2025 Outlook

Creativity within Excellence

CBH | Investment Management

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Contributors: Ali Bencheikh, Marco Bonaviri, Charlie Carré, Daniel Esteves & Christophe Leroy

Design: Kateryna Polishchuk

Contact: am@cbhbank.com

The Year of Mister T’s Economic Shake-Up

In a Nutshell

- The U.S. remains robust, driven by strong consumer spending, AI investments, and initiatives such as the CHIPS and Inflation Reduction Acts.
- Trump’s economic proposals, including tariffs and taxes, are creating volatility and impacting global markets and trade dynamics.
- Earnings growth, projected at 13% for the year, remains the foundation for stock performance.
- In fixed income, income generation will be key, with a focus on high-quality bonds and emerging market debt.
- Private markets offer attractive opportunities.

As 2025 begins, global markets are at a critical juncture, brimming with opportunity yet tempered by complexity. The past year ended on a high note, with equity indices scaling new peaks, propelled by robust earnings and renewed investor confidence. As we enter this new chapter, the task before us is clear: to navigate the evolving landscape with foresight, discipline and an acute awareness of the risks and opportunities that lie ahead.

The U.S. economy remains a standout performer, charting a unique path supported by robust consumer spending, resilient labor markets and an unparalleled wave of investment in artificial intelligence (AI) and digital infrastructure. Fiscal initiatives such as the CHIPS Act and the Inflation Reduction Act continue to fuel a manufacturing renaissance, while the private sector’s focus on automation and energy transition adds new dimensions to growth. This domestic vitality contrasts sharply with subdued activity in other major economies, underlining the U.S. divergence in a post-pandemic world.

This optimism must be tempered however by the challenges posed by The Year of Mister T’s Economic Shake-Up. The dynamics of tariffs, taxes and tensions—the three pillars of Donald Trump’s policy agenda—underscore the volatility that will likely hang over the 2025 scenarios. His approach, combining aggressive tariffs, reduced taxation and strict immigration measures, introduces uncertainty in a multi-polarized global landscape, with far-reaching implications for markets. This backdrop of shifting power structures and negotiation tactics will test investors’ ability to remain resilient amid heightened market swings.

For equities, while 2025 offers reasons for optimism, the maturing bull market and elevated valuations may dampen returns. Earnings growth, projected at 13% for the year, remains the foundation for stock performance, but sentiment and valuations will play pivotal roles.Higher long-term yields, potentially approaching 5%, could periodically stall market momentum, echoing patterns observed in previous cycles. Investors must also be alert to potential disruptions, such as a reversal in momentum for high-performing tech giants, which could lead to broader market turbulence. In such a scenario, undervalued segments, like value stocks and international equities, may outperform.

For fixed income, the focus shifts to income generation over price appreciation. While spreads remain tight, intermediate-duration bonds, higher-quality high-yield credit and select emerging market debt offer compelling opportunities for cautious investors. The “carry” theme will likely define fixed income strategies in 2025, requiring disciplined issuer selection and a vigilant eye on geopolitical risks.

Portfolio strategies must evolve to align with these realities. Moving beyond traditional 60/40 allocations into private markets can unlock meaningful alpha. Private credit, particularly in senior-secured and asset-backed opportunities, provides attractive yield premiums. Meanwhile, the AI revolution continues to shape long-term investment themes, with demand

for data centers, semiconductors, and energy infrastructure driving innovation and capital deployment. These areas offer significant potential, though they also highlight the need for careful risk management and selectivity.

Geopolitical tensions, fiscal sustainability and inflationary pressures round out the landscape of challenges. Policymakers face the delicate task of balancing monetary easing with inflation control, and missteps could either reignite inflation or dampen economic momentum. The path of rate cuts will be decisive, underscoring the importance of agility and adaptability in portfolio management.

For investors, 2025 calls for conviction-driven strategies that embrace structural trends like digital transformation, regionalized supply chains and stable sources of carry. A disciplined focus on valuations, risk-adjusted returns and liquidity will be essential. By balancing optimism with caution and pairing vision with pragmatism, investors can navigate the complexities of today's market while positioning themselves to seize tomorrow's opportunities.

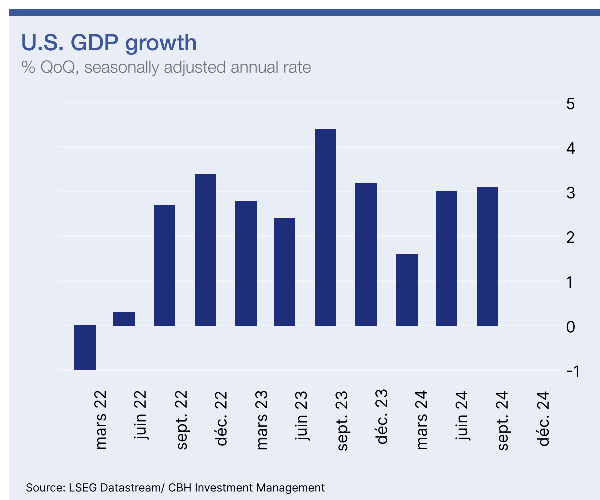
Macro Outlook – United States

Key Takeaways

- Robust economy supported by massive investment in research and technology leading to higher productivity.
- U.S. consumer resilient despite rising inequality thanks to healthy labor market and wealth effect.
- Read our analysis of the U.S. elections: CBH Focus 06.11.2024 (cbhbank.com)
- Long-term yields expected to remain high.

Heading into 2025, the U.S. economy continues to outpace the rest of the world. Its unique cyclical and structural tailwinds explain the divergence from the rest of the advanced economies. The surge in investment, research spending and innovation is supporting the "AI boom" and boosting productivity. Research and development expenditures currently represent approximately 10% of revenues for publicly listed U.S. technology companies, and U.S. companies can use various forms of capital market financing to fund their intangible investments. In addition, fiscal policy is very supportive and is expected to remain so, allowing public and private investment to reinforce each other and create a snowball effect. As a result, U.S. productivity has grown by almost 40% since 2005, while European productivity has been virtually stagnant.

Meanwhile, the U.S. consumer is strong and driving economic growth. Their spending continues to grow at a robust pace thanks to a healthy labor market, which supports disposable income, and the wealth effect of gains in equity and house prices. The of U.S. consumption masks significant divergence and inequality across households. Low-income households and younger people are struggling with high levels of variable-rate debt (including credit card debt), while high-income consumers are benefiting from higher asset prices and rising interest rates. Their debt consists mainly of fixed-rate mortgages.



Overall, the U.S. economy has been less affected by interest rate rises. Business investment has remained strong and the housing market has shown resilience. With 95% of mortgages being 30-year fixed-rate mortgages, corporate borrowing is also dominated by fixed-rate debt. During the pandemic, companies locked in low interest rates, so the Federal Reserve's rate hikes have not had a major negative impact on companies. As a result, the transmission mechanism of monetary policy has been much weaker and the economy has not slowed despite the Fed's aggressive rating cycle.

Following the November elections, Donald Trump will return as President of the United States, having secured majorities in both the House of Representatives and the Senate. This strong mandate will ease the implementation of his proposed policies. However, it is still too early to fully assess the macroeconomic impact of his new administration's agenda. In general, the combination of higher tariffs, tax cuts, and tighter immigration controls is likely to drive inflation, while the effect on GDP growth remains more uncertain.

Donald Trump announced that he would impose tariffs of 10 to 20 % on all imports and a 60% tariff on Chinese imports.

After a sharp decline, inflation has proven to be persistent, supported by a resilient labor market, robust consumer demand and accommodative fiscal policy. In November, core consumer price inflation, that exclude the more volatile items, reached 3.3%. In this context, **the Federal Reserve has signaled caution and a gradual pace of rate cuts through 2025**, aiming for a neutral rate that neither restrains nor stimulates growth.

In this context, yields are expected to remain high for longer, driven by robust economic growth and the structural changes at play (aging population, energy and digital transition), which require massive investments and large fiscal needs.

Driven by interest rate expectations and the prospect of an increasingly strong U.S. economy, the U.S. dollar has appreciated strongly over the past quarter. Currencies will remain volatile in the coming months, given the high degree of uncertainty surrounding upcoming changes in trade policy, inflation and interest rate expectations, but the U.S. dollar should continue to benefit from the attractiveness of the U.S. economy.

Macro Outlook – Euro area

Key Takeaways

- Domestic demand should be supported by rising disposable income.
- Disinflation is well underway and monetary policy is moving towards a neutral stance.
- Headwinds are many and strong and are holding back growth potential: political and geopolitical risks, lack of investment, persistently weak productivity.

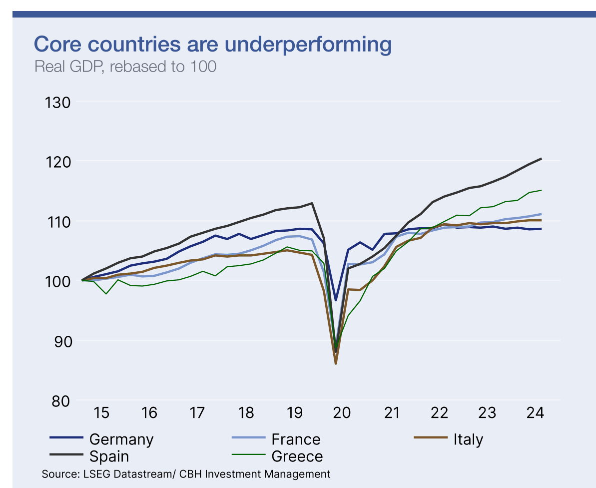
Domestic demand is expected to rebound but the region faces multiple headwinds. The two largest economies in the area are facing political crises. In France, the government will remain fragile due to the lack of a majority in the National Assembly. As a result, fiscal consolidation will be postponed, but the country is likely to suffer months of political, fiscal and regulatory uncertainty. This could undermine consumer and investor confidence, with France's risk premium likely to remain elevated, business investment weak, precautionary savings even higher and GDP growth potentially affected.

Debt brake limits Germany's structural deficit to 0.35% of GDP since 2009

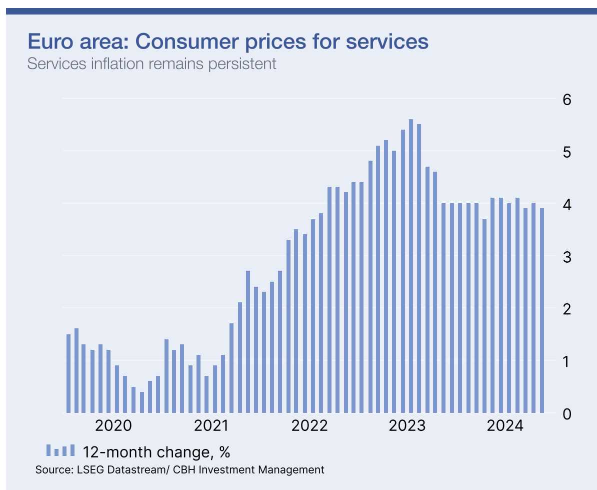
Meanwhile, Germany is facing cyclical and structural economic challenges, partly related to the debt brake rule, the energy crisis, structural shifts in the auto industry, and China's upgrading of its supply chain. To revive economic growth, the Scholz government had planned to implement several measures, including tax incentives for the purchase of electric vehicles and increasing the labor supply of older workers and migrants. The fall of the coalition government has postponed these measures and increased uncertainty. However, with the CDU indicating flexibility on the debt brake, there is hope that the rule could be modified in 2025, paving the way for higher public investment to help modernize infrastructure, raise productivity and increase potential growth.

In addition to national political uncertainty, the euro area faces a structural lack of investment in research and technology, weak productivity and economic growth is being held back by trade tensions and heightened geopolitical uncertainty. The risk of greater friction in global trade could weigh on euro area growth by dampening exports. However, consumer demand is expected to be supported by wage increases, a strong labor market and continued growth in real disposable income, while investment should benefit from more favorable credit conditions.

This regional picture masks significant differences between countries. The two largest economies, Germany and France, are weak, but the peripheral countries are growing strongly.



Divergent growth paths and fiscal policies within the monetary union complicate the ECB's task. Overall, the inflation path is well on track. However, an important part of the disinflation has yet to materialize. Inflation in services and growth wages remains high, and low unemployment in the face of persistent labor shortages and weak labor productivity is leading to increased upward pressure on services prices. In addition, new inflationary shocks are and will continue to hit the euro area economy. An increase



in geopolitical tensions could push up energy prices and freight costs, while extreme weather events could raise food prices.

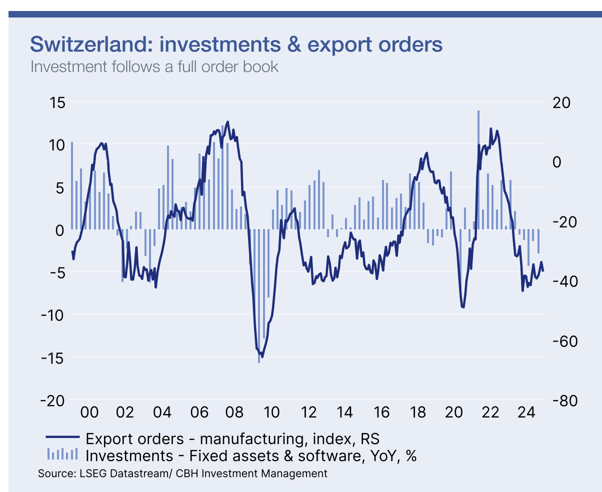
While the fight against inflation is not yet over, **the ECB has gained greater confidence in a sustained decline in inflation towards the 2% target.** The Frankfurt-based institution has cut its policy rate by 100 basis points this year. Monetary policy will remain data-dependent as it moves toward a neutral level that neither constrains nor stimulates the economy. However, the path may prove bumpy given the interplay between the triangle of wages, profits and productivity in influencing inflation dynamics. Services inflation remains high and the euro area is vulnerable to external and idiosyncratic shocks. The ECB gradual and meeting-by-meeting approach maintains flexibility, but exacerbates market expectations.

Macro Outlook – Other Advanced Economies

Key Takeaways

- The Swiss economy is under pressure from the fragility of its main trading partners and the uncertainty surrounding the future of U.S. trade policy.
- The SNB lowered its policy rate by 125 basis points this year and further cuts are on the table.
- In Japan, despite a more favorable environment for private consumption, activity will continue to be hampered by labor shortages.
- The Japanese yen is likely to remain undervalued.

The Swiss economy is weakened by the continued fragility of its main trading partners. The economy has shown resilience, underpinned by the defensive nature of its manufacturing and export base. However, subdued European demand and growing uncertainty about future trade policy following the re-election of Donald Trump are putting pressure on exporting companies, especially as the U.S. has become Switzerland's main trading partner. In this context, manufacturing and goods exports are under pressure and companies are postponing investments. There is a strong correlation between export orders and investment decisions: when order volumes are weak, companies tend to postpone investments. Meanwhile, robust employment growth and real wage increases have supported household consumption. While consumer sentiment is showing tentative signs of improvement, it remains subdued.



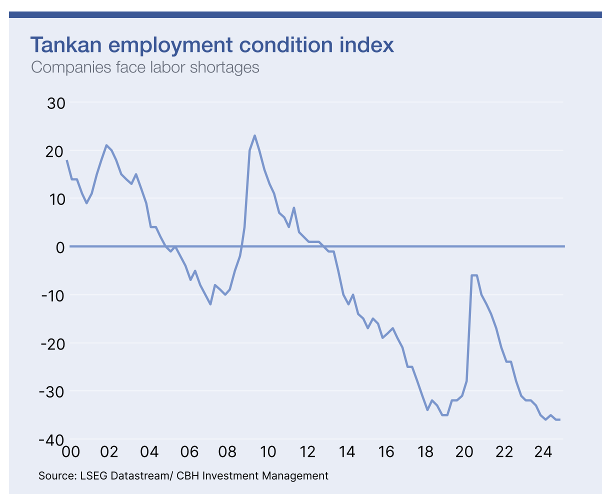
The strength of the Swiss franc is undermining Switzerland's competitiveness, even though Swiss exports, with their high value added, are less sensitive to price fluctuations. In addition, the appreciation of the franc has contributed to the deflationary pressures that Switzerland is currently experiencing.

Inflation remains below the Swiss National Bank's target, mainly due to a decline in imported inflation. The inflation rate for oil products fell from -4.6% in August to -8.8% in November, while inflation for domestic goods and services also declined. The Swiss economy is inherently disinflationary, with productivity growth consistently outpacing wage growth. Meanwhile, long-term inflation expectations have remained largely unchanged. In response, the central bank has ceased its foreign exchange interventions aimed at supporting the franc and reducing its balance sheet. In addition, the SNB has lowered its key interest rate by 125 basis points, including a sharp 50 basis point cut in December. Looking ahead, the majority of analysts still expect the terminal rate to reach 0.25%, although the probability of a 0% terminal rate is increasing.

Japan is hampered by a shortage of factors of production, starting with a limited labor force. In the fourth quarter, the Tankan index of employment conditions continued to deteriorate, hitting a historic low, as a result of a severe shortage of labor. Meanwhile, the country faces growing uncertainty regarding its major trading partners at a time when political instability is likely to continue. First, the United States, Japan's largest trading partner, may impose tariffs that could undermine the competitiveness of

Japanese exporters. Second, demand from China, the second-largest destination for Japanese exports, is likely to remain subdued despite ongoing stimulus efforts.

However, private consumption, the main driver of GDP growth, is expected to pick up in 2025, supported by rising disposable income. Labor unions are pushing for wage increases of at least 5% in 2025, mirroring the gains achieved in 2024. In addition, a $250 billion economic stimulus plan, fueled by both public and private spending, will support the AI and semiconductor sectors, while also providing assistance to low-income households.



The Bank of Japan has adopted a cautious stance following its unexpected rate hike last summer. It kept the uncollateralized overnight call rate steady at +0.25% during its consecutive meetings in September, October and December. The BoJ will continue on its path of monetary tightening, but will remain very cautious given the considerable uncertainty surrounding its growth projections, wage dynamics, underlying inflation and the impact of Trump's economic policies.

Given the strong backdrop for the U.S. dollar – the prospect of even higher U.S. yields and a hesitant BoJ – the yen is likely to remain the most undervalued G10 currency in the coming months. The Bank of Japan may intervene in the currency market again to stem the yen's depreciation.

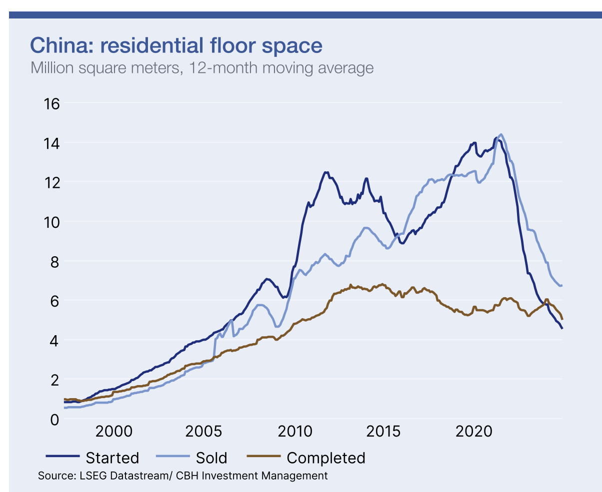
Macro Outlook – Emerging Economies

Key Takeaways

- India is a bright spot despite structural weaknesses.
- China's outlook remains clouded.
- Brazil's tighter policy mix will be a drag on demand.
- Trump's trade policy will affect EM currencies.

Since September, **the Chinese authorities have launched several fiscal and monetary stimulus plans to revive the stock and property markets.** The package includes fiscal support to address local governments' bad debts. After the property market crisis, many provinces could no longer use land sales to pay their loans. As a result, some local governments have cut spending on public services. China is also easing its monetary policy stance from "prudent" to "moderately loose". Chinese policymakers want to boost demand in 2025, especially consumption. However, consumer sentiment is very low and implementation remains uncertain. The Chinese economy has been under deflationary pressure for several quarters. So far, stimulus measures have not been sufficient to restore confidence or revive domestic demand.

China remains a leading trade partner and a key player in the supply chain and innovation in critical sectors. In particular, it dominates critical mineral supply chains. However, China is struggling to find sufficient external demand. In the absence of robust domestic consumption, this has led to overcapacity. In addition, the polarization of U.S.-China relations and a massive loss of confidence by international investors are increasing the country's isolation and limiting its potential at a time when it is facing domestic structural and cyclical challenges.

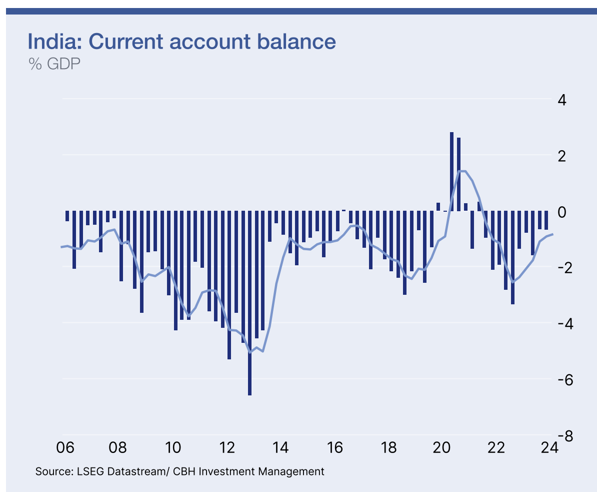


Source: LSEG Datastream/ CBH Investment Management

India is the fastest growing major emerging economy and is projected to become the third largest economy by 2028. However, the pent-up demand created during the pandemic has largely been absorbed and the economy is expected to return to its potential growth path. While activity is expected to slow, it should remain strong in the coming years, driven by increased infrastructure spending, diversified growth drivers and a large, youthful labor force. Despite its strengths, the Indian economy remains hampered by structural weaknesses, including protectionism, regulatory uncertainty and constraints, a weak industrial base, inadequate infrastructure, and low productivity.

India's share of international trade is limited and the country is not expected to be among the hardest hit by the tariffs that Donald Trump is likely to implement. Moreover, the country has dramatically improved its external macroeconomic fundamentals over the past decade and the central bank has strengthened its credibility. However, the Indian market reacted to Trump's election through FX and interest rate risk channels. The sharp appreciation of the U.S. dollar

Indian current account deficit has narrowed from 5% to 1% since 2013 and the credibility of the Reserve Bank of India has improved significantly.



and the rise in U.S. yields spooked investors, despite the Reserve Bank of India's regular use of its FX reserves to manage currency stability.

Brazil is grappling with investor skepticism, as calls intensify for a strengthening of public finances. The risk premium has increased and the real is under great pressure. Meanwhile, economic activity is solid, the unemployment rate is at a historical low and external indicators are robust. Trade-offs between deficit reduction and social support will undoubtedly be difficult. The central bank has embarked on a monetary tightening cycle, diverging from the global trend, as it responds to the resurgence of inflation. The new policy mix is likely to depress demand in 2025.

Emerging markets are sensitive to changes in the U.S. monetary policy and the strength of the dollar. While there are many divergences within this bloc, the re-election of Donald Trump – through higher inflation and controversial trade policies – will increase vulnerabilities across EM economies. Countries with solid external positions and resilient domestic dynamics are likely to fare better.

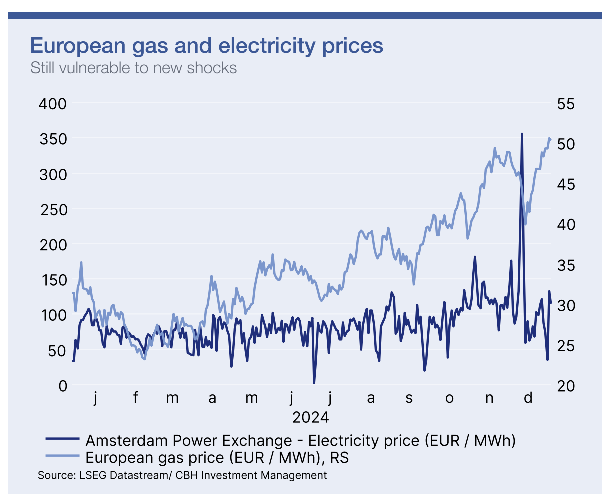
Macro Outlook – Commodities

Key Takeaways

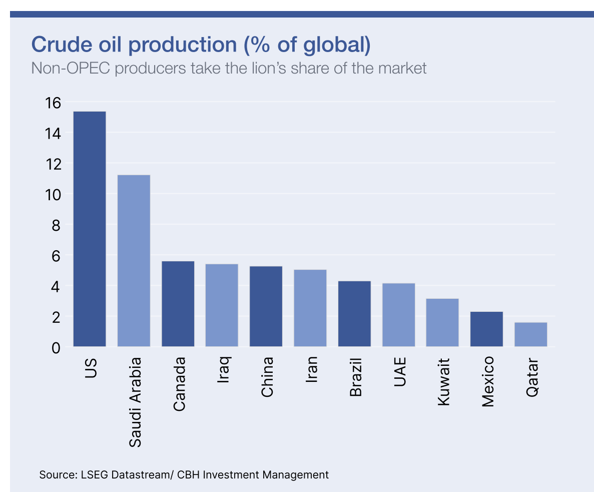
- Despite regional geopolitical risks, oil prices have been largely stable, driven by supply and demand dynamics. Analysts predict a surplus in the oil market by 2025.
- Gold has been a standout performer in 2024, supported by geopolitical risks, and rising demand from emerging market central banks. Despite some short-term pressure from a stronger US dollar, gold is expected to remain a strong asset in 2025.
- Breakfast items, particularly coffee, have seen significant growth in 2024.
- Gas and electricity prices in Europe remain highly volatile, driven by both weather conditions and geopolitical factors.
- Metals, which have become critical to the massive transformation of our economies, require significant long-term investment to meet future demand.

In 2024, breakfast products have undoubtedly taken the lead. Coffee has risen dramatically, reminding older generations of the historic spike in 1976. Cocoa and orange juice are also back on track, as is sugar.

The fall months brought renewed tension in gas prices, driven by a decline in wind power production in Germany due to unfavorable wind conditions. At the same time, the market is concerned about the impact of the conclusion of the last remaining contracts for gas supplies from Russia. Electricity prices in Europe, which are highly sensitive to gas price movements, spiked in mid-December before easing towards the end of the year. This episode underscores the inherent volatility of energy prices, which are driven by both weather patterns and geopolitical tensions.



Meanwhile, oil prices have remained relatively immune to geopolitical shocks. While risks in the Middle East have de- escalated thanks to the ceasefire between Israel and Hezbollah, the fall of the Assad regime in Syria has thrown the region into uncertainty. However, the market has largely been driven by supply and demand dynamics. Most analysts believe that "Chinese Peak Oil" has either already occurred or is imminent, while non-OPEC+ production continues to rise. As a result, the International Energy Agency (IEA) forecasts a market surplus of 1 million barrels per day by 2025.



Despite significant demand driven by the digital and energy transitions, copper and cobalt supplies are comfortably meeting market needs. However, the outlook for nickel, aluminum and platinum is more challenging. According to the World Platinum

Investment Council, the global platinum market will be in deficit for the third consecutive year in 2025, with a shortfall of 539,000 ounces, down from 682,000 ounces in 2024.

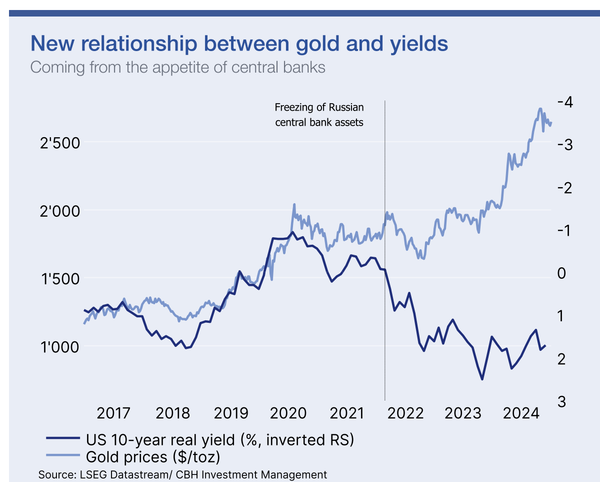
Metals, which have become critical to the massive transformation of our economies, require significant long- term investment to meet future demand, while geopolitical shifts are redefining supply chains. The IEA estimates that demand for minerals needed to power decarbonization, clean energy and electrification will at least double by 2040. In the short term, however, prices have been suppressed by weaker demand, in part due to the Chinese real estate crisis. Investors have little incentive to invest in the face of growing uncertainty and current metal prices. In the longer term, however, the transition to a low-carbon economy supports the transformation of the global energy system and the intensive use of these resources.

> **Gold ends 2024 at $2625per ounce, up 27% since the beginning of the year.**

Gold has been the star this year. The precious metal has been supported by a number of factors, including expectations about the Federal Reserve's policy path, escalating global geopolitical risks and structural demand from emerging market central banks following the Russian central bank's asset freeze. In addition, cautious Chinese households and a reduction in Indian import taxes have added to its appeal. In the last quarter of 2024, the sharp appreciation of the USD and higher yields have weighed on the precious metal. However, ongoing geopolitical tensions, growing demand from emerging market central banks and uncertainty about the trajectory of sovereign debt could push gold higher in 2025.

New relationship between gold and yields

Coming from the appetite of central banks



Source: LSEG Datastream/ CBH Investment Management

Key Macro Data & Forecasts

	Annual				2023			
	2022	2023	2024e	2025e	Q1	Q2	Q3	Q4
United States								
Real GDP	**2,5**	**2,9**	**2,8**	**2,2**	**2,8**	**2,5**	**4,4**	**3,2**
Private consumption	3,0	2,5	2,6	2,1	5,0	1,0	2,5	3,5
Non residential investment	7,0	6,0	4,0	2,7	5,3	9,9	1,1	3,8
Residential investment	-8,6	-8,3	4,1	1,6	-4,3	4,5	7,7	2,5
Domestic demand (contribution, %pt)	2,4	2,8	3,2	2,7	4,8	2,7	3,2	3,6
Inventories (contribution, %pt)	0,6	-0,4	0,0	-0,3	-2,3	-0,2	1,3	-0,5
Net exports (contribution, %pt)	-0,5	0,5	-0,5	-0,3	0,3	-0,1	-0,2	0,0
Inflation (CPI, %yoy)	8,0	4,1	3,0	2,5	5,7	4,0	3,6	3,2
Unemployment rate (%)	3,6	3,6	4,1	4,4	3,5	3,6	3,7	3,7
Euro area								
Real GDP	**3,6**	**0,5**	**0,7**	**1,2**	**1,4**	**0,6**	**0,0**	**0,1**
Private consumption	4,9	0,7	1,0	1,5	1,4	0,7	-0,1	0,9
Investment	2,2	1,8	-2,0	1,6	2,5	1,7	0,9	2,2
Domestic demand (contribution, %pt)	3,3	1,1	0,6	1,4	1,4	1,0	0,6	1,4
Inventories (contribution, %pt)	0,5	-0,9	-0,3	0,0	-0,6	-0,4	-1,0	-1,4
Net exports (contribution, %pt)	-0,1	0,3	0,5	-0,2	0,5	0,0	0,3	0,1
Inflation (HICP, %yoy)	8,4	5,5	2,4	2,0	8,0	6,2	4,9	2,7
Unemployment rate (%)	6,8	6,6	6,5	6,4	6,6	6,5	6,6	6,5
China								
Real GDP	**3,0**	**5,3**	**4,8**	**4,5**	**1,8**	**0,7**	**1,5**	**1,3**
Unemployment rate (%)	5,5	5,1	5,1	5,1	5,3	5,2	5,0	5,1
Inflation (CPI, %yoy)	2,0	0,2	0,4	1,7	1,3	0,1	-0,1	-0,3
Trade	5,6	0,8	3,1	3,4				

Forecasts – Rates

	Actual	Target		Last 5 years	
Policy rate	01/25	3M	12M	High	Low
Fed funds (upper)	4,50	4,25	3,75	5,50	0,25
ECB deposite rate	3,00	2,50	1,75	4,00	-0,50
10-year rate					
Us Treasury	4,60	4,50	4,50	4,81	0,56
German Bund	2,43	2,30	2,30	2,96	-0,64
FX					
EUR/USD	1.03	1,05	1,02	1,23	0,98
USD/JPY	158,36	161	145	160,83	103,36
GBP/USD	1,25	1,28	1,28	1,42	1,12
EUR/CHF	0,94	0,94	0,93	1,11	0,93

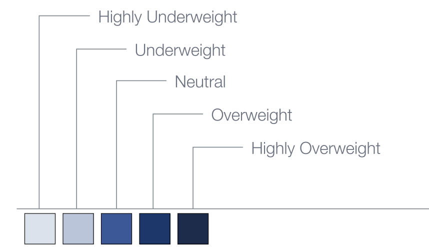
Asset Class Views

These asset class views have a 3 to 12 month horizon.

Where there has been a change since the last Quarterly Insight, the dot (•) indicates the previous view. These views should not be regarded as portfolio recommendations. This summary of our individual asset class views indicates the strength of conviction and relative preferences across a broad range of assets, but is independent of portfolio construction considerations.

	Highly Underweight	Underweight	Neutral	Overweight	Highly Overweight
Fixed Income		•	■		
Government Bonds		•	■		
Corporate Investment Grade			■		
Corporate High Yield		•	■		
Emerging Market Debt Local Currency	■				
Emerging Market Debt Hard Currency		•	■		
Duration			■	•	
Equities			■	•	
United States of America			■	•	
Europe		■			
UK		■			
Switzerland		■			
Japan	•		■		
Emerging Markets ex-China		■			
China	■				
Alternatives				■	
Hedge Funds					■
Gold		•	■		
Commodities		■			
Currencies (against USD)					
EUR		■	•		
CHF			■		
GBP				■	
JPY			■	•	

How to read the table?



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Asset Allocation

Valuation and over-dominance of the U.S. are key challenges

Key Takeaways

- High valuations in global equities and credit reduce expected returns and increase the need to diversify across pockets of value.
- The over-dominance of the U.S. equity market in global benchmarks limits the opportunity set for diversification.
- The importance of the U.S. equity market poses significant risks to investors, including the strength of the dollar and concentration risk from the Mag7.

While 2022 was one of the worst years for multi-asset portfolios in the last 100 years, leading some misguided pundits to proclaim the death of the traditional 60/40 model, balanced portfolios came back with a vengeance in 2023 and 2024. What kind of vintage will 2025 be? While we remain moderately optimistic, asset allocators will need to contend with mounting challenges, including high valuations in risk assets, reduced regional diversification opportunities in equities, and geopolitical fragmentation.

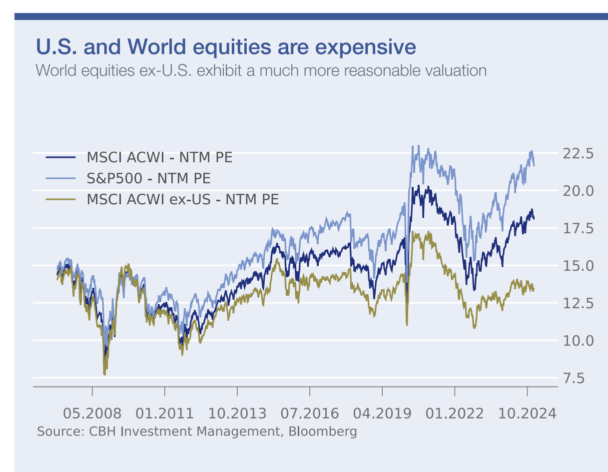
Rich valuation in equities and credit markets

Global equities appear expensive, with the MSCI ACWI next-12-month (NTM) price-to-earnings (PE) ratio trading at 18x, well above the average of the last 20 years of 14.7, which is 1.6 standard deviation higher. A significant portion of this overvaluation is driven by the U.S. market, which now represents 67% of the global benchmark, with the S&P500 trading at a 21.6x NTM PE, recently peaking at 2.2 deviations above the last 20 years average. In contrast, the MSCI ACWI ex-U.S. trades at 13.4x NTM PE, near its last 20 years average, reflecting a more reasonable valuation.

While valuation is a poor timing tool, it does suggest that equity returns are likely to be lower over the next decade, as long-term returns tend to be correlated with valuation. This poses a challenge for asset allocation, as equities are the primary performance driver in multi-asset portfolios. Overvaluation is also evident in the credit market, where U.S. high yield credit spreads are below 300bps, a level that has only been reached in four brief periods over the past 30 years. This compression reduces expected returns, as the bulk of performance is now dependent on carry rather than price appreciation. While valuation is a long-term concern, it underscores the increased need to search for pockets of value within equities and credit, as well as the importance of diversifying across these areas. Additionally, the elevated valuations raise the need for tactical hedges, as market corrections can be more sudden and abrupt in a high-valuation environment.

U.S. and World equities are expensive

World equities ex-U.S. exhibit a much more reasonable valuation



Source: CBH Investment Management, Bloomberg

Reduced regional diversification opportunity set in equities

With the U.S. equity market accounting for more than 65% of the MSCI ACWI, global equity benchmarks

are heavily dominated by U.S. stocks. While this is partly justified by the strength of U.S. corporate innovation and profitability, it creates a structural challenge for asset allocators by skewing exposure for investors seeking geographic diversification, thereby narrowing the opportunity set for regional diversification. In addition, this over-dominance exposes investors to heightened risks. First, it tethers investors to U.S.-specific factors, such as Fed policy, political developments, or economic cycles, potentially amplifying volatility when these risks materialize. Second, it creates significant currency risk that can either amplify or erode returns for international investors with a base currency other than the U.S. dollar. While currency hedging is an option, it adds complexity and cost, making it difficult for investors to balance the benefits of U.S. equity exposure with the risks associated with USD dependency.

Third, concentration risk arises from the "Magnificent 7" (Mag7) stocks—Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla—which together account for more than 30% of the S&P500 index due to their large market capitalizations and strong performance. While these companies have been key drivers of innovation and growth, their dominance poses risks to portfolios. The heavy reliance on a small number of companies, especially in the technology and growth sectors, means that the performance of global equities becomes overly dependent on their fortunes. Any adverse developments—whether regulatory, competitive, or macroeconomic—affecting these companies could have an outsized impact on portfolio returns. For example, a passive balanced investor with a 50% equity allocation would have an aggregate exposure of approximately 7% to Apple, NVIDIA, and Microsoft, more than to any other equity region.

Seeking robustness after two stellar years

Following our updated strategic asset allocation framework, we enter 2025 with a neutral stance on equities. While valuations are tight, we maintain our preference for U.S. equities on a regional basis and for growth stocks from a style perspective. To mitigate concentration risk from the Mag7, we hold positions in U.S. mid-caps, which we find attractive from a cyclical standpoint. We are neutral on duration, with an average of approximately 4 years. In credit, we are in the process of reducing investment grade (IG) bonds in favor of short-term high yield (HY) and emerging market debt (EMD) to capture the still attractive carry in a tight credit spreads environment. We continue to be overweight hedge funds as a necessary source of diversification in a still positive correlation context between bonds and equities. In our USD-based portfolios, we have tactically fully hedged our EUR exposure.

Equities

No viable alternatives (yet) to ever-dominating U.S. equities

Key Takeaways

- Supportive U.S. macro backdrop bodes well for earnings growth over the next 12 months.
- The broadening out of growth expectations across all sectors is providing a new impulse.
- The risk of earnings disappointments is elevated given the high bar for earnings growth expectations.

As we look ahead to 2025, the global equity market is expected to deliver positive returns, albeit more modest than in the past two years. Valuations are stretched, particularly in U.S. mega-cap growth and technology stocks, increasingly limiting the potential for multiple expansion. This environment requires investors to be more selective in their sector and stock picks, creating a favorable context for active management.

No viable alternatives to U.S. stocks

As 2024 draws to a close, analysts project earnings growth of 9.5% for the S&P 500, marking the fourth consecutive year of expansion. While the "Magnificent 7" are estimated to achieve a remarkable earnings growth, the remaining 493 companies are expected to post a much more modest increase in EPS. However, earnings growth is anticipated to become more broad-based in 2025, with all 11 sectors projected to report positive growth—an occurrence not seen since 2018 and a key factor likely to support the market next year. At the index level, the U.S. equity market continues to exhibit strong fundamentals, with high operating margins expected to improve further and EPS forecasted to grow by 15%. Another significant driver for U.S. equities lies in the market's structure, which provides high exposure to the technology sector and the growth factor. In an era when artificial intelligence (AI) is poised to enhance productivity across industries, the U.S. leadership in this field strengthens its position for equity outperformance.

The main headwind to the outlook is stretched valuations, particularly among mega-cap growth companies, which limits the potential for further multiple expansion. While this reduces the long-term appeal of the asset class, we contend that these valuation levels are well supported by superior earnings growth and shareholder returns. In addition, we believe that elevated earnings growth projections for 2025 pose a significant risk, should companies fail to meet these lofty expectations.

Tailwind from structural reforms in Japan

We maintain a positive long-term outlook on Japanese stocks, supported by microeconomic factors. Chief among these are the structural reforms initiated by the Tokyo Stock Exchange, which encourage companies to enhance corporate governance, improve transparency and prioritize shareholder returns. These initiatives have resulted in record share buybacks in 2024 and increased profitability, aligning Japanese corporations more closely with global standards. Such developments are unlocking value and attracting international investors. Furthermore, earnings in FY 2025 are projected to grow by 9.2%, outpacing the 8.3% expected for European stocks (Stoxx 600).

Europe and China continue to grapple with significant challenges

The outlook for European equities continues to be clouded by a weak macro backdrop, structural issues and pockets of heightened political turmoil.

Europe's heavy reliance on exports is another concern, as the region's economic performance is highly sensitive to global demand, particularly from China. The threat of more tariffs by the new Trump administration only adds to these concerns. The silver lining is that European equities are attractive from a value perspective. Additionally, we expect the ECB to pursue its rate-cutting cycle on the back of moderating inflation, offering some support to European stocks.

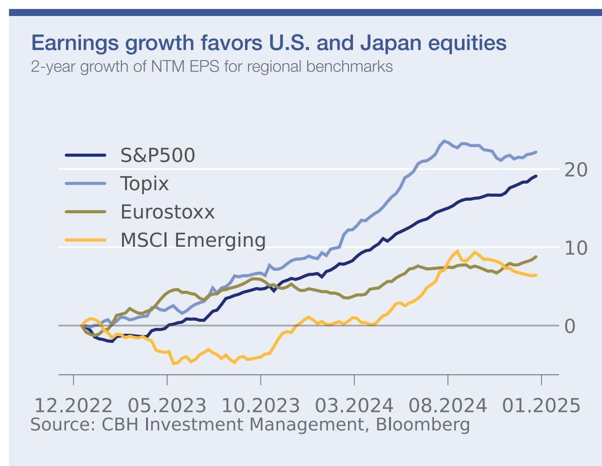
While we acknowledge that the Chinese authorities have effectively put a floor under the economy, we see these efforts as mostly aimed at providing short-term economic relief and bolstering market sentiment. The property market is still showing limited signs of recovery, which continues to erode consumer confidence and spending. GDP growth is expected to decelerate further in 2025 and 2026, and anticipated trade tensions with the U.S. pose significant risk to China's export-driven economy.

U.S. and AI remain core exposures

We enter 2025 with a neutral stance on equities. While we are neutral U.S. equities, we maintain our tilt towards growth and technology. In addition, we are mitigating concentration risk and seizing the opportunities from Trump's agenda (e.g., tax cuts and deregulation) with an exposure to mid-caps. We are increasing our exposure to Japan to neutral thanks to improving corporate governance and earnings growth potential. In contrast, we have an underweight on European and Emerging Market equities. Specifically, we are underweight China within the EM space, due to ongoing structural challenges and geopolitical risks. Within Emerging Markets, we see Frontier Markets as an attractive alternative for global equity investors.

Earnings growth favors U.S. and Japan equities

2-year growth of NTM EPS for regional benchmarks



Source: CBH Investment Management, Bloomberg

AI remains a key theme for 2025, as it is expected to continue driving earnings growth throughout the year. We are seeking opportunities beyond the semiconductor industry, including in AI infrastructure (data centers and power generation), software and cloud providers.

Fixed Income

Focus on carry as the scope for spread compression is limited

Key Takeaways

- Bond markets are at a crossroads, shaped by the interplay of economic resilience, inflation uncertainty and volatility.
- We are wary about duration risk, as Trump's agenda should drive renewed inflationary pressures.
- We expect credit to outperform Treasuries and are more positive on high yield in a carry-focused strategy.
- Emerging debt hard currency offer attractive opportunities in the short-dated segment, but selectivity is key.

Fixed income investors are navigating a complex environment characterized by elevated real yields, persistent interest rate volatility and renewed inflationary pressures under the new U.S. administration. Structural headwinds and inflation concerns increase the likelihood of rising long-term yields, prompting caution toward long-duration bonds. While the Fed is likely to continue its rate-cutting cycle, the potential for slower-than-expected rate reductions adds another layer of complexity. As a result, we expect U.S. government bonds to underperform relative to credit markets. However, bond investors can still find value within credit markets, where default rates are projected to remain benign amid supportive growth conditions. High yield bonds, corporate hybrids, and short-term hard currency emerging market debt stand out as attractive options, offering compelling yields for investors willing to adopt a selective approach.

U.S. rates skewed to the upside

We see the U.S. 10-year yield biased to the upside, driven by several forces. From a cyclical perspective, inflation could climb back toward 3% in the second half of the year, spurred by the new administration's agenda, with policies such as tax cuts, tariffs, and tighter immigration controls likely to fuel stronger U.S. growth and inflation. If inflation proves more persistent than anticipated, 10-year Treasury yields could exceed 4.5%. Furthermore, the market is already pricing in only two Fed rate cuts in 2025, and a further reduction in expectations for rate cuts could exert additional upward pressure on yields. Structurally, rising fiscal deficits and sustained bond issuance should push long-term yields higher. Given the persistent interest rate volatility, an unattractive term premium along the U.S. curve and our cautious outlook for long-term rates, we favor reducing interest rate sensitivity in portfolios by focusing on 3-5-year maturities. While inflation-linked bonds may face headwinds in the near term due to higher real interest rates, their performance could improve later in the year if inflation risks materialize further, providing a potential opportunity in a more inflationary environment.

Attractive carry supports a positive view for high yield

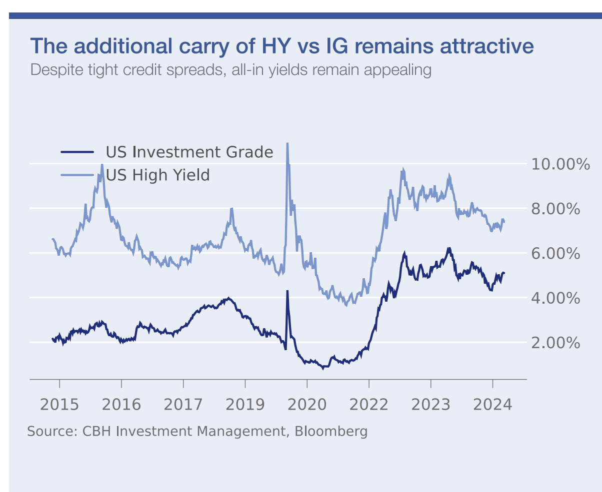
Medium-term investment-grade (IG) bonds remain a cornerstone of fixed-income portfolios, offering stability supported by IG issuers' low default risk and robust credit profiles. These factors provide a buffer against persistent volatility in the fixed-income market. However, with credit spreads in the IG space at historically tight levels, opportunities for price appreciation are limited, leaving returns primarily dependent on carry.

In contrast, high-yield bonds appear more attractive in the current benign macroeconomic environment, offering higher yields and stronger return potential. The outlook for U.S. high-yield (HY) bonds in 2025 is

supported by strong fundamentals and a favorable macroeconomic environment. HY issuers are entering the year with robust balance sheets and default rates are expected to remain low, underpinned by improving economic conditions and manageable refinancing pressure. Pro-growth policies to be introduced by the new administration are anticipated to further strengthen corporate performance, providing a supportive backdrop for the asset class. Additionally, strong demand for HY bonds is expected, driven by their attractive yield relative to other income-generating assets and bolstered by risk appetite in financial markets. The primary appeal of HY bonds in 2025 lies in their high carry, which is expected to be the main driver of returns. With valuations already stretched, opportunities for further credit spread tightening are limited, making the steady income generated by these bonds an attractive feature. Even if spreads experience some volatility, the impact on total returns is likely to remain muted, supported by the cushioning effect of high starting yields. We maintain a preference for the short-dated segment of the HY market, which offers reduced duration risk and manageable refinancing exposure.

Selective opportunities in EM hard currency bonds

We remain cautious on local currency emerging market debt, as President-elect Trump's expansionary policies are likely to strengthen the U.S. dollar. This could pressure EM central banks to keep interest rates elevated to defend their currencies, constraining their ability to stimulate economic growth. Conversely, hard currency emerging market debt presents attractive opportunities, particularly in short-dated bonds. These bonds offer higher relative yield compared to developed market counterparts while carrying reduced duration risk. The yield to worst for EM hard currency bonds has rebounded significantly from October lows, now providing an appealing carry above 6%. Additionally, post-Covid defaults have left EM hard currency indices relatively clean, with improved fundamentals that should help mitigate potential negative effects from U.S. policies. These factors combine to enhance the attractiveness of hard currency EM debt in a challenging global environment.



The additional carry of HY vs IG remains attractive

Despite tight credit spreads, all-in yields remain appealing

Source: CBH Investment Management, Bloomberg

Forex

Bullish USD view is path of least resistance for now

Key Takeaways

- The new U.S. administration's policies are expected to bolster growth and reignite inflationary pressures.
- The Eurozone is facing a dire macroeconomic environment and political instability, putting pressure on EUR/USD.
- The fiscal-monetary policy mix is expected to support a strong U.S. dollar.
- The yen has some appeal given the BoJ's normalization stance, but the potential against USD is less than against EUR.

Trump 2.0 is bullish for the greenback

In recent years, the strength of the U.S. dollar has largely been driven by favorable rate differentials and the narrative of "U.S. exceptionalism". The re-election of Donald Trump further reinforces these factors, particularly through adjustments to the fiscal-monetary policy outlook and the threat of tariffs, which are expected to bolster economic growth and reignite inflationary pressures.

We anticipate that, as in recent years, the relative path of monetary policy expectations will continue to play a key role in driving EUR/USD in 2025. In this regard, the divergence between the Fed's and the ECB's outlooks is becoming increasingly pronounced. The market is pricing in only two more Fed rate cuts in this cycle, but with U.S. growth and inflation on an upward trajectory, further reductions in rate cut expectations are likely. Conversely, U.S. protectionist policies are expected to negatively impact Eurozone growth by Q4 2025, likely prompting the ECB to adopt a more dovish stance than currently anticipated. As a result, the 2-year U.S.-Eurozone interest rate differential should remain above 200 basis points in the months ahead, providing continued support for the dollar.

The growth outlook is expected to further support the dollar as the U.S. economy is projected to grow at a significantly faster pace than the Eurozone (2.1% versus 1%). Trump's pro-growth agenda contrasts with the challenging conditions in core Eurozone economies such as Germany and France. The expected U.S.-Eurozone growth differential has substantially widened from 0.4% during the summer to more than 1% currently, strongly supporting the greenback in the second half of 2024. In addition to the challenging macro backdrop and the dovish ECB outlook, regional political instability will likely continue to weigh on euro-denominated assets. A case in point is the dismal French political situation, which has led to short-term French OAT yielding more than Greek sovereign bonds. This pervasive pessimism toward the eurozone is expected to cap any meaningful rebound in EUR/USD.

While much of the optimism for the U.S. dollar appears to be largely priced in, we don't think this is the time to be fighting dollar bulls. A strong dollar outlook is the path of least resistance for now, as there is no clear catalyst for improvement in the Eurozone in the near term. Only signs of stabilization in Eurozone growth, reduced political tensions or a shift in monetary policy expectations could provide modest upside for EUR/USD.

After a 7.6% drop in EUR/USD from its August peak, we believe the pair is now due to consolidate as investors assess the new administration's policy priorities and the timeline for economic drivers. Looking through this likely short-term rebound, our medium-term outlook remains constrained and we see the pair trading in the 1.02-1.10 range in the first quarter of 2025.

Bullish JPY view best expressed against the euro

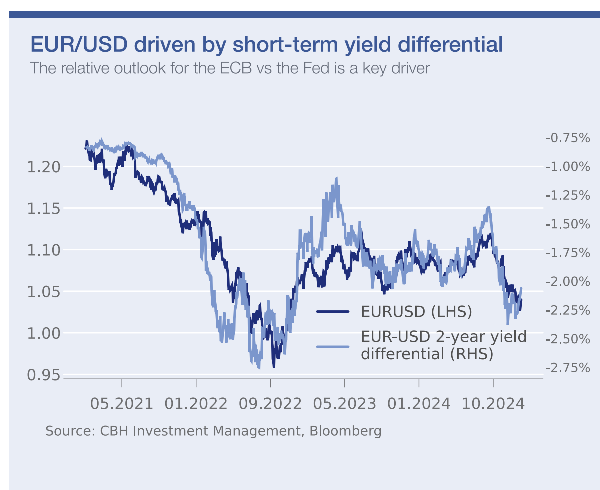
USDJPY has experienced a notable rally, regaining circa 13% from the September low of 140 to reach 157. However, we believe the potential for further significant upside is limited. The previous high near 162 is expected to act as strong resistance, capping any substantial movement in the near term.

In our view, the primary driver of USD/JPY remains the interest rate differential between the U.S. and Japan. In this context, we expect the BoJ to continue gradually normalizing policy rates, supported by stronger wage growth and rising inflation risks, which are making the BoJ's accommodative stance increasingly unsustainable. While the Fed is now expected to implement fewer rate cuts than previously anticipated, the current 10-year yield differential of approximately 3.5% is likely to narrow to 3% in 2025 as the BoJ continues its cautious policy normalization. Given these factors, we expect USD/JPY to trade below 150 during the first half of 2025. Another factor supporting a moderately positive view on the yen is its valuation. While using currency valuation for tactical views is debatable, the extreme reading of the Japanese yen warrants attention. According to the OECD's simple but effective purchasing power parity (PPP) model, the yen is currently undervalued by 67%. This structural undervaluation sets a floor for the yen.

Still, we expect any potential weakness in USD/JPY to be muted, as the yield differential between the U.S. and Japan remains exceptionally wide. Despite observing several episodes of yen strength over the past two years, typically coinciding with local peaks in U.S. yields, Japanese investors continue to favor higher-yielding USD bonds. In our view, a more compelling way to express a bullish view on the yen is through a short EUR/JPY position. The euro is facing pressure from weak macroeconomic conditions and ongoing political instability in the Eurozone. Furthermore, the stark divergence between expectations of the dovish ECB stance and the BoJ's continued tightening path strengthens the bearish case for EUR/JPY.

EUR/USD driven by short-term yield differential

The relative outlook for the ECB vs the Fed is a key driver



Source: CBH Investment Management, Bloomberg

In 2025, Carry is King

As the global economy enters 2025, the investment landscape will be dominated by one prevailing theme: carry. The income derived from holding assets will emerge as a cornerstone of portfolio performance, supported by elevated bond yields, robust credit fundamentals and dividend resilience across equities. In an era of resilient growth in the U.S., stabilizing global economies, and moderating inflation, carry strategies—spanning fixed income, equities, structured products and private markets— are well-positioned to capitalize on the combination of steady growth and periodic market fluctuations expected in the year ahead.

Fixed Income: Locking in the Yield Premium

Nowhere is the carry theme more evident than in fixed income. After years of muted returns, bond yields are at levels not seen since the 2008 financial crisis, offering investors a rare opportunity to lock in attractive income. While policy rates have already eased from 5.50% to 4.75% and are expected to decline further in 2025, all-in yields remain near historic highs. Notably, the U.S. 10-year rate is higher than it has been 96% of the time over the past decade, and the 5-year rate is higher than it has been 93% of the time over the same period. Against this backdrop, we favor intermediate-duration bonds, which strike a balance between offering attractive yields and reducing interest rate risk in the event of renewed inflationary pressures. Credit spreads, while tight, reflect a fundamentally sound macroeconomic backdrop. Investment-grade bonds, upper-tier high-yield credit and selective emerging market debt present compelling options. Our focus remains on higher quality issuers within high-yield and emerging markets, while maintaining a cautious approach to sectors with greater idiosyncratic risk and countries potentially vulnerable to pressure from evolving U.S. trade and foreign policy under the new administration. With spreads unlikely to tighten further, income rather than capital appreciation will dominate fixed income returns.

Equities: The Return of Dividends

In equity markets, carry is manifesting itself in the rediscovery of dividends as a driver of total return. For much of the past two years, the dominance of a fewtechnology behemoths overshadowed broader equity opportunities. In 2025 however, market participation is expected to broaden beyond the technology leaders (the Magnificent 7), with an increased focus on companies with sustainable dividend growth. Historically, dividend growers have proven resilient, outperforming non-dividend payers with lower levels of volatility, particularly during periods of market uncertainty. As inflation remains elevated, stocks with consistent dividend growth offer a dual advantage: a reliable income stream that provides a potential hedge against rising costs and the opportunity for long-term capital appreciation. Trading at a discount to technology leaders, these companies make a compelling case for inclusion in diversified portfolios, combining stability with growth potential.

Structured Products: Optimizing Carry in Volatile Markets

Structured products, particularly reverse convertibles, provide a practical solution to the complexities of the 2025 market environment. Offering high-yield-like returns, they allow investors to precisely tailor their exposure to specific factors and risks, ensuring alignment with their strategic objectives. By delivering elevated coupon payments tied to equity volatility, reverse convertibles offer a robust income stream while maintaining partial downside protection. This makes them an effective tool for navigating market fluctuations without fully exposing portfolios to equity market volatility.

Private Markets: A Transformative Carry Play

Private markets are uniquely positioned to harness the transformative potential of carry in 2025. From private credit to infrastructure, these asset classes

address the growing demand for income while simultaneously financing large-scale projects beyond the reach of public markets. Infrastructure investments, whose cash flows are often indexed to inflation, provide a hedge against persistent price pressures and exhibit reduced sensitivity to interest rate fluctuations. Meanwhile, private credit offers access to opportunities not readily available in public markets, such as loans to middle- market companies and sectors underrepresented in traditional equity or fixed-income indices. These investments deliver yields that often exceed those found in public markets, making private credit a compelling choice for income-oriented portfolios. However, we advise investors to prioritize opportunities that are first-lien, senior-secured and positioned at the top of the capital structure with strong covenants.

The prominence of carry in 2025 will be underpinned by a confluence of favorable factors: stabilizing growth, resilient corporate fundamentals and evolving monetary policy. As investors navigate the complexities of an era defined by transformation and divergence, carry strategies offer not only income, but also a degree of predictability and resilience. In a world where returns must increasingly be earned rather than given by rising asset prices, carry will reign supreme. The challenge for investors will be to harness its potential across the full spectrum of opportunities to ensure that portfolios are both fortified against uncertainty and positioned to thrive in the year ahead.

AI – The X Factor of 2025

Artificial intelligence (AI) has swiftly moved beyond the realm of speculative technology and emerged as the engine driving a significant transformation across sectors. From reshaping economic and geopolitical landscapes to redefining industry dynamics, AI is the central axis around which future growth will revolve. Its integration into the global economy is poised to dictate long-term investment strategies, and its influence will certainly be felt across markets and economies in 2025 but also beyond.

Geopolitical Shifts and Global Competition

AI is not merely a tool for innovation; it has become a strategic asset that is reshaping the geopolitical order. The race to dominate AI is fundamentally about power—economic, technological and military. Nations, especially the United States and China, have heavily invested in AI to assert their global influence. China's state-backed initiatives and rapid infrastructure scaling challenge the U.S.'s technological supremacy, but the latter retains a key advantage through its capital markets and public-private sector alignment. Europe lags in terms of AI infrastructure development, hindered by fragmented financial markets and slower decision- making. However, its interconnected electric grid offers a critical advantage, particularly as electrification becomes integral to AI growth.

This race for AI is about more than economic dominance; it is about securing strategic influence, and nations are positioning themselves accordingly. Nations are taking different paths to assert their positions, with significant implications for investors' asset allocation who need to navigate these changing dynamics and identify the leaders in AI innovation.

AI Development and the Resources That Shape It

AI thrives on critical resources—land, commodities, energy, and capital. Yet, the global distribution of these resources highlights profound disparities in competitiveness among nations. The United States holds a clear advantage, leveraging its deep and diversified capital markets and an enviable alignment between public and private sectors. This symbiosis allows the U.S. to sustain leadership in AI innovation and attract significant investment in cutting-edge technologies. China is also in a strong position, as it excels at rapidly scaling up infrastructure, supported by centralized planning and huge government-backed investment. This model has enabled China to rapidly develop strategic sectors such as telecommunications (5G and fibre optics), electric vehicle (EV) batteries, high-speed rail and renewable energy. Its five-year strategic plans outline an ambitious vision, now targeting the rapid expansion of data centers to underpin AI development.

Europe, however, faces notable challenges. Its fragmented financial markets and slower, consensus-driven decision-making hinder its ability to compete at scale in AI development. Nonetheless, Europe is not without strengths; its robust, interconnected energy network offers a critical foundation for advancing AI-driven innovation.

These differences reinforce the leadership of the United States in the AI sector, while firmly establishing China as its principal competitor.

AI's Role in Long-Term Expected Returns and Asset Allocation

AI is reshaping long-term investment strategies by directly influencing expected returns and strategic asset allocation.

As AI becomes more integrated into the economy, it is poised to drive potential growth, supporting riskier assets. At the same time, the significant investment required to scale AI technologies is likely to sustain elevated long-term interest rates.

This dynamic reinforces the strategic leadership of U.S. equities, as the giants of the AI ecosystem are expected to continue to deliver strong earnings growth, even if their valuations appear lofty.

In contrast, Europe's lack of traction in AI development is dampening its growth potential. While European equities offer attractive valuations, the region's limited progress in AI innovation poses a risk to long-term earnings growth.

China presents a more complex opportunity. Its AI potential is vast, and valuations are remarkably low. However, the investment outlook is clouded by political risks and a tendency toward overcapacity, which necessitate a cautious approach. The final allocation decision depends heavily on an investor's tolerance for country-specific risk premia.

AI is pivotal to long-term asset allocation, but it also offers tactical opportunities for the year ahead.

Are Big Tech Stocks Overvalued?

A key concern among investors is whether the Big Tech companies, the primary beneficiaries of AI's rapid progress, are now overvalued. Another pressing question is the scalability and profitability of AI use cases across industries.

While current valuations do reflect expectations of sustained growth, we believe these stocks should remain a core component of portfolio allocation. Their dominant position allows them to capture the lion's share of the gains from the AI revolution. Additionally, their ability to identify and acquire cutting-edge technologies and companies continually rejuvenates their growth potential.

However, we are more cautious about AI use cases in non-tech industries. These sectors often require significant upfront investments and have longer timelines for widespread adoption. While these applications are critical to maintaining competitiveness in the long term, the path to monetization and meaningful returns remains uncertain. Investors should weigh these factors carefully when diversifying their exposure to AI-driven opportunities.

A Barbell Strategy for AI-Driven Opportunities

To navigate this landscape, a balanced approach to asset allocation is essential. We advocate a barbell strategy that captures both core and niche opportunities within the AI value chain:

– A core allocation to leading hyperscalers that dominate the AI ecosystem, with cumulative investment by the top five players expected to exceed $1 trillion by 2027. Their scale and integration make them critical components of any AI-focused portfolio.
– A satellite allocation to carefully selected niche AI themes, such as data centers.

In Europe, data centers are one of the few bright spots, offering significant upside potential. Europe lags far behind the U.S., with only a quarter of its data center capacity (MW per GDP). This gap creates a compelling opportunity as demand for data processing and storage continues to outstrip supply.

There is also a growing political recognition of the urgency to act. The Draghi report has underlined the strategic importance of AI for Europe's sovereignty. Bold and transformative investments in innovation and advanced technologies are no longer optional, they are imperative. Expanding data center infrastructure and integrating advanced AI applications are crucial steps to closing the gap with global leaders.

AI as the driving force of todays and tomorrow's economy?

As we move towards 2025, its influence will be felt across all sectors, reshaping the investment landscape and redefining strategic asset allocation. From its impact on global power dynamics to its transformative effects on productivity and inflation, AI will shape both economic policy and investment strategies for the foreseeable future. For investors, the question is no longer whether to invest in AI, but how best to position themselves to capture its potential. In this new era, AI is not just a factor - it is the X factor for 2025 and beyond.

Cryptocurrency Corner

Statistical headwinds vs attractive fundamentals

Key Takeaways

- Cryptocurrencies as an asset class are dominated by Bitcoin and Ethereum, both of which are highly correlated.
- Bitcoin's role as a store of value and hedge against fiat currency debasement supports its inclusion in portfolios.
- Volatility is declining, while correlation with U.S. equity is increasing as adoption becomes more widespread.
- Ethereum's position as the leading platform for blockchain innovation provides exposure to the growing digital economy.

The development of cryptocurrencies since Bitcoin's (BTC) inception in 2009 has been nothing short of remarkable. Over the past decade, cryptocurrencies have evolved from niche digital experiments into a prominent force in technology and finance. At the core of all cryptocurrencies lies blockchain technology—a digital ledger that securely records transactions. Unlike traditional systems, blockchain operates on a decentralized network of computers, ensuring both transparency and security. As interest in the space has grown, thousands of new cryptocurrencies have emerged, each aiming to address specific challenges or offer innovative use cases, further expanding the diversity and potential of the ecosystem.

Bitcoin is the first decentralized digital currency, created to address the limitations of traditional financial systems, such as reliance on central authority, high transaction costs and lack of transparency. Operating on a peer-to-peer network, Bitcoin enables direct transfers of value without intermediaries. Its capped supply of 21 million coins and decentralized design have earned it the nickname "digital gold". BTC is perceived as a hedge against fiat currency debasement and a store of value because its fixed supply and decentralized nature make it resistant to inflationary policies and currency devaluation, unlike traditional currencies that can be printed at will by central banks.

Smart contracts, self-executing agreements encoded on blockchains such as Ethereum (ETH), Solana and Avalanche, automate processes without intermediaries, ensure trust and reduce disputes through pre-defined terms. These contracts enable decentralized applications (dApps) in finance, gaming and other sectors, facilitating activities such as lending, trading and asset ownership. Ethereum, in particular, offers a compelling value proposition as a financial asset due to its central role in powering dApps and smart contracts, driving demand for Ether in decentralized finance (DeFi) and non-fungible tokens (NFTs). The EIP-1559 upgrade introduces a deflationary dynamic by burning a portion of transaction fees, reducing the supply of ETH over time. While the supply of ETH is not capped, this mechanism can create upward price pressure if the supply reduction exceeds issuance, particularly during periods of high network activity. Additionally, Ethereum's transition to Proof-of- Stake (PoS) enhances its scalability, reduces its energy consumption, and offers staking rewards, further increasing its attractiveness as an asset.

Down to our question: are cryptocurrencies a true asset class, and should they be included in the asset allocation opportunity set? Considering the Nasdaq Crypto Index (NCI) as a well-designed gauge, we observe that the cryptocurrency market is mainly composed of Bitcoin at 73%, Ethereum at 16.5%, Solana at 5.3%, Ripple at 2.2% and the remaining 2.76% spread across multiple cryptocurrencies. Hence, when discussing cryptocurrencies as an asset class, we mainly consider Bitcoin and Ethereum.

At first glance, cryptocurrencies may not seem particularly attractive in multi-asset portfolios due to their high volatility and positive correlation to global equities. The 1-year volatility of Bitcoin stands at 40%, more than double the volatility of the Nasdaq100 which stands at 18%. Interestingly, we observe that Bitcoin volatility, while still elevated, has been decreasing rapidly as institutional money flows into the space. Over the 2023-2024 period, Bitcoin's average 1-year volatility was 39.7%, a sharp decline from the 79% seen during the 2017-2018 period or the mid-2013-2014 period, when it reached 140%. We believe this trend will continue, making volatility more manageable and encouraging more investors to explore cryptocurrencies, potentially creating a virtuous cycle of adoption and stability. Regarding correlation with risk assets, while the 1-year correlation remains moderate at circa 0.27, unlike volatility, 1-year correlations are increasing as Bitcoin's adoption grows, making the asset class more influenced by global risk appetite trends that sweep across financial markets. ETH also appears statistically unattractive with higher volatility than BTC and a more significant correlation to U.S. equities. Hence, from a purely statistical point of view, the case for both Bitcoin and Ethereum in a multi-asset portfolio remains fragile.

Statistics are only one axis to consider the appeal of an asset class. When it comes to cryptocurrencies, we like to include their fundamentals in the analysis. In this regard, given Bitcoin's properties such as limited supply and decentralization, we maintain that Bitcoin can find its place in a well-diversified portfolio, The continued growth of Ethereum's ecosystem and its position as the leading platform for blockchain innovation also make it an attractive asset, providing exposure to the expanding digital economy.

Bitcoin rolling 1-year volatility

Institutional adoption leads to volatility reduction

Source: CBH Investment Management, Bloomberg

To successfully include cryptocurrencies in a multi-asset portfolio, careful consideration must be given to fine-tuning the optimal allocation, with the choice of allocation method being critical. Approaches such as risk contribution, portfolio optimization, or market capitalization can yield significantly different outcomes. Numerous studies have shown that a modest allocation to cryptocurrencies—typically between 1% and 5%— can improve a portfolio's risk/return profile while having only a minor impact on drawdowns. Additionally, we believe investors allocating to BTC and/or ETH should regularly reassess their allocation due to the highly dynamic nature of these assets.

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Geneva

Headquarter CBH Bank
Bd Emile-Jaques-Dalcroze 7
P.O. Box 1211 Geneva 3, CH cbhbank.com
t +41 22 839 01 00

Zurich

Branch Office
CBH Bank
Bahnhofstrasse 82
P.O. Box 1213
8021 Zurich, CH
cbhbank.com
t +41 44 218 15 15

Luxembourg

SICAV 1618
Investment Funds
106, route d'Arlon
L-8210 Mamer
Grand Duché de Luxembourg
1618am.com

London

Subsidiary
CBH Wealth UK Limited
2-4 Cork Street, London
W1S 3LG, UK,
cbhbank.com t +44 207 647 1300

Hong Kong

Subsidiary CBH
Asia Limited
Suite 2001, 20th Floor,
K11 ATELIER, 18-24
Salisbury Road, Tsim Sha Tsui, Kowloon, Hong Kong, HK
cbhbank.com
t +852 2869 0801

Nassau

Subsidiary
CBH Bahamas Ltd.
CBH House, East Bay Street
P.O. Box N-1724
Nassau, N.P., Bahamas
cbhbank.com
t +1 242 394 61 61

Rio de Janeiro

Subsidiary 1618
Investimentos
Av. Ataulfo de Paiva,
204 Salas 305 a 308
Leblon, Rio de Janeiro/RJ
CEP: 22440-033, Brazil
1618investimentos.com
t +55 21 3993 6901

Sao Paolo

1618 Investimentos
Subsidiary
Rua Iguatemi, 192
Itaim Bibi, São Paulo -SP
CEP: 01451-010 Brazil
1618investimentos.com
t +55 11 4550 4401

Tel Aviv

Representative Office
CBH Bank
Rehov Tuval 40
Ramat Gan 5252247
Israel
cbhbank.com
t +972 73 793 62 22

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CBH | Compagnie Bancaire Helvétique

Asset Management
Boulevard Emile-Jaques-Dalcroze 7
P.O.Box
CH - 1211 Geneva 3

am@cbhbank.com
www.cbhbank.com