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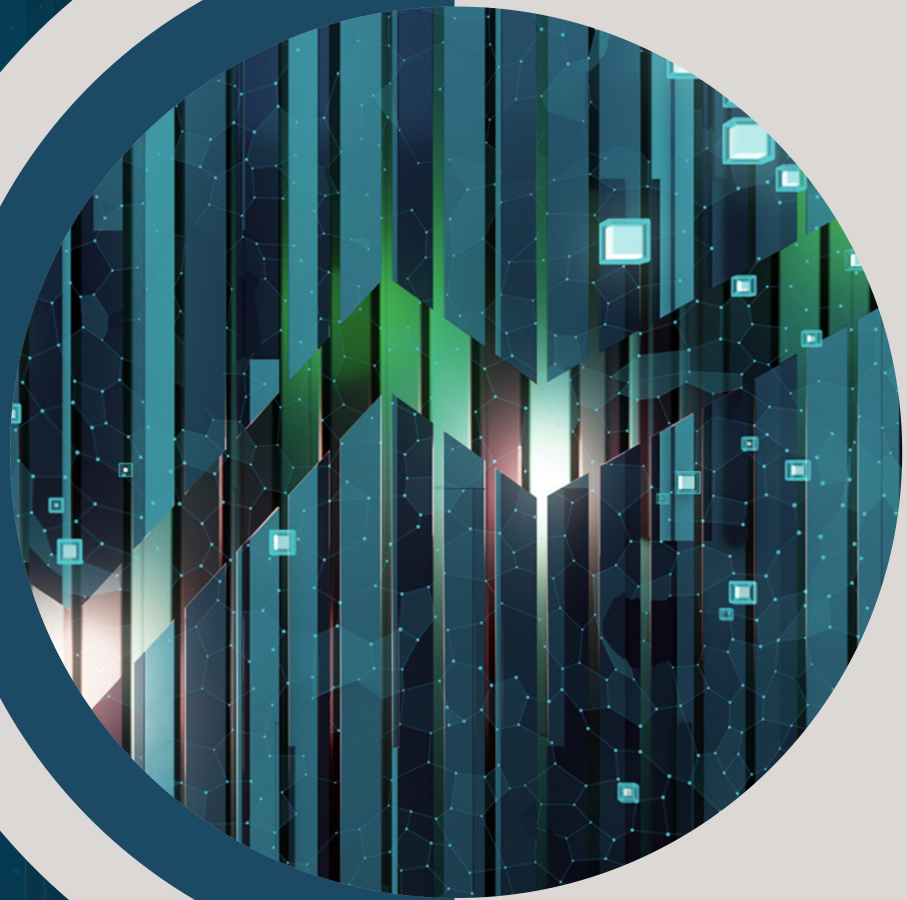

Will policy uncertainty trump growth?

Investment Outlook 2025

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After a stellar year, equities still appeal

World equity markets returned near 25% in euro terms in 2024, driven primarily by large capitalisation US stocks. It's a stellar performance for sure, but it follows nearly two years of flat price performance in the All-Country World Equity Index between late 2021 and 2023.

JOE PRENDERGAST
Head of Investment Strategy

From the end of 2021 to the time of writing, world equity total returns have been just over 10% in annual terms. That's around 2% less than the annual rate recorded over both the past five and 10 years, and about in-line with the average total return of the past 20 years.

Looking forward from this juncture, it's right to be cautious and to worry that 2024 might have been an overshoot to some degree, at least for US equities. Measures of market complacency, such as the subdued levels of implied equity volatility and the high degree of bullish sentiment among US retail investors, warn there may be corrections ahead. But with corporate earnings growth supported by the resilience of world economic growth, underpinned notably by a strong US economy, there should be less grounds for medium- to longer-term valuation concern.

> “Our indicative expected returns for global equity markets reflect the potential for moderation in equity returns in the near term.”

Our Chief Economist Dermot O'Leary sees plenty to be exercised about from a policy and geopolitical perspective in 2025, but with the US set for a deregulation agenda in the financial and energy sectors, and a looser fiscal stance, US growth may once again confound expectations of moderation let alone material slowdown or recession. US policy uncertainties may be greater for major trading partners, with risk of downgrade to forecasts in Europe in particular in a bad trade policy scenario. But scope for the European Central Bank to cut rates remains considerable from current levels. And if the US trade policy agenda is less aggressive than feared, there could even be some upside surprises for sentiment.

Our indicative expected returns for global equity markets reflect the potential for moderation in equity returns in the near term. Over the coming five years, our Chief Investment Officer Bernard Swords expects average annual total returns of around 6.6% globally. Despite the limited appeal of euro area cyclical and structural fundamentals, European expected returns are modestly higher than in the US, partially due to the higher dividend yield but also due to more appealing valuations. Healthcare is the standout sector, with double-digit expected returns based in part on expectations of a strong earnings rebound in 2025.

In bond markets, our Fixed Income Strategist Moyah Flanagan outlines the relative stability of euro area fixed income in 2024 and prospects for more of the same in 2025. European Central Bank rate cuts are well priced-in, suggesting little upside potential for government bonds above their starting yield. But with global growth and earnings holding up, corporate bonds still offer attractive potential.

Wishing you all the best for the year ahead.

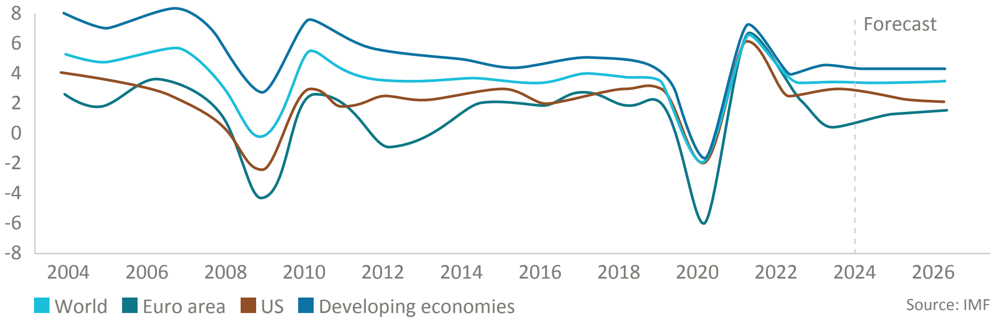
Is the benign growth picture about to be undermined?

DERMOT O'LEARY
Chief Economist

A cursory glance at the global economic trajectory over the past 12 months and for the coming year may lead some to believe that all is calm. Global growth of 3% is currently anticipated for 2025, bang in line with 2023 and the expected outturn for 2024. Beneath this seemingly benign macro picture, there are very clear regional differences as well as policy shifts that have the potential to disrupt dramatically over the coming 12 months.

These disruptive influences include the potential for a seismic shift in the global trading environment under a Trump/Republican administration, an apparent focus on deregulation, the ongoing AI revolution and the now seemingly disputed goal of the energy transition. Add in ongoing wars in Ukraine and the Middle East and there is plenty to be exercised about from a policy and geopolitical perspective in 2025.

Figure 1.
Regional growth dynamics



Source: IMF

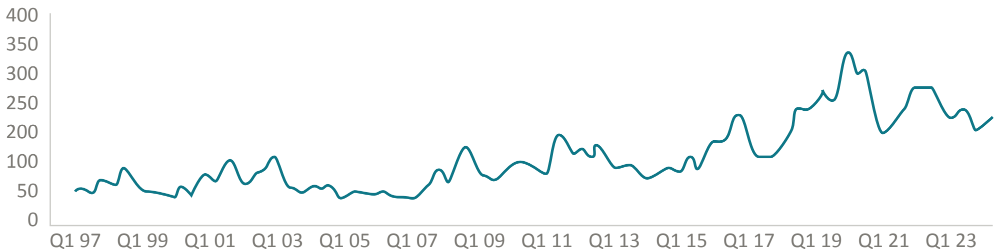
The impact of these factors will be mixed, albeit highly uncertain. Trump's policy mix can certainly be classed as unorthodox, but we already have a playbook, even if it is somewhat different from the first time out. There has already been early evidence on the threat of tariffs. We would expect this to continue, especially with China, but we are not certain that broad tariffs will be sanctioned on US allies too given the likely impact on inflation and growth.

A deregulation agenda in the financial and energy sector could have positive impacts on credit provision and the price of energy that will speed up US growth, for instance. Looser fiscal policy will propel short-term growth too.

The potential negatives stem from the impact of policy uncertainty on investment and spending decisions, the inflationary impact of tariffs as well as the growth implications for those regions targeted by the tariffs. Europe stands out for particular mention here given its weak starting position and the uncertain political outlook at the start of 2025. Germany is in the midst of a slow contraction amid challenges to its industrial model from China and high and volatile energy prices. Attempts to jolt the economy back to life through fiscal policy actions have faced both political and legislative backlash that have been part of the downfall of its government. Growth forecasts are subject to downside risks in Europe.

Along with a relatively benign, albeit uneven, growth picture in developed economies, the coming year will likely bring further relief on the interest rate front in the context of an ongoing disinflationary process following the price spike of the 2022/2023 period. Interest rates have already come down in all of the developed economies, providing an aid to financial markets. Markets did get ahead of themselves earlier this year in expecting ongoing aggressive rate cuts. Unlike in 2022 when a sharp increase in rates caused risk assets to falter, we don't see scope for a repeat this time out, even if interest rates are not moving back to the levels of the 2010s.

Figure 2.
Economic policy uncertainty* to remain high



Source: Federal Reserve *A measure of uncertainty for 20 countries

Structural growth remains our main focus in 2025

BERNARD SWORDS
Chief Investment Officer

The overall background outlined by our Chief Economist Dermot O'Leary is a good one for equity markets. However, after strong returns in 2024, particularly after the US election, we think much of this outlook is reflected in prices and thus returns will be more modest in 2025.

It is likely to remain a US-led world in the short term, but this could change once we have clarity about US trade and taxation policy. As our Chief Economist Dermot O'Leary pointed out, there are many risks out there which could affect the economic out-turn. Thus, we keep equity exposure close to benchmark levels and keep structural growth as our main focus.

We do not expect to see the type of equity returns we experienced in 2024 to be repeated as there were some factors behind the exceptional level of performance. Firstly, the US economy performed much better than expected. Secondly, the build out of the IT infrastructure to enable the use of Artificial Intelligence (AI) tools was much bigger than forecast, boosting earnings and prices through the performance of the IT mega caps. While the market cap-weighted world index is up 23%, the equal-weighted index is up 'only' 17% . Lastly the US election delivered a US business, and hence a US equity market friendly result. This has driven a large move in US equities in the second half of the year (see figure 3). Many of these factors will not repeat as we look forward: economic growth expectations have risen, the rate of growth in AI-related capital investment will naturally decline and the US election is now done.

Figure 3.
Equities push higher in H2 2024

	Since 30 June 2024	Year-to-date 2024
World (local)	7.5%	21.8%
FT World (euros)	9.1%	24.9%
Euro Stoxx	-0.6%	8.0%
S&P500	10.4%	27.3%
MSCI Pacific Basin	3.6%	12.7%
Topix	-3.4%	16.1%

Source: Factset as at 29 November 2024.

For now, maintain a US focus…

We increased our exposure to US equities in 2024 as we expected the US election to deliver a more US-centric policy mix regardless of the winner, and the US economy was showing much greater momentum than the rest of the world. As it has turned out, the US election has delivered a policy outcome that is more extreme in its focus on 'America First' and US economic momentum has not faded. The exact policy measures that will be implemented are still uncertain and hence the US market looks the safest place to be in for now. A robust US economy means that having some exposure to US domestically-focussed equities, e.g. banks or rails, has made sense.

…but keep structural growth as the main theme

We have outlined a benign economic background, but it is important to remember that this indicates only trend growth, not super-normal growth. Hence, we focus on industries that are less sensitive to the economic cycle (e.g. Healthcare, or Insurers rather than banks). We also focus on structural growth areas, such as the energy transition through investing in companies that enable electrification. Of course, one cannot ignore the AI theme. Capital investment will still be going into this area for some time; hence, we maintain exposure to the IT mega-caps; electrical equipment is also seeing strong AI-driven demand. We think that this theme will broaden out in 2025 to include beneficiaries for the diffusion of AI rather than just the product providers. So, Financials and Industrials have intellectual property that should become more valuable using AI tools. Healthcare could benefit from faster product development and diagnoses with these tools. Regionally, we remain underweight and neutral on Asian and European equities, respectively. These regions have lagged in 2024, and the European valuation is lower, so it is potentially attractive if we see a catalyst for change.

Warning: The value of your investment may go down as well as up. Past performance is not a reliable indicator of future performance.

Indicative expected returns for global equity markets

BERNARD SWORDS
Chief Investment Officer

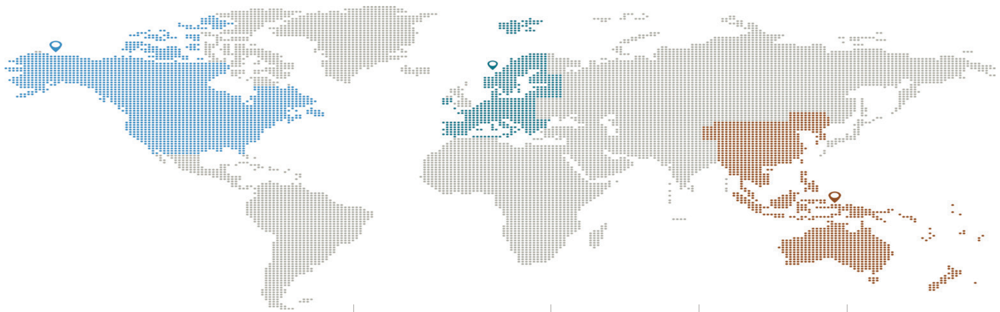
Every year, we calculate indicative long-run expected returns for major equity markets. Subject to our assumptions on economic fundamentals and market conditions, we expect world equities to return in the region of 6.6% on average over the coming five years.

Our average annual expected return from equity markets over the next five years moves down 1% from last year primarily due to higher valuations. A global economy growing at close to trend levels should support a good level of earnings growth. We expect profits to grow by 6.5% per annum (p.a.) on average over the next five years, 1% higher than trend since 2000. However, valuations have increased, particularly in faster growth segments. As the growth is realised, valuations seem likely to decline. Consequently, even though the background is a good one for equity markets, we expect equity returns to be more modest going forward, c. 6.6% p.a. on average over the next five years.

Healthcare leads by sector as a strong earnings recovery is expected in 2025. Low returns are projected for IT and Communication Services as valuations have increased substantially in 2024. This could be offset should the emergence of AI and other structural changes lead to a step-up in earnings.

Regional disparity is low. The euro area scores best as it has a higher exposure to the lower valued sectors and has a higher dividend yield. But this comes at the cost of lower earnings growth.

Figure 4.
Expected equity total returns p.a. by region



	US	Euro	Asia Pacific	World
Valuation contribution	-2.90%	-1.47%	-2.20%	-2.30%
Earnings contribution	7.50%	5.20%	5.50%	6.70%
Dividend	1.60%	3.30%	2.80%	2.20%
Total	6.20%	7.03%	6.10%	6.60%

Source: Goodbody as at 29 November 2024.

Figure 5.
Expected equity total returns p.a. by sector

Energy	**Materials**	**Industrials**	**Consumer Discretionary**	**Healthcare**	
5.6%	9.2%	7.1%	8.5%	11.7%	
Consumer Staples	**Communication Services**	**Utilities**	**Property**	**Financials**	**IT**
7.7%	5.7%	7.2%	4.5%	7.8%	5.7%

Source: Goodbody as at 29 November 2024.

Warning: The value of your investment may go down as well as up. Past performance is not a reliable indicator of future performance. Projected performance is based upon past results and cannot be relied upon as an indicator of future performance. Our expected returns are indicative only. Returns for individual years and overall outcomes can vary significantly.

A steadier path for European fixed income returns in 2025

As economic and political uncertainty unfolded throughout the year, the US and euro area economies have followed diverging paths.

MOYAH FLANAGAN
Fixed Income Strategist

The US proved by far the more resilient of the two, with a series of positive Springtime economic surprises helping delay interest rate cuts and push bond yields steadily upwards in the first half of the year. Ongoing disinflation and softer data in the euro area triggered a first rate cut from the European Central Bank in June. The Federal Reserve followed in September, as US data finally lost momentum.

Despite the rate cuts, government bond yields are net flat to higher for the year so far. At just above 2.0% in early December, the benchmark 10-year German bond is little changed year-to-date, with activity confined to a narrow range around an average 2.35% yield. The US 10-year is 0.30% higher in yield year-to-date, near 4.25%. Euro area bond spreads were well behaved with the single but notable exception of France, where a snap election and political change triggered an unwind of institutional investor exposure. Fear of further politically- or fiscally-induced volatility fuelled the unwind, taking the 10-year yield spread over Germany from under 0.5% in May to almost 0.9% in December.

With sluggish growth and moderating inflation as a backdrop, the European Central Bank looks set to deliver further rate cuts. However, investors have already priced nearly 150 basis points of further cuts from here, with the deposit rate expected to drop under 2%.

As such, we expect euro area fixed income to offer steady returns as we head into 2025. Political stresses may see spreads widen within the bloc but would likely support German bonds outright and could accelerate the case for monetary ease. We expect euro area core and periphery sovereigns to offer up stable returns as we approach the new year. In summary, the overall effect of the US uncertainty may in fact highlight the steadier trajectory for fixed income returns in Europe.

> “With corporate fundamentals holding up well, the case for high-quality corporate credit remains strong in our view.”

With the world economy bolstered by US resilience for the past two years, global corporate profits have held up and default rates among issuing companies have stayed very low by historic standards. As such, European corporate bonds have fared well, with the total returns of more than 5% along the credit curve year-to-date, outperforming government equivalents by well over 1%. With corporate fundamentals holding up well, the case for high-quality corporate credit remains strong in our view. An argument against its inclusion within portfolios would be harder to make given the relative expected return outlook.

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Arrange a call back at a time that suits you.