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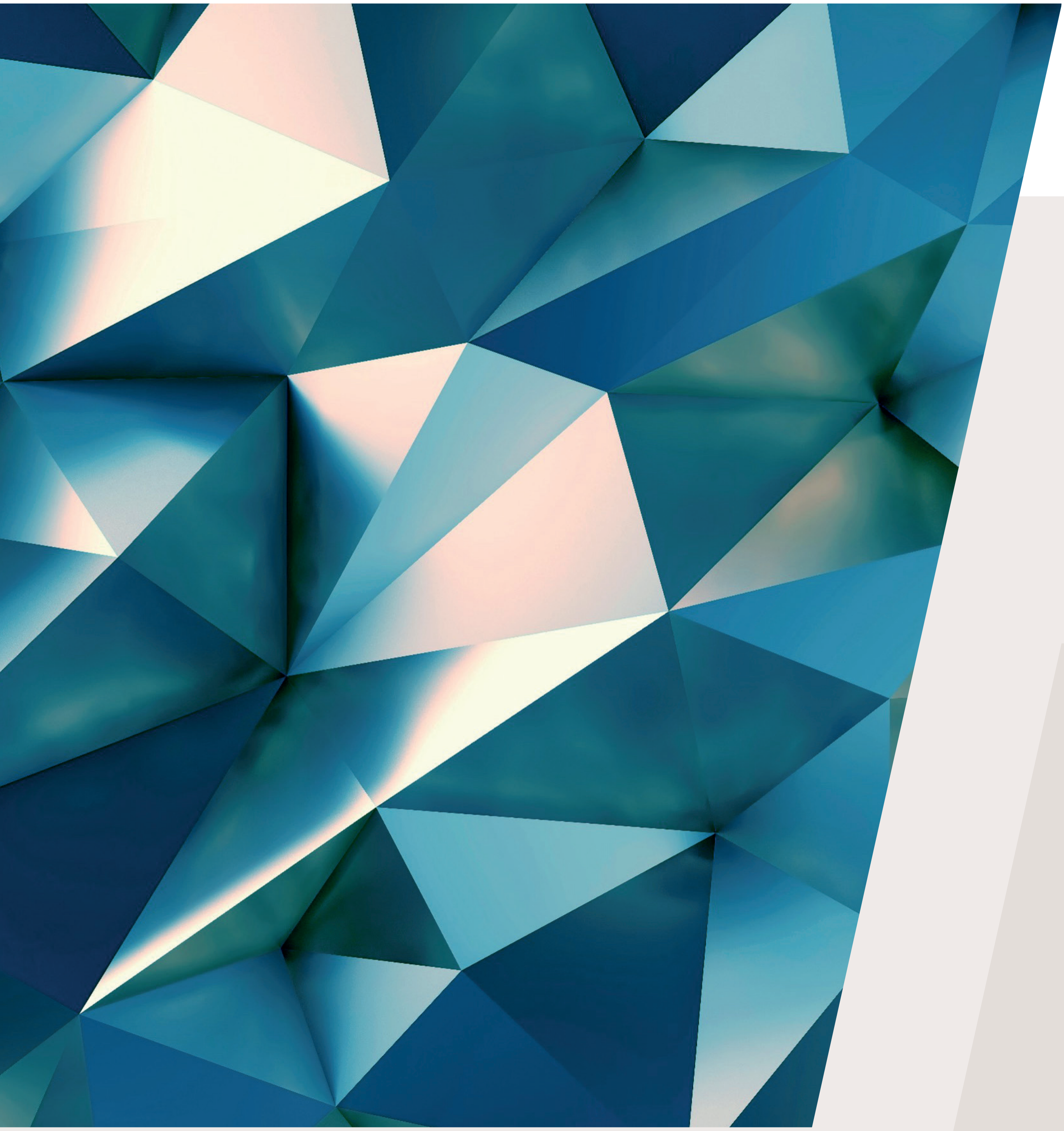

MARCH 2025

Mosaique Asset Allocation

Our current view

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KEY POINTS

- Tariffs and peace talks illustrate political uncertainty
- Inflation and valuations pose more conventional risks
- We stay tactically neutral on the main asset classes

THE MACRO PICTURE

Politics does not always affect portfolios, but the chances of it doing so currently are quite high. The risks seem obvious, but can be overstated – and those risks do not point only in one direction, though it sometimes feels as if they do.

Developments in the first month of the new US administration illustrate our point. President Trump's proposals to raise tariffs on US imports, for example, are a very visible threat to global economic stability. It is still not clear, however, exactly how large they will be, or whom/what they will cover. It seems quite possible that they are at least partly a negotiating tool, designed to encourage the US' trading partners to buy more US exports. If and when they take effect, we would expect the revenues to be recycled as tax cuts, muting some of the damage.

Meanwhile, the US president may be catalysing moves towards peace, first in the Middle East, and more recently around Ukraine. It is far too soon to conclude that conflict will cease – in the case of the Ukraine initiative, the US approach may be unworkably one-sided – but the possibility that they could has been largely overlooked amidst the understandable indignation and trepidation which has greeted Trump's return to office. The reduction in energy costs and trade disruption which ceasefires might bring would likely boost growth and risk appetite – a possibility which helps balance some of the more obvious, negative scenarios.

Political uncertainty was just one of the reasons for turning more tactically cautious on stocks back in November (we took a profit, closing an overweight position, and using the funds to raise liquidity to neutral, while staying neutral on bonds). Indeed, other reasons felt more important at the time, namely: a possible revival of inflation and interest rate risk; elevated US stock valuations after that market's two-year surge; and over-enthusiastic expectations of what Artificial Intelligence could reasonably be expected to deliver soon.

These more conventional concerns are still with us, and together with the ongoing geopolitical uncertainty lead our asset allocation committee to remain uncharacteristically neutral on the big three asset classes, as we wait for some clarity.

The global economy does seem still to be growing respectably – though not evenly: Europe continues to lag the US and of course Asia. Momentum is likely to be augmented in 2025 by a further loosening of fiscal policy in the US, Europe and China, and in the context of low unemployment rates could quite easily spill over into renewed inflation risk.

Indeed, headline inflation rates seem to have bottomed in 2024, having in some cases returned to target only briefly. We think a major rebound is unlikely, but we have long seen inflation sticking in the 2-4% range. If unemployment were higher, central banks might feel able to ignore this, but in current circumstances they may be less inclined to do so – hence our concern that investors may have been overly optimistic about the room for further interest rate reductions. Such concerns did indeed hit money and bond markets in the New Year: they have faded a little since, but could easily be rekindled.

Meanwhile, US stock valuations remain elevated: they have only been significantly higher once, in 2000. Admittedly, there were far more signs of froth then: the companies leading stock markets higher with poor (or non-existent) profitability and weak balance sheets. Interest rates and bond yields were higher then too. But while the narrower group of companies leading the market higher recently are profitable and mostly debt-free, there are some signs of excess in the claims being made for AI, and in the scale of recent spending on energy and capex in pursuit of them.

INVESTMENT CONCLUSION

We have been unusually neutral in our asset allocation since November, when we closed an overweight in stocks and an underweight in liquidity. A mix of cyclical, valuation and geopolitical concerns argues against tactically favouring either stocks or bonds currently. At neutral we are well-positioned to move in either direction if/when we think circumstances change.

Meanwhile, Mosaique portfolios will of course still benefit if stock markets do drift higher, and if bond returns deliver today's historically respectable yields, but in line with benchmark weightings – neither more nor less.

The exception is a technical one. In Swiss franc portfolios, bond yields are sufficiently low as to lead us to prefer liquidity. The SNB is perhaps the most credible central bank currently, facing negligible inflation risk and arguably presiding over the best all-round economic performance of any big economy, but we think it is unlikely to cut policy rates as far as it could, leaving local bonds perhaps facing a relatively one-sided outlook.

Asset allocation overview

Equities. While we are neutral on stocks, and partly on account of US valuations, we still prefer the US market to others. We do not yet see other regions consistently outperforming. A sustainable settlement in Ukraine could change that, but assuming such an outcome currently would owe more to hope than analysis. In the meantime, elevated levels of geopolitical risk – and the US economy's leading position in the business cycle – seem to us to favour US assets. We balance our US overweight with an underweight in the Swiss market, which we think is too defensive for the 'wait-and-see' scenario we have in mind.

Sector-wise, we continue to favour a mix of cyclical and structural growth. This does still include both technology and communications, despite their recent advance (and some of the elevated expectations mentioned above): we expect their leadership to fade, not to go sharply into reverse. It also includes financials – recently elevated at the expense of industrials, which we felt were too exposed to tariff risk.

The sectors which we underweight to fund these positions are consumer staples, utilities and real estate. The first two are conventionally defensive, and we are not that negative on market levels currently (utilities have also benefited recently from some of that over-enthusiastic spending on energy). Real estate can be more cyclical, but can also require more of a boost from lower bond yields than we see currently.

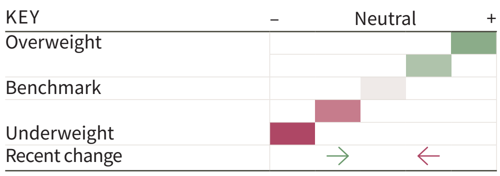
Fixed income. Within bond holdings, we have similar views for each currency base. In Euro, Franc, dollar and GBP portfolios we favour longer duration and the highest quality bonds.

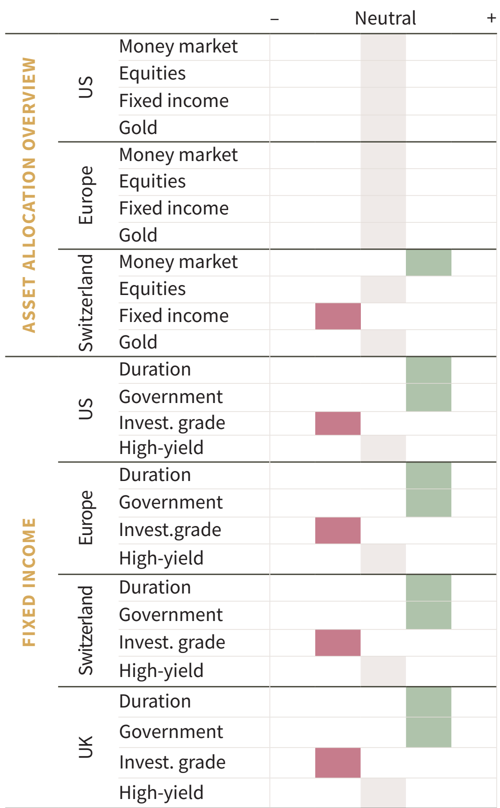
Our longer duration stance has detracted from performance in recent months, but on our one-year tactical view we think it remains appropriate. We do worry about inflation risk, as noted; but we think that central banks will avoid making earlier mistakes, and either refrain from excessive rate cuts or even raise them if circumstances warrant (not our current view). This will allow yield curves to flatten anew as it becomes clear that inflation is not rising back out of control. We see current ten-year yields as having normalised, with room to fall when conditions permit.

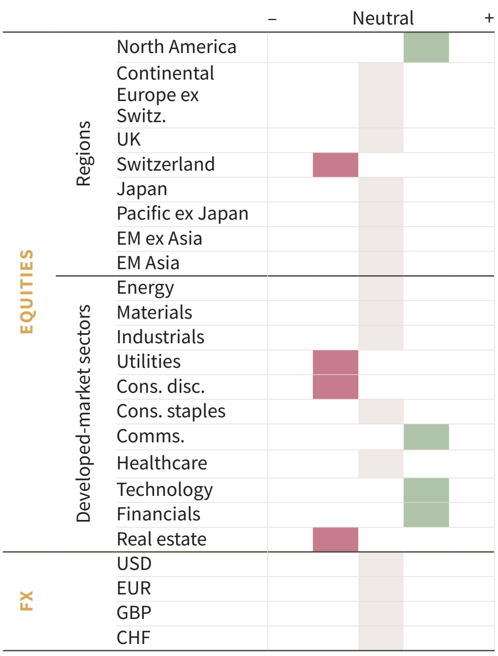
We prefer government bonds currently, not because we see the corporate sector as over-leveraged and/or heading for recession, but because valuations there look rich. Spreads have fallen to levels not seen since before the Global Financial Crisis. We prefer speculative grade bonds to investment grade, because while spreads in both are historically narrow, with little sign of corporate distress their higher absolute yields look more attractive.

Currencies. For a while after the election it seemed as if the dollar was about to break higher, but as we write it has fallen back, and the major cross rates again look rangebound. Our currency conviction remains low: there are few outlandish valuations, and monetary policies are not dramatically divergent. Our continuing regional preference for US stocks implicitly delivers a modest pro-dollar stance to portfolios.

Asset allocation







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