

2025 Portfolio Outlook

US exceptionalism – the only game in town?

2024 saw the US market delivering 28% vs. 9.5% from Europe (Stoxx 50) and 7.7% from the UK (FTSE 100). Economically and financially, the US is seen as the only game in town right now and the 2024 numbers show us just that. US consumer spending remains resilient, corporate growth is stable, and US consumers own more US stocks as a proportion of their personal wealth than at any point going back to the 50s. Finally, Trump's ascension to the 47th President on a pro growth agenda has added further speculation on US dominance in 2025 as Trump brings in further corporate tax cuts whilst the Federal Reserve cuts interest rates by another percentage point to make the US exceptionalism story stick through the next 4 years. Right now, we see US GDP in 2025 running at 2.5% and nearly double that of Europe and UK so this positivity seems well placed.

So yes, it looks great for the US right now in performance terms, however, as markets move higher, and specifically US markets, the US is now 70% of global indexes and climbing, up from just 30% in the 80s. With this high level of concentration, we think it's plausible that any minor idiosyncratic blip in US

positivity will cause global stock volatility. The S&P 500 is also trading at a price to earnings ratio (P/E) of 22x vs. a historic average of 17x (this means the average US stock is now more expensive than its historical average).

Therefore, TAM is what can only be described as cautiously optimistic given the current set up. We remain invested into the US over 2025 but with every record high we will parse the achievement to see if it needs hedging with more defensive investments under the mantra that what goes up, will at some point come back down again. Twinned with the notion that a lot of the economic success in the US in 2025 has already been purchased by investors in anticipation of its arrival.

Taking a moment to highlight what the downside looks like; we think the largest risks to the US next year remain around the inflation and unemployment dynamic with geopolitics and foreign policy coming in second. At the moment the US Federal Reserve (Fed) is happy to cut interest rates with inflation stable and unemployment steadily rising. This rate cutting narrative is doing a lot to underpin the strength in the © 20 24 TA M As se t M an ag em en t L td stock market right now and will be essential for the continuation of the rally into 2025.

If this narrative becomes challenged in 2025 e.g. inflation starts rising towards 3%, then the Fed would have to increase the prospect of raising rates to combat it. This would almost certainly send this stock market rally into reverse. This is not our base case but worth looking out for nonetheless.

Likewise, with US debt to GDP at 123%, only Greece, Italy and Japan owe more per dollar of Gross Domestic Product. With the US fiscal deficit sitting just under -7% this is more severe than almost all developed nations. If the US wasn't the reserve currency of the world, this debt picture would likely be punished by the international investment community more than it has been. With this backdrop, Trump embarking on a debt fuelled spending spree could cause the treasury market to revolt in a Truss-esque scenario which, again, we do not see as the base case, but it is worth monitoring.

Despite these downside risks, it remains likely that the economic strength we have seen from the US will continue but perhaps with more volatility than in 2024 as investors demand more and more robust economic growth. All while inflation drops to support the notion of buying more American stocks. Likewise, the US debt path is shaky, but Trump is aware of this and has implemented Musk's Department for Governmental Efficiency (DOGE) to try and cap government spending all the while trying to bring the fiscal deficit from -7% to -3% and avoid casting the huge treasury market onto the rocks.

Translating that into performance, we see strength (investment gains) coming from the US market in 2025 but likely not to the extent of the 28% we have seen from the S&P 500 in 2024. We envisage, in a scenario of continued economic strength, the US market in 2025 moving up in the region of another 10%, which is lower than 2024 but more in line with annualised performance from the US market over history. As we always say, average returns are a good thing for long-term performance. Long-term investors predominantly don't want a market running too hot or too cold for too long because it increases the likelihood of a volatile future for their wealth. Afterall, "not too hot and not too cold" is "just right" for the Goldilocks principle.

Whilst our call for headline US returns is lower than what we have seen in 2024, we still see plenty of areas of opportunity to outperform in 2025. There is a strong theme of performance coming from smaller companies and yes you guessed it, US smaller companies, which we see as both cheap vs. their larger peers in the S&P 500 but also a big beneficiary of Trump's drive to make American products in America and sell them to Americans. There is the potential that the US mega-cap tech stocks begin to run out of steam in 2025 with investors taking profits on these successful investments and funding the purchase of global and US small caps.

Looking past the US

Outside of the US, there is a widely used investment idiom that it is darkest before the dawn. With investors seemingly giving up on European and UK stocks in a severe case of US FOMO (fear of missing out), these markets are left under owned and underpriced to the extent we have not seen going back to the 90s. Let's also not forget that outside US mega cap tech stocks, US earnings from generic companies have only marginally beaten that of their EU counterparts and we think 2025 could well see European earnings match or beat the US. Given US investors are currently paying a lot more per share to own those earnings, it makes logical sense Europe becomes a more attractive place to buy stocks with similar earnings growth at a much more reasonable price, i.e. - Europe has a better risk premium!

To our mind, all it would take is a small change in the current market narrative to get investors turning to these unloved markets as a great place to buy high quality companies trading at much lower valuations than their US counterparts. Such triggers could be: a peace deal in the Ukraine war, growth recovery in Germany under the new chancellor Merz, a meaningful spending package coming from the EU, or a recovery in Chinese spending; to which the EU is primed to benefit from.

Time for government debt?

On the bond side, US corporate and high yield bonds have been the place to be this year over government bonds, and whilst this outperformance has made global government debt look oversold and corporate bonds expensive, we do still see the potential for US corporate bonds to do well in 2025 and to that end high yield as well. Afterall, if one is positive about stock market performance in 2025 this rationale would also lend itself to a more positive view on the bonds of companies over countries.

Conversely, much like my earlier comment about the risk of an equity market persistently breaking all-time highs, the US government bond market remaining cheap offers up a fantastic defensive layer to a client's portfolio should the positivity in equities come back down. So yes, US government bonds are the ugly duckling right now, but we all know how that story ended.

Gold continues to glitter

As the market moves higher and higher it also makes sense to offset some of this strength by buying into investments which do very well in down market periods. Usually, these investments are linked to rises in stock market volatility and can prove a potent and often overlooked safe haven. Finally, precious metals have had a fantastic year in 2024 and on the margin, we see this persisting into 2025 as geopolitics shows

no sign of abating and the direction of inflation remains far from certain to which Gold is usually a good safe haven.

Active vs. passive

It has certainly been a tough year for active management in 2024 and I would simply say, this isn't a complete surprise. However, I would and regularly do caution those chastising active management for underperforming. With a global stock market dominated by 70% US stocks and within that, 60% of the US performance coming from 7 stocks, it remains very tough for any manager running a 20 – 30 stock portfolio of high-quality companies to beat. This is not down to incompetence of fund managers but merely down to the concentrated nature of the market making it very challenging to outperform those 7 stocks. To illustrate, when the share price value of 7 US companies becomes more valuable than the entire stock markets of India, Switzerland, France, China, Canada, UK and Japan, this isn't a market which sees most active managers winning.

To us at TAM, active management is more cyclical than many realise. That means there are times in our investing lives when picking good companies just does not work as well as merely buying all of them. TAM sees the concentration of performance in such a small clutch of leading stocks, which indexes are weighted so heavily towards, as the very stepping stone that active management is going to use to rise above the concentrated market when the huge weighting towards 7 stocks begins to act as a drag than a booster.

It is often at times of concentration that many simply ignore high-quality companies currently not in vogue. This allows active managers to stock up on these investments at better prices for that eventual snapback. Ultimately, the ramifications of these 7 stocks rallying into eternity will simply break the market as it stands today, which is at its heart a weighing machine not a voting machine, just as susceptible to greed and hubris as quality stock analysis. I reference my earlier point about the beauty of the Goldilocks principle and the long-term value in slow and steady. So, if some of you decide to enter the perennial debate of active vs passive over the Christmas turkey (you would be surprised at how many do talk about this), TAM's view, we hope, will add grist to that particular mill.

Concluding remarks

Yes, 2025 is a year which will likely see good returns but also higher volatility as investors need more good news to keep buying stocks. With the economic strength of the US showing no signs of abating and interest rates continuing to be cut, we think investors are likely to benefit from this good news. This underpins our call that markets can continue to move higher in 2025 and thus justifies the overweight to the stock market we have now.

However, investing isn't solely about increasing clients' wealth. It is equally about not giving those gains back when we hit turbulence. This is exactly where diversification comes into play and we see 2025 as a year in which clients will need a blended set of investments to ride above any uptick in volatility, and specifically US led volatility as markets stagger higher. Diversification and active management are, after all, the left and right hands of any good client portfolio looking for active management.

Therefore, off the back of an undeniably positive footing heading into Christmas, TAM is looking forward to 2025 for a strong year for clients' portfolios. We remain excited at the prospect of buying into areas of the market which have been overlooked in pursuit of delivering high quality at a steep discount for the quintessential long-term investor.

Likewise, over the course of 2025 we look forward to delivering you more investment notes to keep you up to date on how things are going, and on what and where we have been finding that great quality.

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