Rothschild & Co
Wealth Management

Three divergent paths forward

A scenario analysis of the year ahead

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Foreword

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An ongoing mix of disinflation with growth made 2024 a good year for capital markets – as we'd thought it could be. Lower inflation brought falling interest rates, while growth underpinned healthy corporate earnings. Bonds were supported by the former, while stocks benefitted from both, though their advance (as in 2023) remained narrow.

Looking to 2025, the evolution of this benign cycle (so far) with the policies of the new US administration seemed an obvious axis around which to construct our scenario analysis. As usual, we identify three alternatives: our current Mosaique view as the central one, and variants which might be seen as "better" and "worse" cases for portfolios.

Our central view was in fact modified towards the end of 2024. We took a profit on stocks, cancelling our overweight position and adding to liquidity, in light of a possible revival in inflation risk in 2025, elevated stock market valuations (particularly around the market-leading AI theme), and the political uncertainty associated with Trump II. As a result we start 2025 with a neutral stance on each of the big three assets, but an ongoing regional preference for the US, and a sectoral mix which still favours structural and cyclical growth at the expense of defensiveness (though we now prefer financials to industrials).

The "worse" case here is unfortunately very easy to picture currently: it is one in which Trump's belligerent approach triggers a full-blown trade war, and a significant economic setback for the global economy. This would eventually facilitate (even) lower interest rates, but a marked decline in corporate profitability, increased risk aversion and a rotation in stock market leadership towards defensiveness.

The "better" case here is perhaps more difficult to imagine, but distinctly possible nonetheless. In this case, Trump's trade brinksmanship pays off, much in the way that Ronald Reagan's Star Wars gambit did all those years ago in the defence context. A "levelling up" of trade policies might deliver a revitalised global trading framework, and a vigorous and initially non-inflationary surge in economic growth. Stranger things have happened – and remember, it is China, not the US, which is currently the world's most protected large economy.

What if?
Three market scenarios (i)

Trump for better or worse is the theme of this scenario exercise.
Our central Mosaique view is compared with trade war ("worse") and trade deal-making ("better") scenarios.

Scenario	Trade war	Mosaique views R&Co central scenario	Trade reinforcement
Position	Worse case	Base case	Better case
Definition	Big tariffs on US imports are met with widespread and equally large retaliation. Trade slumps, economic activity shrinks, and deflation talk revives	Growth continues, supported by initially looser monetary and fiscal policy, but inflation risk revives, prompting an eventual rethink on interest rates	Trump secures a Reagan-style détente on trade. China opens up more, European consumers spend, and it's 'business as usual' in the US. Deregulation keeps inflation at bay
Macro implications			
GDP	Expectations for GDP growth fall markedly as trade slumps and predictions of recession revive	GDP grows at a healthy pace, with unemployment staying low. Profitability remains healthy	Global growth surges to firmly above-trend levels in 2025, emerging Asia regains its dynamism, Germany sees export-led recovery
Inflation	Consumer prices leap initially but as activity slows falls, inflation fails to take hold and deflation looms	Sticks above target in in 2-4% range, and begins to move towards the top half of that range	Headline inflation stays in 2-4% range, kept at bay by productivity gains and deregulation
Monetary policy	As recession approaches, central banks cut interest rates sharply, but the economy fails to respond	Central banks initially continue to cut, but by less than markets expect, and expectations of a rebound in rates build by year-end	Policy rates and long-dated yields stay close to current levels
Investment implications[1]			
Equities	★☆☆	★★☆	★★★
Fixed income	★★★	★★☆	★☆☆
Cash	★★☆	★★☆	★★☆
Gold	★★☆	★★☆	★☆☆
Investment positioning			
Equity regions to favour	▪ Safe havens and defensive markets (Switzerland, US and in this context UK) may outperform. ▪ Avoid high beta markets such as Europe and emerging markets.	▪ Developed Market returns remain driven by sector mix: leadership remains led by "growth" for now, but some broadening. ▪ Leadership may shift to cyclical regions and sectors. Defensive regions to underperform.	▪ Cyclical exposure leads the way. Europe and emerging Asia may return to favour as global growth accelerates. US stocks may continue to continue to keep pace. ▪ Defensive markets, such as Switzerland to underperform.
Equity sectors to favour	▪ Rotation towards staples, healthcare and utilities. ▪ Software over semiconductors. ▪ Avoid cyclical and 'value'. Momentum driven segments will likely suffer.	▪ Continue to favour cyclical growth with a bias for IT, communications and financials.	▪ Financials benefit from steeper curve, fewer provisions. ▪ IT (specially semis) and discretionary may outperform.

[1] Investment implications range from returns below inflation rates (one-star), similar to inflation rates (two-star) to above inflation rates (three-star)

What if?
Three market scenarios (ii)

The regional and sectoral rankings below reflect a mix of judgement and quantitative analysis, with most weight given to the former.

Scenario	Trade war	Mosaique views R&Co central scenario	Trade reinforcement
Equity regions			
North America	★★☆	★★★	★★☆
Euroland	★☆☆	★★☆	★★★
Switzerland	★★★	★☆☆	★☆☆
UK	★★★	★★☆	★★☆
Japan	★★☆	★★☆	★☆☆
EM Asia	★☆☆	★★☆	★★★
Equity sectors			
Communications	★★☆	★★★	★★★
Consumer discretionary	★★☆	★☆☆	★★★
Consumer staples	★★★	★★☆	★☆☆
Energy	★☆☆	★★☆	★★☆
Financials	★☆☆	★★★	★★☆
Health care	★★★	★★☆	★★☆
Industrials	★☆☆	★★☆	★★☆
Information technology	★★☆	★★★	★★★
Materials	★☆☆	★★☆	★★☆
Real estate	★★☆	★☆☆	★★☆
Utilities	★★★	★☆☆	★☆☆

Notes

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