Global Investment Strategy

First Quarter 2025

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Overview

World economy and capital markets

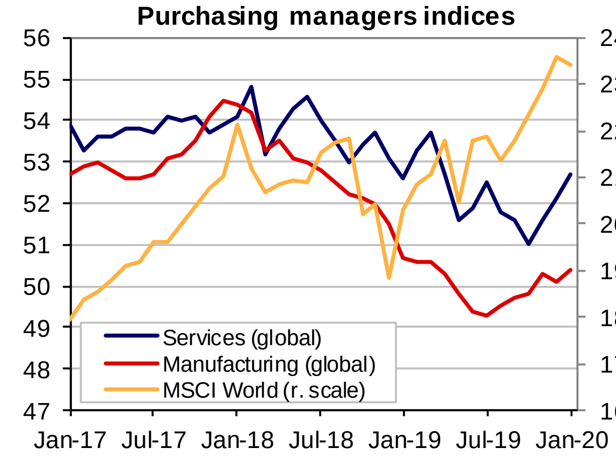
- Economic growth in the US is robust, while it is at the lower end of expectations in Europe and China. This constellation will prevail in 2025.
- US foreign trade policy is the key unknown at present. A variety of scenarios are conceivable: In the base scenario, we see much higher tariffs only on imports from China, which is why we have only slightly adjusted the 2025 economic forecasts outside China.
- Due to the subdued economy, interest rates in Europe are falling faster and more sharply than in the US, with the rate gap supportive of the US dollar. We continue to recommend quality bonds with medium-term maturities.
- The US stock market remains fundamentally best positioned, with US economic policy implemented in a way that is not noticeably harmful to the economy. For Europe's stock markets, the fundamental data are mixed, though not negative: We focus on quality growth stocks, shares with high dividend yields and companies with a high proportion of sales in the US, ideally with production facilities in the US.

Agenda

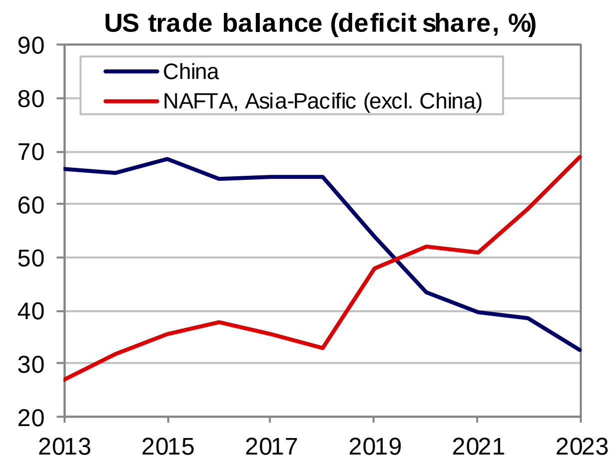
USA: Trade conflict with China since 2018

The United States has started to increase import tariffs on Chinese products in several steps since the beginning of 2018 under Trump, with the Biden administration continuing on this path. While the overall US trade deficit in relation to economic output has changed little in recent years, the deficit with China has fallen, although the deficit with other countries, especially Vietnam, Mexico and Canada, has risen in the wake of the expected circumvention strategies.

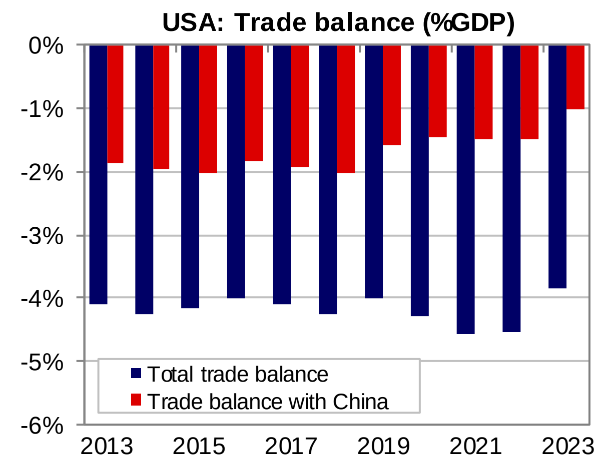
The decline in the global industrial purchasing managers index in 2018 and 2019 was likely related to the uncertainties associated with the tariff increases. In contrast, the trade conflict with China had only a minor impact on the stock market (MSCI World) following the announcement of higher tariffs, but the weaker industrial economy was a factor behind the setback at the end of 2018.



Source: S&P Global



Source: Bureau of Economic Analysis



Source: U.S. Census Bureau, BEA

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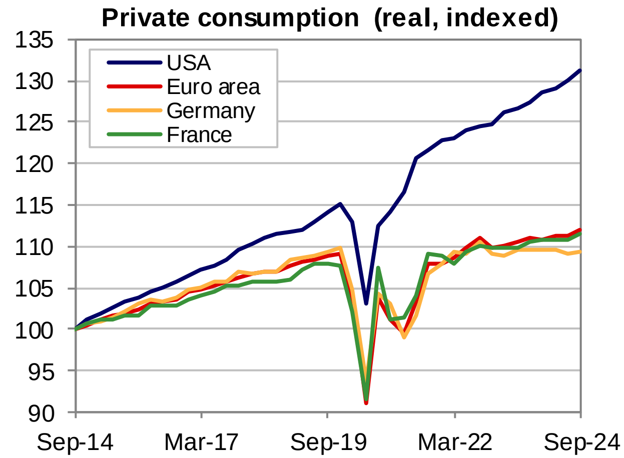
Europe and US compared

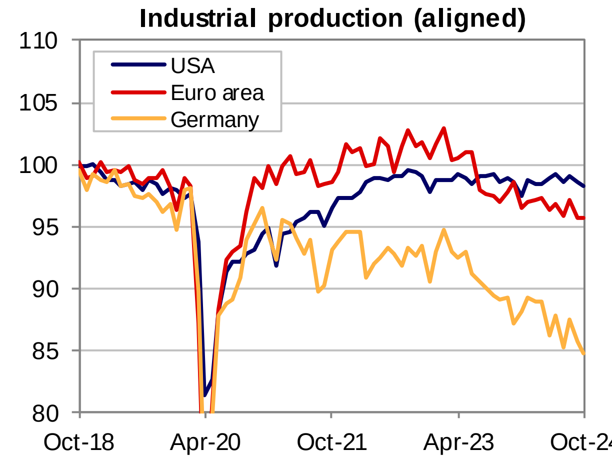
Unlike in the US, private consumption in the euro area is barely growing. In Germany, it has stagnated for over two years. The level of consumer spending is also well below pre-pandemic trends.

Incomes are rising in the euro area, but the savings rate is exceptionally high and has recently trended upwards (see the chart showing disposable income in relation to consumption).

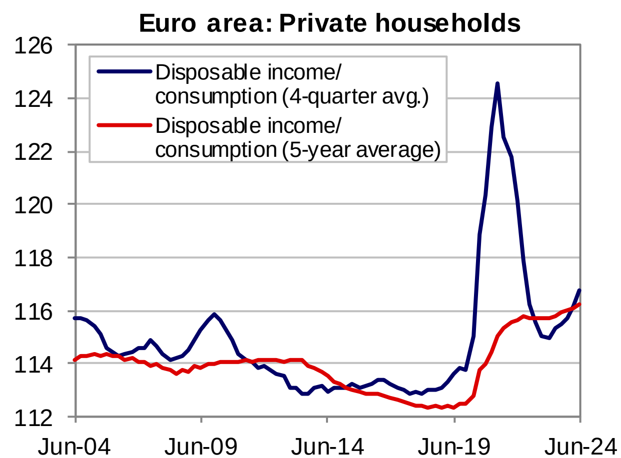
In addition to subdued consumption, Germany's industrial sector has been weighing on the euro area economy.



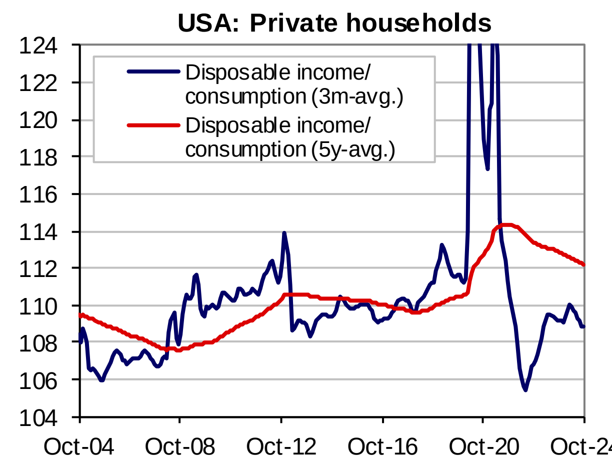
Source: Bureau of Economic Analysis, Eurostat



Source: Fed, Eurostat, Statist. Bundesamt



Source: European Central Bank, Eurostat



Source: Bureau of Economic Analysis

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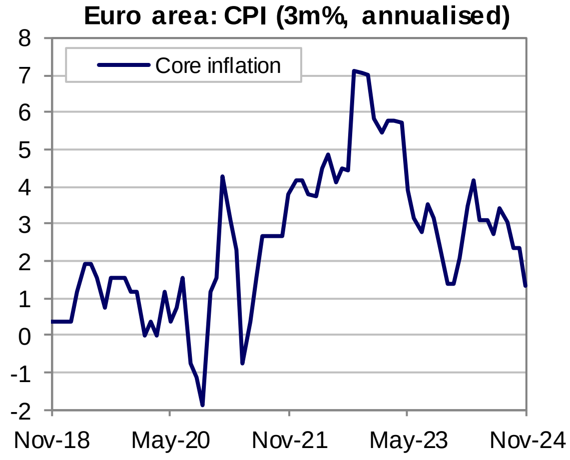
Service sector inflation moderating

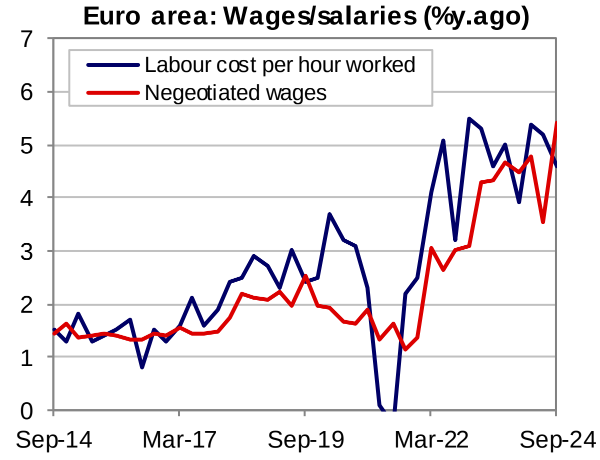
Following a surge in inflation triggered by industrial goods during the pandemic, goods price inflation has largely normalised already in 2023. In the medium term, goods prices are comparatively stable due to technological progress and intense global competition.

In contrast, prices for services (e.g. healthcare) tend to rise over time. One reason is that services are often labour intensive and less exposed to global competition and technological progress. Visible progress has been made in lowering service sector inflation in recent months, which has also driven down core inflation.

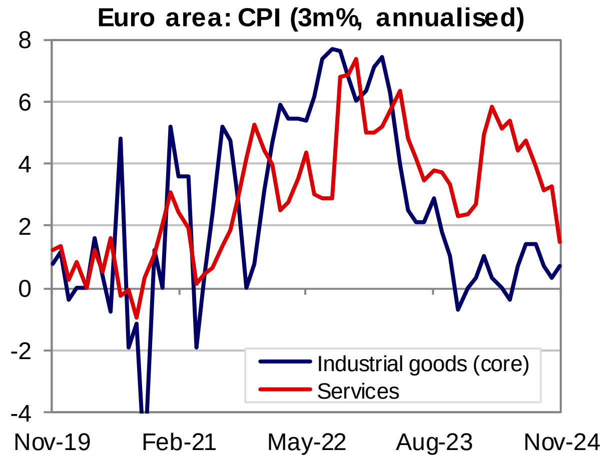
Freshly negotiated wages have risen again in the third quarter. In a soft economy, rising wages may not be a hindrance towards lower inflation.



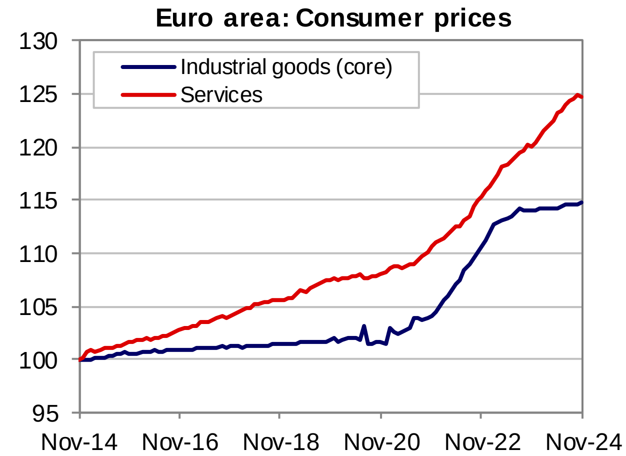
Source: European Central Bank



Source: Eurostat



Source: European Central Bank



Source: European Central Bank

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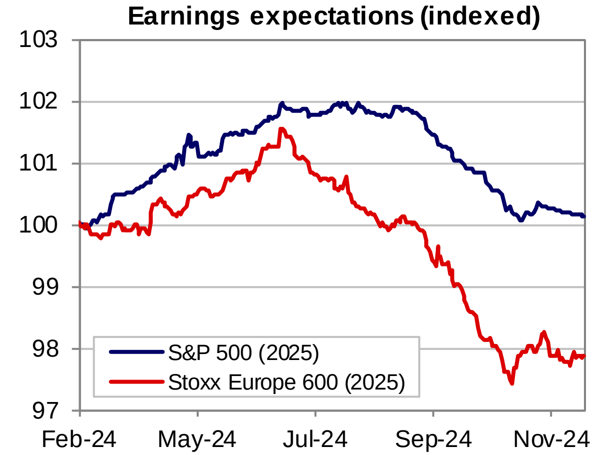
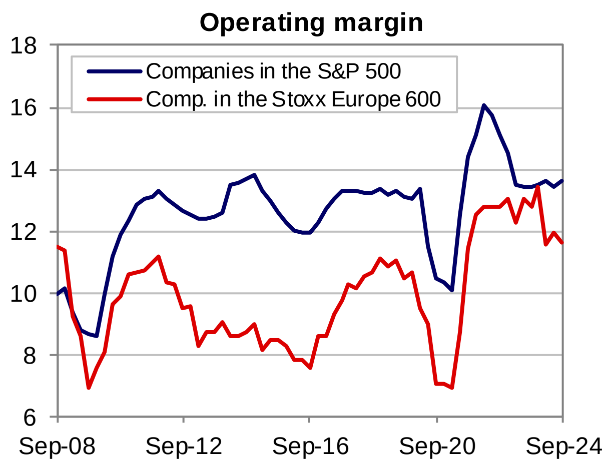
Corporate earnings: A decent third quarter

In the third quarter of 2024, sales and profits at the index level were changed little in Europe compared to the previous year and increased by around 5% in the US. Expectations were roughly met on average, although a lowered outlook from some companies – in Europe, the number was higher than usual – led to somewhat lower analyst estimates for 2025.

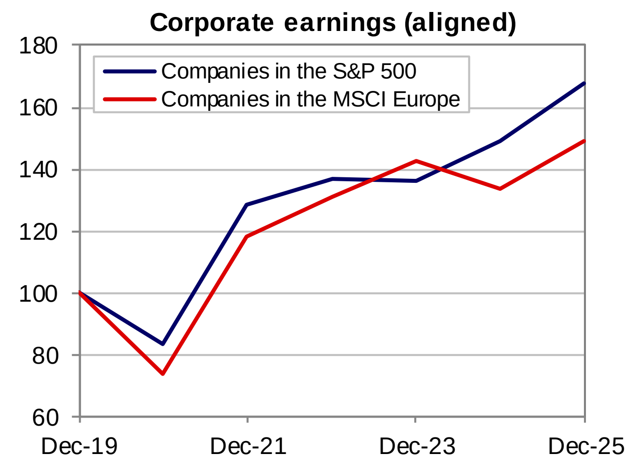
In the US, earnings growth is expected to increase steadily in the coming quarters, while the trend in Europe is less clear. According to the analyst consensus, European profits will increase in 2025 after a soft 2024.



Source: Bloomberg, own calculations



Source: S&P Global, Stoxx



Soucre: Consensus estimates (Bloomberg)

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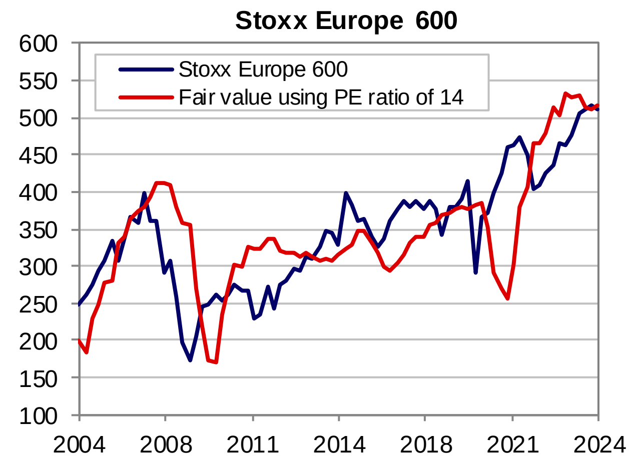
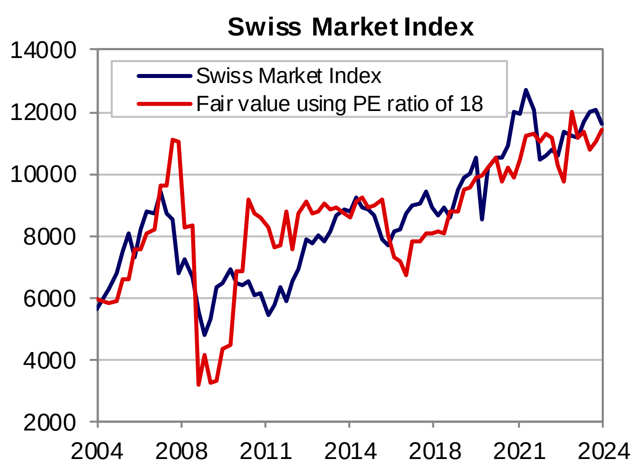
Equity markets and valuations: Europe

The charts show the performance of the broad equity index Stoxx Europe 600, the German DAX Index (40 companies, with the index shown here excluding dividends, which is why the index values do not correspond to the published DAX Index value) and the Swiss market (Swiss Market Index, 20 companies).

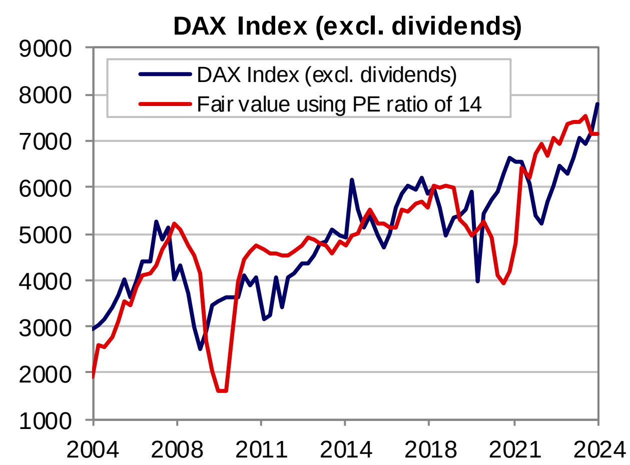
In addition, the charts show a fair value based on the average price/earnings ratio of the past 20 years. There are currently no meaningful valuation anomalies on the European stock markets.



Source: Stoxx



Source: Stoxx



Source: Deutsche Börse

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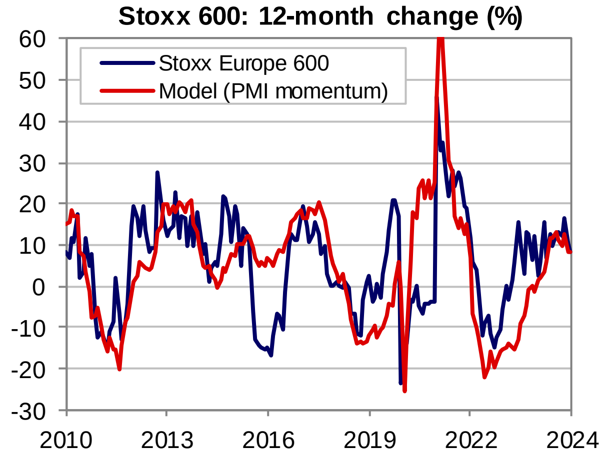
Economic and equity market momentum

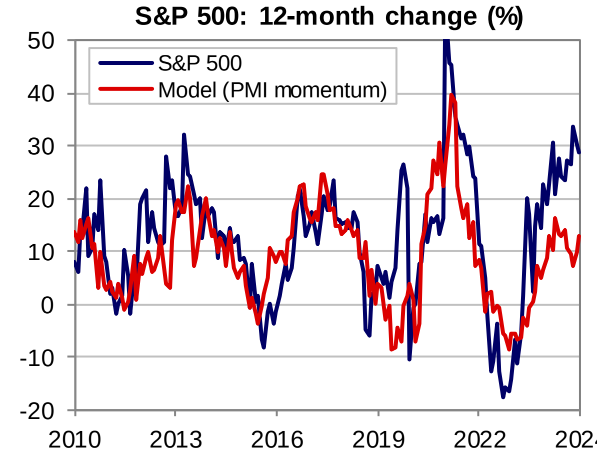
The stock markets and the relative performance of cyclical versus defensive stocks follow the economic momentum, which can be well mapped using industrial purchasing managers indices (PMIs).

According to the model, the stock markets in Europe and the US rise when the PMI remains unchanged or increases and fall when the PMI falls noticeably (in Europe already with a fall of around three PMI points).

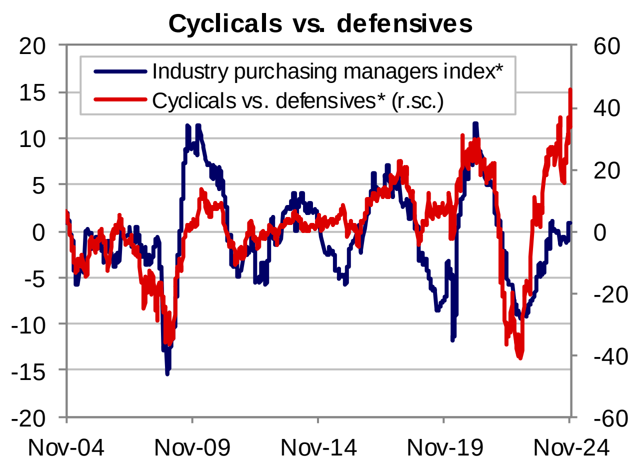
The loss of economic momentum currently represents some burden for Europe, although it must be borne in mind that many larger European companies are not primarily active in Europe, but globally.



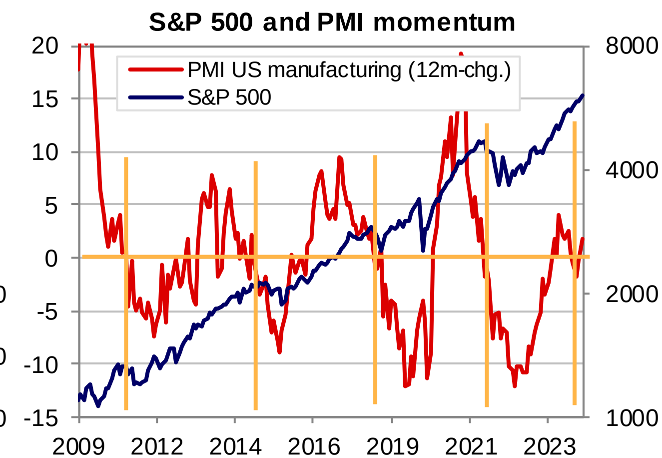
Source: S&P Global, Stoxx, own calculations



Source: ISM, S&P Global, own calculations



*Deviation 24m-avg. Source: Bloomberg, own calc.



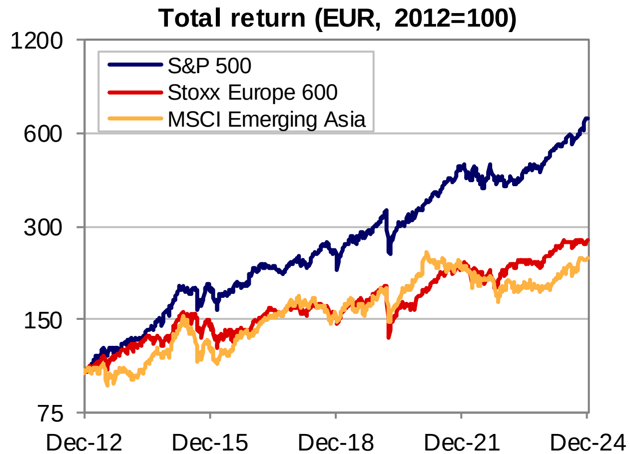
Source: ISM, S&P Global, own calculations

Regional trends: Index sector composition the key driver

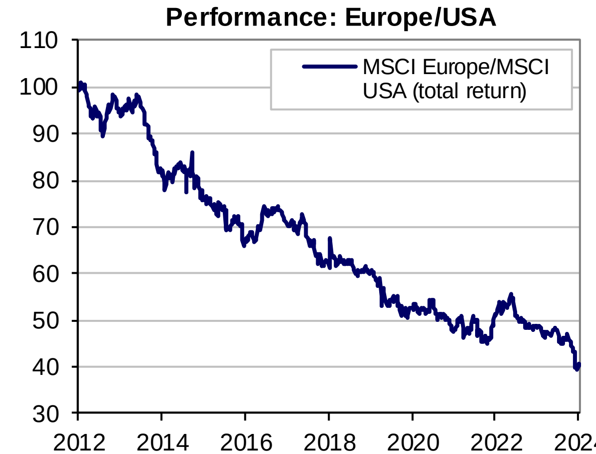
The US stock market (S&P 500) outperforms Europe and the Asian emerging markets in terms of corporate earnings and returns over the long term. The US market is more defensive than Europe (e.g. a lower weighting of financial companies). When technology stocks and technology-related sectors outperform, the US market has a clear advantage (weighting of around 40%, compared to less than 10% in Europe).

The conditions for outperformance in Europe, where value stocks are over-represented, include a good global economy, high bond yields (positive for financials) and rising commodity prices.

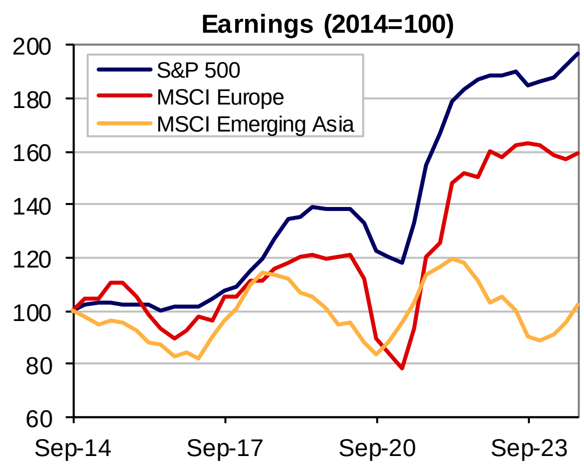
Based on free cash flows, Europe has been valued more favourably than the US since 2022. However, a favourable valuation alone is unlikely to be enough for outperformance.



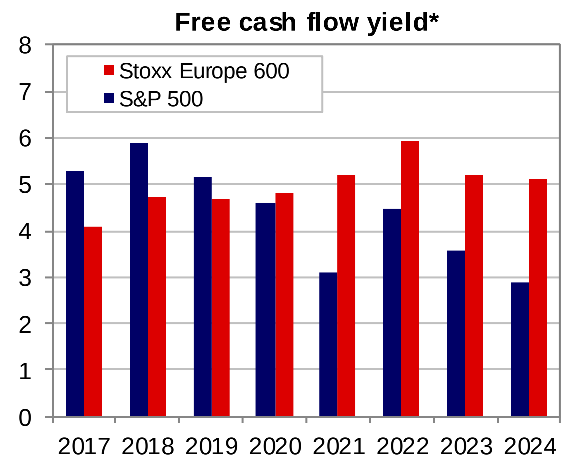
Source: S&P Global, STOXX, MSCI



Source: MSCI



Source: S&P Global, MSCI



*Key sectors. Source: Own calculations

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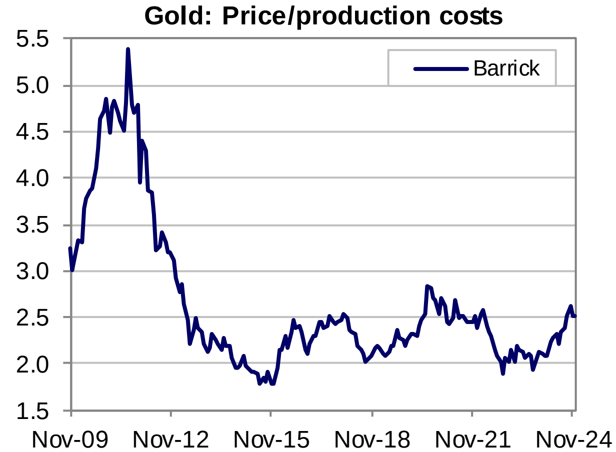
Gold

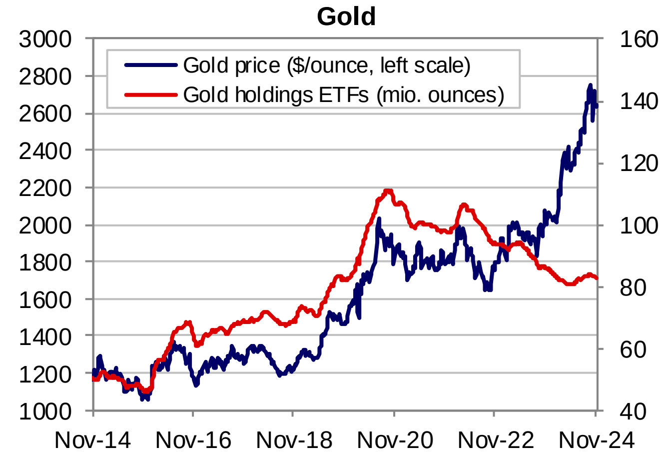
Gold will continue to benefit from purchases by central banks, though momentum will likely slow in 2025 after a stellar 2024.

The gold price is now at the upper end of established valuation ranges in relation to cash production costs and full costs, although the valuation is not excessively high. Rising production costs in recent years justify a certain increase in the price of gold.

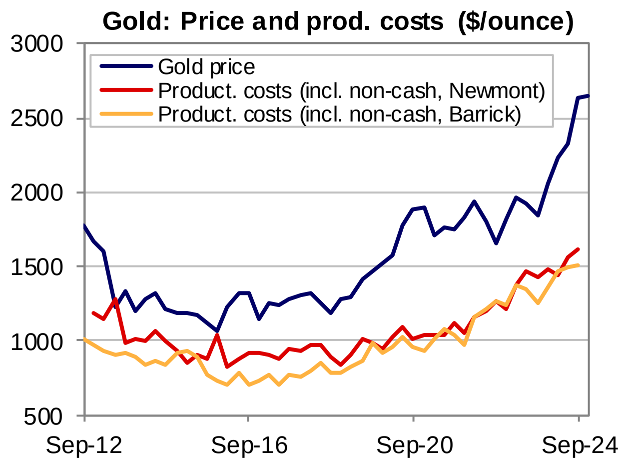
Over longer periods of time, equities perform significantly better than gold (by a factor of five over the past 40 years), in part due to equities' dividend payments. Gold offers some diversification in some multi-year period, which argues in favour of a – albeit low – gold allocation in long-term oriented investment portfolios.



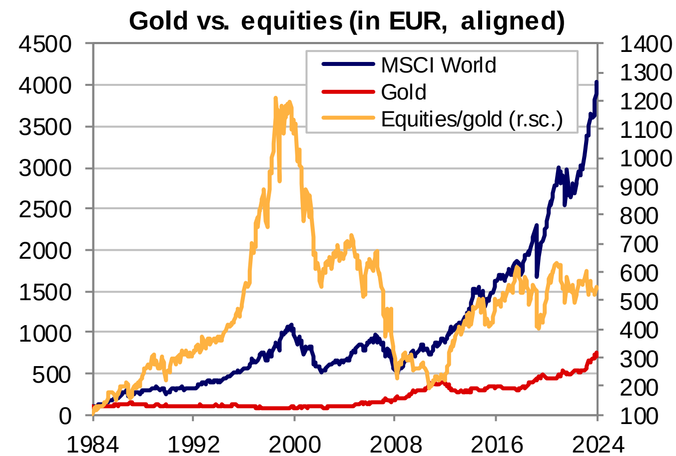
Source: Companies, Bloomberg BGN, own calculations



Source: Bloomberg



Source: Companies, index provider



Source: MSCI, Bloomberg

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Data sources in charts or tables that are not specifically mentioned are either companies or index provider.

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