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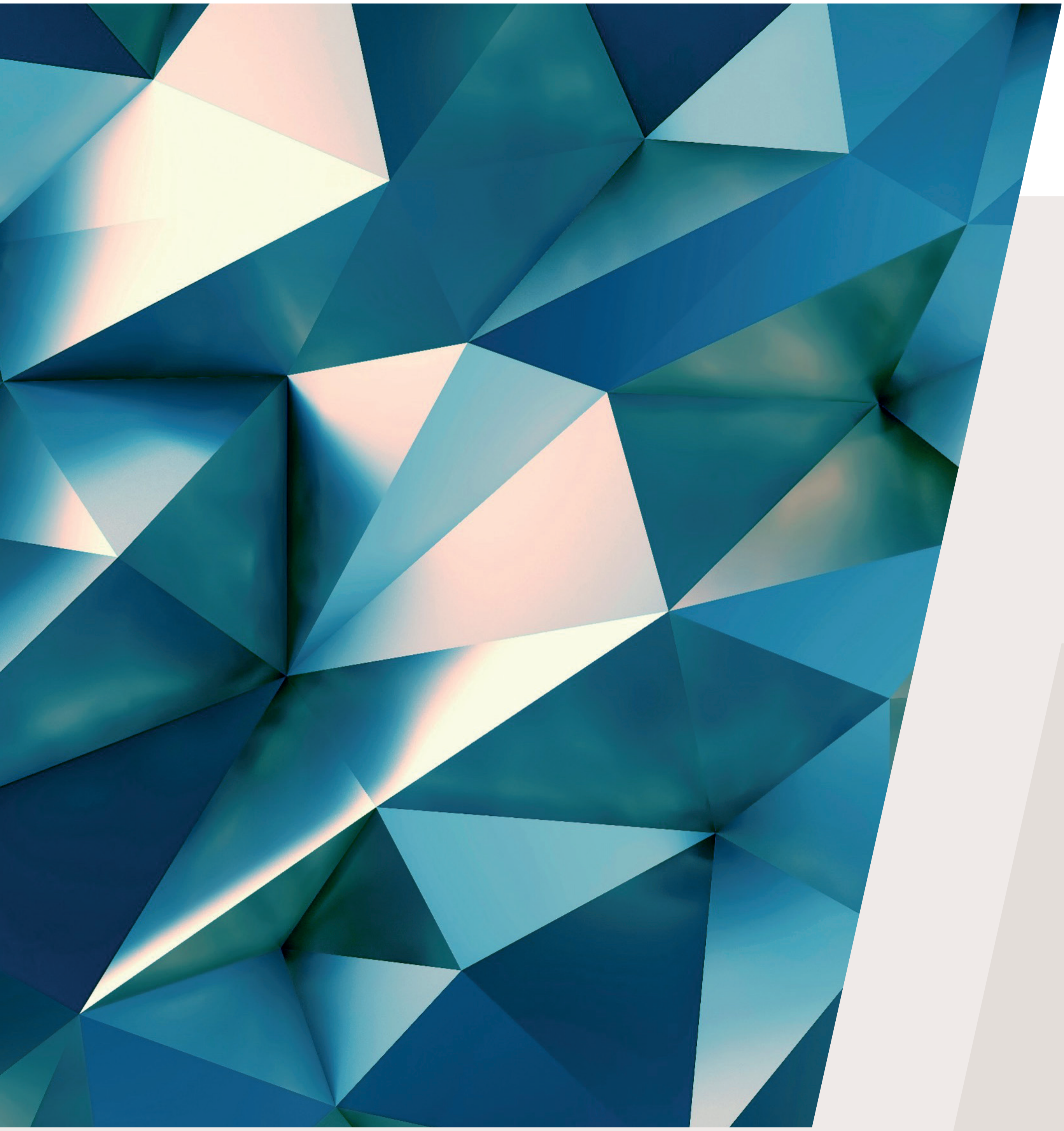

FEBRUARY 2025

Mosaique Asset Allocation

Our current view

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KEY POINTS

- Trump's second administration need not have a dramatic impact on portfolios
- We are tactically cautious, but because of valuations and inflation risk
- We stay neutral on asset allocation, but with ongoing regional and sectoral positions

THE MACRO PICTURE

As we write, President-elect Trump's inauguration is imminent. Much uncertainty still surrounds his administration's intentions, capabilities and personnel, with many announcements likely in the days and weeks ahead. In itself this might argue against further tactical portfolio realignment for now, but when things settle we doubt that the implications for the global economy need be dramatic. Even the impact of additional tariffs may be more nuanced than economists fear, not least because taxes may be falling at the same time – as occurred in his first administration.

The business cycle often matters most in the narrow investment context in any case. For now it continues to offer a relatively constructive backdrop, but we do wonder for how much longer than can continue – not so much because of Trump II, but because economies remain historically rather fully utilised, and global inflation risk may resurface as a result in 2025. Money and bond markets recently have perhaps been registering the possibility that the interest rate outlook may not remain as friendly as it has been.

There are still few signs of reckless excesses in the US or European private sectors: savings by households and businesses are more than sufficient to finance capital outlays. Government balances are however more of a concern – fiscal policy is loose and poised to become more so in the US, China and much of Europe – and with unemployment still low, expansionary fiscal policy is one of the sources of that possible revival of inflation risk.

Growth is currently patchy, admittedly. It remains above trend in the US, below trend but still highly respectable (by Western standards) in China, but largely absent in Europe, where key (manufacturing) industries remain out of global favour, and structural weaknesses persist. Even there, however, growth may receive some boost in 2025: France and Germany have both lost governments recently because fiscal policy has been seen as too tight to begin with.

With inflation no longer falling steadily, the balance of risks may be tilting back towards some revival. We have always thought it would prove sticky in the 2-4% range. That stickiness has not stopped central banks cutting interest rates so far, but in the US and UK in particular they are showing signs of slowing or pausing their easing – and indeed, might eventually even feel the need to consider hiking rates anew.

For now, the outcome still seems most likely to be a growth/inflation mix which remains historically friendly, but stock prices have risen a long way in the last two years, far in excess of corporate earnings, and investors may be over-optimistic about what Artificial Intelligence can reasonably be expected to deliver soon.

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 of Swiss franc-based portfolios, where we felt in December that the SNB's remarkable credibility had driven bond yields back down to negligible levels, leaving us preferring liquidity there.

INVESTMENT CONCLUSION

When we cut stocks from overweight to neutral in November, we placed the funds not into bonds, which might be vulnerable to if inflation risk were to revive, but into cash, lifting it from underweight to neutral. This left us neutral on each of the big three assets – which seemed appropriate at such an advanced stage of the cycle, and with geopolitical uncertainty so visible.

Portfolios will still benefit in absolute terms from any stock gains. Meanwhile, dollar and euro-based portfolios at least receive above-inflation income from both bonds and cash (and even in franc-based portfolios we doubt that yields and rates are headed back to the significantly negative levels seen a few short years back).

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, but still left us with some ongoing significant divergence from benchmarks.

Asset allocation overview

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

Within the equity market, we favour a mix of cyclical and secular growth sectors, with overweight positions in financials, technology and communications. We had favoured industrials, but in November cut that overweight to neutral because of its particular sensitivity to tariffs (replacing it with the overweight in financials, which might benefit from deregulation). The technology and communications have considerable momentum: they include some of the most expensive stocks, of course, but our concern at exaggerated expectations for AI has been addressed by the reduction in equity weightings.

Our overweight positions have been 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 again of late, the latter is of course to some extent a hostage to political fortune.

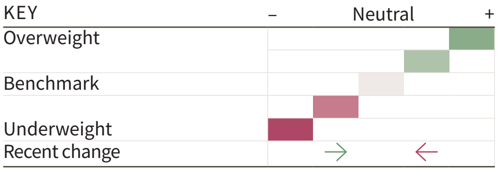
Regionally, the arguments in favour of the US have if anything become more compelling, and we have stayed overweight. From February 2024 we also favoured most of continental Europe too, but this position disappointed, and we cut it back to neutral in November, raising the UK market to neutral as we did so. We remained underweight Switzerland, which we have seen as too defensive.

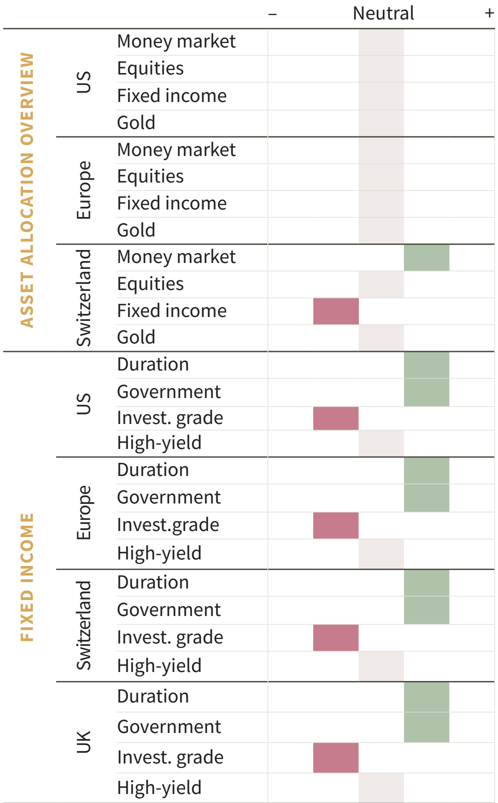
Fixed income. Our preference for longer-duration exposure has again hurt over the New Year, this time in euro-based portfolios as well as dollar-based ones, and as noted we do think that inflation risk could revive this year. But yields remain close to longer-term notions of neutral, and central bank policy may be more credible this time around, allowing yield curves eventually to flatten once again.

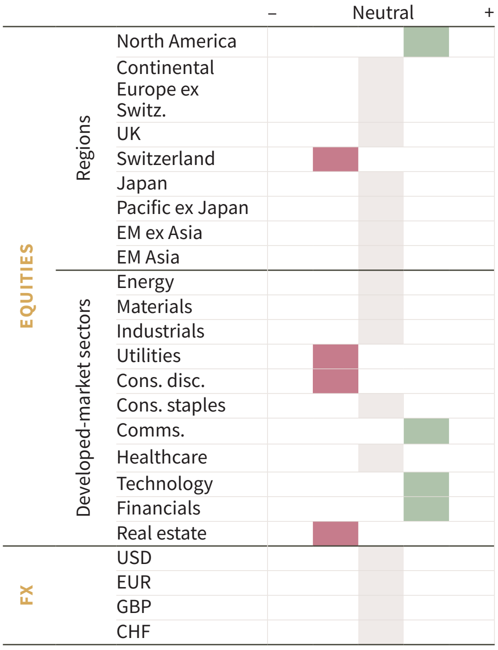
We continue to favour government bonds over credit – even in franc-based portfolios – not because we worry about corporate defaults, but on valuation grounds (the same reason we trimmed our stock weightings). Credit spreads have not been materially lower in the post-GFC period.

Currencies. The dollar has risen further against almost all currencies in recent weeks. One of the many inconsistencies surrounding the new US administration is that while it seems often to be seeking a lower dollar, its wider actions might make the US economy more, not less, attractive to global investors (arguably, in capital markets at least, America has never not been great). For now, though, none of the big bilateral cross rates yet looks historically extreme (though the dollar/yen rate is close), and we continue to express our preference for the US via stocks rather than currency selection.

Asset allocation







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