatively inexpensive). We stay 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 currently in prospect to perform more strongly), and by a more recent underweight in the consumer discretionary sector. The latter is of course to some extent a hostage to political fortune.

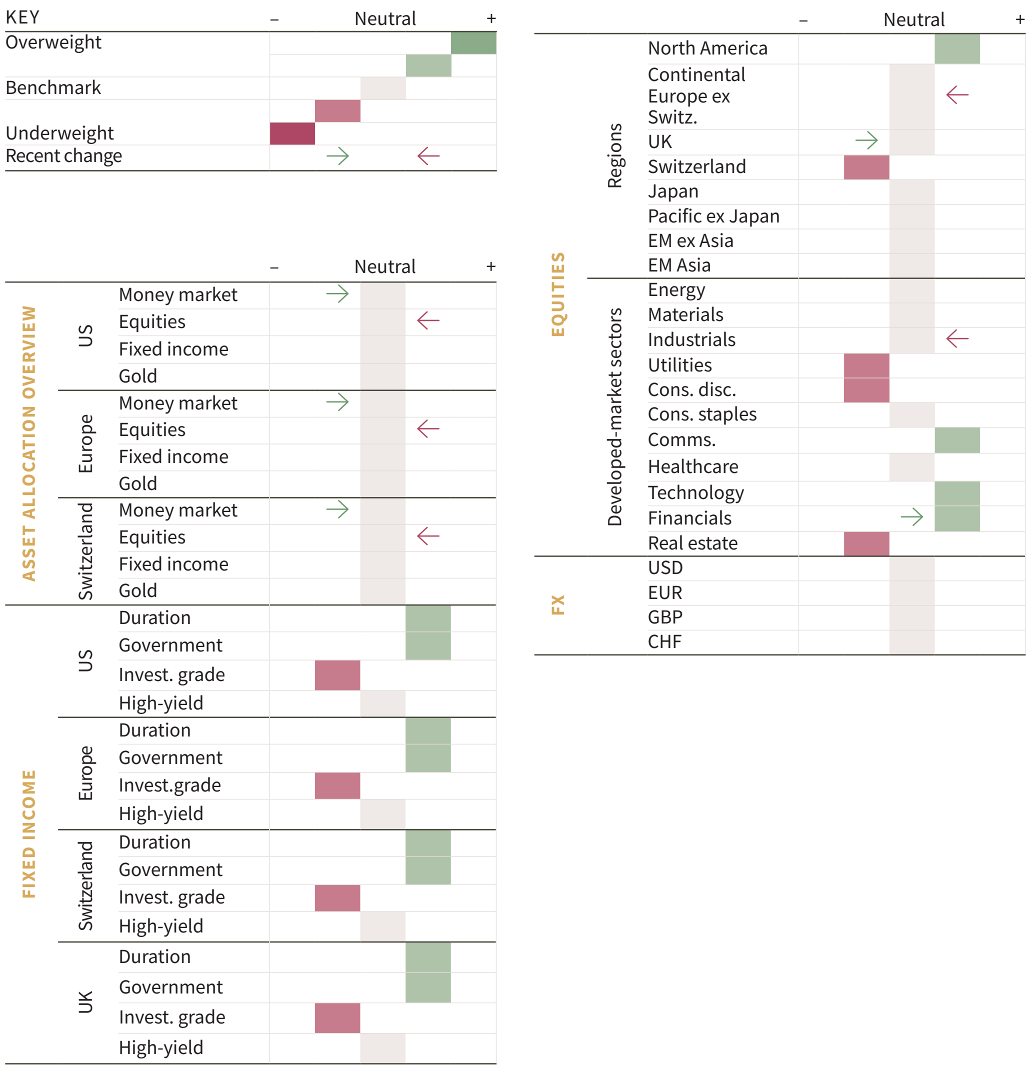
Regionally, the arguments in favour of the US are if anything more compelling, and we stay overweight. Since February we have also favoured most of continental Europe too: this position has disappointed, and we see no reason for it to come good soon, so now cut it back to neutral, raising the UK market to neutral as we do so. We stay underweight Switzerland, which feels a step too far in the defensive direction currently.

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 are now 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 – not because we worry about corporate defaults, but on valuation grounds (a similar reason for our reduction now in stock weightings). Credit spreads have not been lower in the post-GFC period.

Currencies. The dollar has rebounded further on Trump's win and the prospect of enhanced global risk alongside potentially more expansionary US fiscal policy. Yet again, however, the big bilateral cross rates 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/