VAN LANSCHOT KEMPEN

INVESTMENT MANAGEMENT

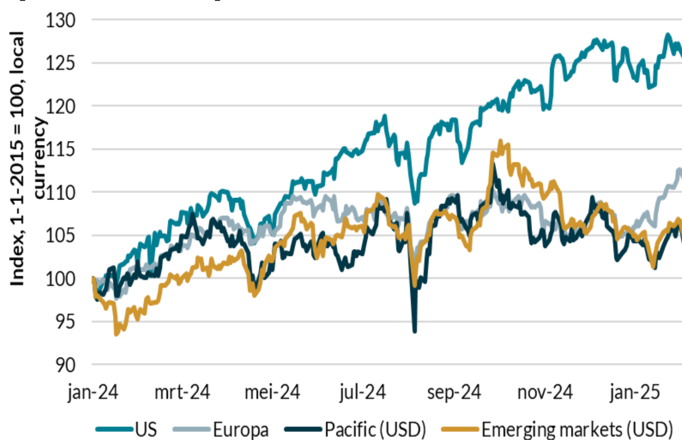
Asset Allocation Outlook

February 2025

- Equity markets plagued by AI and import tariffs
- US economy charges ahead, Eurozone stagnates
- Partial profit-taking on equity overweight

Despite uncertainty about the new Trump administration's emerging policies and the potential response from the Fed, equity markets got off to a positive start this year. The MSCI global equity index climbed 3.3% measured in US dollars. Industrialised nations outperformed emerging markets. Remarkably, at an upturn of 6.3% the European STOXX 600 beat the US S&P500 (+2.7%) by a substantial margin. Following the sharp movements in bond yields in December, it was calmer on the government bond market in January. Overall, US yields declined by a few basis points, while their German counterparts were up slightly. Spreads on investment grade and high yield credits tightened somewhat on balance. Real estate succeeded in recovering somewhat after the downturns caused by bond yields in December.

Equities starts 2025 in a positive mood



Source: LSEG, Van Lanschot Kempen

In our investment policy we've taken partial profit on our overweight in US equities. We've reinvested the proceeds in US government bonds. We're positive about US equities but now slightly more cautiously positioned.

Shocks on the equity markets

At the end of January, equity markets were taken by surprise at the news that Chinese start-up DeepSeek has developed an AI chatbot that could rival more advanced models, such as Chat GPT by US tech company OpenAI. In this case though, at a fraction of the price and without the most advanced AI chips manufactured by Nvidia. The chip maker lost 600 billion US dollars in market value in a single day, the biggest one-day loss ever recorded.

Nvidia stock plummets after DeepSeek news

Source: LSEG, Van Lanschot Kempen

As the revenue model of AI in general was called into question, many tech companies saw their equity prices plummet. Dutch company ASML, for instance, dropped by 7%. The S&P500 lost 1.5%. The index rallied over the next few days, driven by sound earnings and growth data from the US and aided by Fed Chair Powell, who is inclined to

further cuts to interest rates. Yet it's a sign that US equities especially have priced in an optimistic scenario.

The next shock came when US President Trump fired the opening salvo in the trade war. For Canada and Mexico this in principle means import tariffs of 25%, for China 10%. US and European equities fell by nearly 2% in response to this news; the losses were bigger in Japan, Korea and Taiwan. The losses were recouped somewhat when the US postponed the tariffs for Canada and Mexico by one month after they promised to increase border patrols. All three affected countries announced countermeasures, including import tariffs on US goods and export restrictions on strategic goods. It's perhaps surprising that markets reacted so violently to all this. After all, Trump has consistently pointed to what he sees as unfair trade relations and linked the import tariffs to issues such as illegal migration and drugs flows. Trump didn't immediately announce import tariffs at his inauguration, causing markets to breathe a light sigh of relief. That relief has now dissipated. This is bad news for Canada and Mexico. They're the US's biggest trading partners and will now experience greater difficulties on the US market. The depreciation of the Canadian dollar and Mexican peso will offer some compensation, as both currencies are at their lowest levels versus the US dollar for several years. A recession is nevertheless likely in the two countries unless negotiations on migration and drugs lead to a deal involving lower tariffs. We'll have to wait and see whether this happens though.

For Europe this mostly means that Trump delivers on his promises. It only seems to be a matter of time before the US introduces an import tariff of 10% on European goods. This would squeeze growth by an estimated 0.2%. While this is manageable, it does come at a time when growth is already weak in Europe. The ultimate effect at global level will partly depend on any countermeasures that countries implement, options for bypassing tariffs, currency movements and new trade agreements between countries.

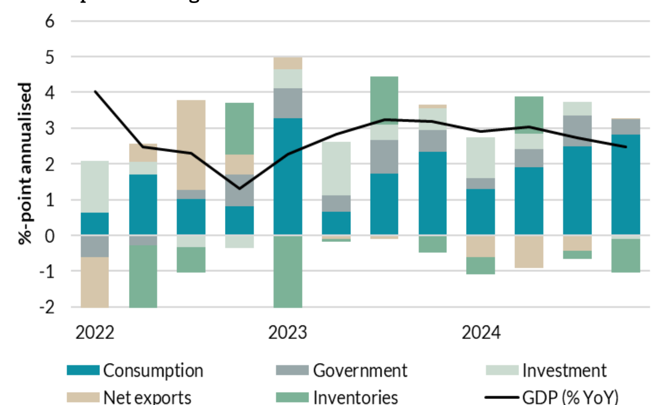
The shock was smaller on the Chinese equity markets. Rumours had been circulating of a 60% tariff for China, so this is better than expected. Of course, it doesn't mean there isn't more to come.

US equities fell, even though Trump claims tariffs will be good for the US. For US companies and consumers, however, it means that many goods will now be more expensive. Just over 10% of US consumer spending consists of imported products and services. If they become an average of 10% more expensive, this will push up inflation by 1 percentage point. In practice the increase will be smaller because exchange rates, manufacturers and distributive trade will absorb a portion of this. However, it will make it more difficult for the Fed to reduce interest rates further. And equity markets continue to be allergic to the prospect of fewer interest rate cuts.

US and Eurozone growth diverging

At first sight, US economic growth appears to have been marginally worse than expected in the fourth quarter. A growth rate of 0.6% versus the third quarter was lower than forecast and slightly down on the preceding quarters. It was mainly stock building that put a sizeable drag on growth. This is temporary and nothing to worry about. Consumer spending was in fact extremely strong. Growth in real incomes, higher equity prices, lower savings and rising car sales following a variety of natural disasters are shoring up consumer spending.

Consumption drives growth in the US



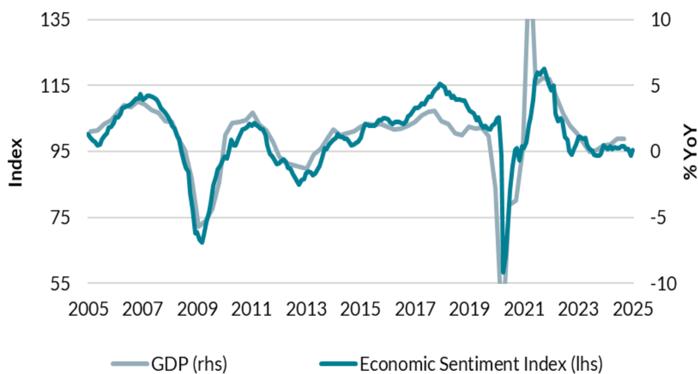
Source: LSEG, Van Lanschot Kempen

One point for attention is the marginal downturn in corporate investment. This is remarkable as business confidence and investment appetite have improved recently and robust earnings growth often leads to higher investment growth. This may simply be a standard statistical variation. Moreover, the uncertainty surrounding the US elections could have prompted businesses to be more cautious. What may also have played a part is the fact that businesses invested large amounts under the tax stimuli introduced by the Biden administration and are now easing the pace somewhat. Orders for capital goods were up in December following another sharp upturn in November. The downturn in corporate investment in the fourth quarter therefore looks to be temporary. All in all, there are few signs of a substantial slowdown in US economic momentum.

The same cannot be said of the Eurozone though after the economy stagnated in the fourth quarter. This is a setback as an acceleration in growth was visible in the first three quarters. The breakdown into expenditure components hasn't been published yet. However, this growth rate matches the poor leading indicators, such as Germany's Ifo

index, the expectations sub-index of which was unchanged in January at an extremely low level. Or the Economic Sentiment Index, which did climb slightly in January but has been pointing to stagnation for months.

Eurozone growth stalls in the fourth quarter of 2024



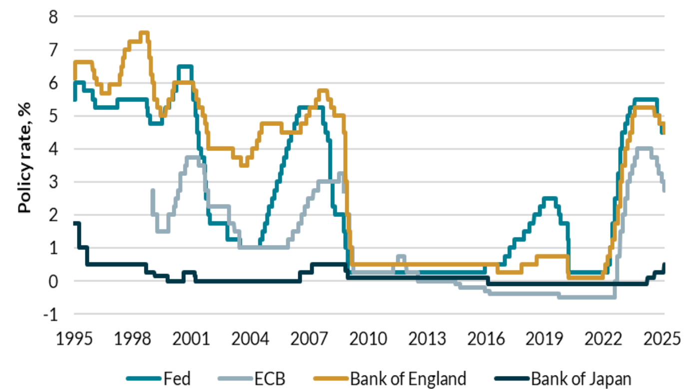
Source: LSEG, Van Lanschot Kempen

We continue to expect a consumer spending-driven recovery this year but it's not a given.

Fed introduces a pause, ECB & BoE cut rates

The Fed caused turmoil on the financial markets in December. Not by cutting interest rates, that was universally expected, but by raising its inflation forecast at the same time. In doing so it signalled to markets that it would cut rates by less. The question, therefore, was whether the Fed had prepared markets better in January. This indeed proved to be the case. At what the Fed describes as a solid job market and inflation that hasn't dropped further towards the target rate of 2%, the Fed announced it was in no hurry to implement further interest rate reductions. The Fed is still inclined to make further cuts though. Firstly, according to Fed Chair Powell the Fed's policy interest rate remains restrictive. He claimed this was visible in the low level of economic activity in interest rate-sensitive sectors, such as the housing market, and the fact that inflation has come down in recent years. Secondly, the Fed expects inflation to fall further. Wage growth has already dropped sharply, and the Fed no longer views the job market as a source of inflation. In Powell's view, there's no need for the Fed to wait until the target rate of 2% has been reached before making the next cut to interest rates. The Fed only needs to see that inflation is heading in that direction. Many of the questions at the press conference focused on Trump's potential policies. Powell was silent on that score, but it certainly looks as if the Fed's wait-and-see attitude of 'no hurry' is partly prompted by the uncertain political climate. Markets barely responded to all this. Given that markets only anticipate a further two cuts to interest rates by the Fed, it would have been difficult for the central bank to present a hawkish surprise.

Fed pauses, ECB and BoE cut, Bank of Japan hikes



Source: LSEG, Van Lanschot Kempen

The ECB did cut rates by 0.25%-point and clearly stated its intention to do so again in coming months. According to the ECB, the process of disinflation is well on track. Inflation remains high in the service sector due to high wage increases, but the ECB says these are a response to the high inflation of recent years and therefore temporary. And there are signs that wages will rise less steeply. Add to that the weak economy, fragile consumer confidence, banks that are again tightening their lending conditions slightly and the ECB's confidence that it will accomplish its target rate of 2% inflation this year and the upshot is a central bank that is confident enough to signpost further cuts to interest rates. The ECB isn't saying by how much and when, but the direction is clear. A further three cuts to rates would bring the ECB to a neutral interest rate. Growth would need to be worse than expected for more interest rate cuts than that.

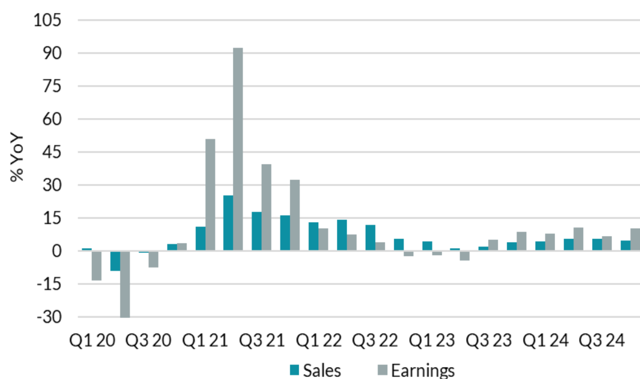
The Bank of England also cut rates by 0.25%-point, after a pause in December. The policy committee turned quite dovish. Seven members voted in favour of the rate cut, while the two remaining members voted for an even larger 0.5%-point cut. With the Bank foreseeing a cautious and gradual approach to further rate cuts, it sounded decidedly less dovish than the ECB.

US equity overweight slimmed down slightly

We've held an overweight in US equities in our investment policy for some time now. This asset class's strong performance versus other asset classes resulted in the US equity overweight growing to above the target we had originally envisioned. We're now taking partial profit on this overweight and reducing it to the original target size.

We continue to be positive about US equities. Growth is solid and leading indicators are generally positive. The ISM index for industry climbed to over 50 in January for the first time since October 2022, which points to growth in this sector. The sharp upturn in new orders is especially encouraging, as is the improvement in employment. Profitability is also at sound levels in US industry. Over one third of the companies in the S&P500 equity index have already reported results over the fourth quarter. These show earnings growth of 7%, nearly 6 percentage points higher than forecast. Earnings are growing slightly faster than revenue, which suggests that profit margins are holding up well.

Robust sales and earnings growth among S&P500 companies



Source: LSEG, Van Lanschot Kempen

The breadth of the earnings growth is likewise positive. More than 70% of the companies publishing results have succeeded in exceeding expectations. The robust earnings growth is visible in the communications, financial services and IT sectors. The energy and basic industrial sectors are reporting significantly lower earnings.

So why take profit? Mainly because of the position exceeding the size we envisioned but also because of the substantial uncertainties. All sides lose out in a trade war. Expected US earnings for 2025 are holding up well but the number of analysts adjusting earnings downwards is growing. This means that earnings growth is still concentrated in a number of extremely large companies. The reaction to the news about DeepSeek demonstrates that US equities have priced in an enormous amount of optimism. We therefore wanted to restrict the overweight somewhat.

We're reinvesting the proceeds in US government bonds and hedging the exchange risk, reducing our exposure to the US dollar in the process. This is because the equity position wasn't hedged. In the US, we held an overweight in government bonds and a larger underweight in investment grade credits. Overall, therefore, we held an underweight in US investment grade bonds. This meant that we've profited from the upturns in yields in the past few months. As a result, we now think it's a good time to reduce the underweight in US investment grade bonds marginally.

Tactical outlook

Asset classes	
Equities	**Overweight**
Equities got off to a positive start in 2025, climbing in all regions. The biggest upturn was in Europe. We've maintained our neutral position in Europe as we don't think the uncertain growth outlook and moderate earnings trends compensate for the low valuations. In the US, we've taken partial profit on our overweight. US equities' strong performance had caused this overweight to exceed the target size we'd envisioned. We continue to be positive given the outlook for growth, earnings trends and our expectation that bond yields won't climb further. Yet we also recognise the risks of a trade war and the number of analysts adjusting their earnings forecasts downwards. We view higher US import tariffs as a risk for the Pacific region and emerging markets too. The Chinese economy continues to grapple with problems as well. However, this doesn't make up for the low valuations of these equities. We hold a neutral position in the Pacific region and emerging markets.	
Government bonds	**Overweight**
Following the substantial upturns in yields in December, January was a calmer month for the bond markets. Yields were down slightly in the US and up marginally in Germany. The biggest movements were in the UK, where 2-year bond yields fell by 16 basis points, and in Japan, where 10-year yields climbed by 16 basis points. The policy meetings of the Fed and ECB, at which the former introduced a pause and the latter cut interest rates, produced no surprises for bond investors, nor did they constitute a reason to adjust forecasts. Lower-than-expected rates of inflation and worse-than-expected growth data resulted in markets forecasting a higher number of interest rate cuts in the UK. Japan's central bank raised interest rates and announced its intention to do so again. We don't believe that bond yields in the US and Europe will rise further. Lower inflation and lower interest rates at central banks have the potential to push down bond yields. A trade war is inflationary. We hold a small underweight in Eurozone government bonds and an overweight in the US. However, given the underweight in US investment grade credits, we still hold an underweight in US investment grade bonds overall. We've reduced this underweight slightly by buying US government bonds. On balance, we continue to prefer equities to bonds.	
Investment grade credits	**Underweight**
Spreads on US investment grade credits were unchanged for the second consecutive month in January. In the Eurozone, spreads tightened by 11 basis points. Such tight levels make investment grade credits unattractive versus government bonds, especially in the US. We've maintained our underweight in this asset class as we believe the chance of an outperformance deriving from tighter spreads is smaller than the risk of an underperformance caused by wider spreads. The Eurozone is fast approaching this point too. Yet spreads are less tight in the Eurozone in relative terms and on top of this spreads account for a larger portion of the total interest compensation. This is why we still prefer investment grade credits to government bonds in the Eurozone. As an illustration, total returns on US investment grade credits and US government bonds were about the same. In the Eurozone, credits generated a return that was 0.6 percentage points higher. As the underweight in the US is bigger than the overweight in the Eurozone, we hold an underweight overall in this asset class.	
High yield credits	**Underweight**
Spreads on US high yield credits tightened slightly more than those on their Eurozone counterparts in January. This went some way to cancelling out the diverging trends in December when spreads widened in the US and tightened in the Eurozone. Our outlook for high yield credits remains unchanged. We think spreads are extremely tight, making this asset class unattractive in relative terms versus government bonds. Even if the economy continues to grow over the coming quarters, we still view the spreads as small. This is because companies will face higher interest charges. Furthermore, we know that if the solid sentiment on this market deteriorates, the liquidity of these bonds will quickly dry up and spreads will widen. The tight spreads mean there's less upward potential in this class than for equities.	
Emerging market debt	**Neutral**
Lower US bond yields and tighter spreads led to a downturn in yields on emerging market debt issued in US dollars in January. Yields on bonds issued in local currency likewise fell. This made emerging market debt the best-performing bond class, despite the small yield movements. Interest compensation on emerging market debt in US dollars remains attractive, despite the contraction and the bonds now enjoying a more neutral valuation than other asset classes. Spreads are high in a number of the weak countries. Little risk premium has been priced in for the more robust countries. Growth is holding up well in emerging markets and there's relatively little exposure to Asia compared to emerging market equities or bonds issued in local currency. This reduces the negative risk from weak Chinese growth. Cuts to interest rates by the Fed could boost this asset class, but US import tariffs pose a risk. The interest compensation on emerging market debt in local currency is too low compared to developed countries. Currencies could likewise be squeezed by Trump's import tariffs.	

Asset classes	
Listed real estate	**Neutral**
Listed real estate has underperformed versus general equities since 2022-2023 when interest rates climbed. Higher interest rates made rental yields less attractive in relative terms and led to higher interest charges for property companies. Since then, this asset class has moved closely in line with interest rate expectations. The upturn in yields between mid-September and the start of this year has impacted listed real estate. Some measure of relief was felt on the interest rate markets in January thanks to better-than-expected rates of inflation in the US and UK, which enabled listed real estate to earn small positive returns for both global developed and Europe. With the exception of the office sector, vacancy levels are low. Rental growth is being boosted by inflation and economic growth. We expect this to continue given the small supply of new properties in the real estate sector. We hold a neutral outlook for this asset class. Valuations are relatively cheap versus general equities. Versus interest rates, global developed listed real estate is expensive and European real estate has a neutral valuation in our opinion. Transactions remain at low levels but an increase in transactions in 2025 will create greater clarity on the value of the underlying properties.	
Commodities	**Neutral**
The Bloomberg general commodity index climbed by 4% in January. Oil and metal prices were up slightly, but it was mostly the price of gold, which shot up by 7%, that pushed up the index. We see no reason to change our neutral position in commodities. The OPEC countries have maintained their production restrictions but have sufficient capacity to increase production if demand permits this. The weakness in global industry and China is likewise squeezing the upward potential for oil prices. We see little upward potential for metals for the same reason. The price of gold remains high. We think the gold price is mainly being shored up by the gold purchases of central banks. It's impossible to predict how long this will persist. Gold is an interesting investment at times of uncertainty but given its high price a large amount of uncertainty and/or lower interest rates have already been priced in.	

Market review

Equities

	Index	Past month	Past 3 months	From 31-12-2024
Global (MSCI AC)	1102	2.6%	2.4%	4.0%
Developed markets (MSCI World)	3864	2.7%	3.0%	4.2%
Emrging markets (MSCI EM)	1102	2.2%	-2.6%	2.5%
United States (S&P500)	6084	1.8%	2.6%	3.4%
Eurozone (EURO STOXX 50)	547	6.6%	9.9%	8.2%
United Kingdom (FTSE 100)	8727	5.8%	6.9%	6.8%
Japan (Topix)	2752	-0.2%	1.3%	-1.2%
Netherlands (AEX)	925	3.8%	5.7%	5.3%

Government bonds (10-year)

	Yield (%)	Past month (bp)	Past 3 months (bp)	From 31-12-2024 (bp)
United States	4.44	-18	0	-13
Japan	1.27	13	28	19
Germany	2.37	-7	-2	1
France	3.09	-18	-7	-10
Italy	3.44	-13	-28	-9
Netherlands	2.56	-11	-11	-4
United Kingdom	4.49	-13	-8	-9

Investment grade credit

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2024 (bp)
United States	84	0	4	2
Eurozone	91	-9	-8	-10

High yield bonds

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2024 (bp)
United States	266	-10	-8	-26
Eurozone	297	-4	-22	-14
Emerging markets (USD)	315	-5	-20	-10
Emerging markets (Local currency)	200	5	-10	-2

Real estate

		Past month	Past 3 months	From 31-12-2024
Global		3.1%	-2.6%	2.6%
North-America		3.4%	-2.0%	2.3%
Europe		4.6%	2.0%	3.7%

Commodities

		Past month	Past 3 months	From 31-12-2024
Bloomberg index		5.1%	6.3%	5.6%
Base metals		4.2%	-0.4%	3.9%
Brent oil (USD per barrel)	74.33	-3.1%	-1.7%	-0.5%
Gold (USD per troy ounce)	2853	8.2%	6.9%	8.7%

Returns in local currency
bp = basis point (0.01%)
Data as of 6 February 2025
Source: LSEG

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