

JANUARY 2025

2025: a year when diversification matters

We explore four key questions for investors in 2025 and why diversification might be the answer.

With uncertainty surrounding significant parts of the policy agenda of new US president Donald Trump, as well as the trajectory of major economies and their interest rates, 2025 is shaping up to be a year when diversification matters.

To negotiate a fast-changing environment, market participants may need to follow the adage of not putting all their eggs in one basket. Consider diversification across asset classes, currencies, sectors and companies to manage the four major questions facing markets in 2025.



Gregor MA Hirt
Global CIO Multi
Asset

Key takeaways

- With markets seeking clarity about US policies under Donald Trump, as well as the path of interest rates and the fortunes of the US and Chinese economies, we think a diversified approach to asset allocation can help to manage uncertainties ahead.
- Building a widely diversified portfolio, including assets such as gold, private markets or catastrophe bonds, and staying invested through market volatility can help to mitigate risks and capture opportunities.
- Some of the assets we favour in the current environment include US small caps for their attractive valuations and support from fiscal policies, the Japanese yen, given its safe-haven asset qualities, and longer-term opportunities in China in areas like artificial intelligence and big data.



1 Will US growth hold up?

We expect 2025 to start with reasonably positive momentum for risky assets, helped by resilient US earnings growth and lower interest rates, underpinned by a continuingly robust US economy.

As 2025 progresses we will look for signs that the US economy meets our expectation of a soft landing, where inflation slows and recession is avoided. Alternatively, performance may turn out stronger, with faster growth and more inflation. Of course, a more challenging backdrop may emerge, with the economy slowing sharply – or even sinking into recession.

We think US equities will likely outperform their international counterparts due to stronger economic growth in the US and potential support from Mr Trump's "Make America Great Again" agenda. However, we are cognisant of downside risks, as demonstrated by the sharp falls in US technology stocks in late January prompted by a new artificial intelligence product from Chinese startup DeepSeek. We think the episode shows the value of an equal-weighted portfolio that can avoid concentration in a few large-cap stocks.

In our multi asset portfolios, we favour US small caps for their attractive valuations and support from fiscal policies. We still like the broad technology sector due to the prospect of reduced anti-monopolistic measures under the Trump administration. Our other equities pick are US banks over European ones for their potential to thrive under potentially swift deregulation.

2 Will Mr Trump deliver?

In our view, the new US president may hold significant sway over markets. Investors will be watching closely to see the extent to which Mr Trump's campaign promises become a reality.

We've already seen some key announcements from the new White House, but uncertainty still surrounds significant parts of the policy agenda. In our view, some of Mr Trump's plans may be conflicting. Lower taxes, deregulation and supportive fiscal policies should boost equities. However, reduced immigration could cut worker supply in a labour market already facing low unemployment and unfilled vacancies. Less immigration may lead to higher wages and lower company profits.

Mr Trump's neo-mercantilist policies – including lower taxes and bilateral trade agreements – could disrupt global trade and supply chains and reduce productivity.

And his approach to foreign policy may make for a rocky geopolitical backdrop if his recent combative comments about Mexico, Greenland, Canada and Panama are any guide.

The common factor between all his policies might be higher future inflation, which might not be a problem for risky assets unless it spirals out of control.

3 Will interest rate paths diverge further?

A crucial factor to track will be how the US Federal Reserve (Fed) responds to any overheating in the US economy. Bond markets have factored in some economic re-acceleration and fewer Fed interest rate cuts. Over the past few months, US bond yields have seen a substantial rise, which in our view limits the risk of further setbacks.

If the Fed's monetary policy path deviates further, other central banks may have to decouple their monetary policy stance from the US. We could see a scenario in which the Fed becomes more hawkish and holds or even raises rates, as the European Central Bank (ECB) turns more dovish and continue to lower rates. Despite falling inflation in Europe, the ECB's hand may be forced by upcoming elections in Germany and potential political instability in France.

We may see more volatility in the US Treasury market if inflationary pressures re-emerge and market participants begin to believe that the Fed could delay rate cuts. Although more Treasury market volatility is not our base case scenario, we are closely monitoring the demand for longer-dated Treasuries.

Divergence in monetary policy will likely bring swings in foreign exchange markets. The US dollar has strengthened significantly since the US election. We would not be surprised to see more currency volatility once Mr Trump's trade policies are introduced. In our view, the Japanese yen has become more attractive due to the Bank of Japan's intent to raise interest rates further and the yen's reputation as a safe-haven asset.

4 Will China's economy revive?

Finally, markets will want clues about the health of the world's second-largest economy. China is facing persistent headwinds, especially in the real estate market.

Mr Trump's threat to impose tariffs of 60% on Chinese goods to the US may create further obstacles for China. However, the prospect of a trade war with the US may prompt China's government to roll out fresh stimulus. The government has already stepped in as a backstop and appears committed to supporting growth and consumers.

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With many investors on the sidelines, another positive is that market valuations are attractive. We remain tentatively optimistic about China's outlook. We see China's challenges as growing pains in the economy's transition – a shift that should provide opportunities for longer-term investors particularly in areas like artificial intelligence, big data and other technologies.

Mitigating risks and capturing opportunities

In summary, we remain confident about 2025, even if returns may be more muted than we have seen over the past 12-18 months. But we are prepared to reallocate our portfolios in the event of shifts in the geopolitical and economic landscape.

We think investors can follow two guiding principles to manage the uncertainties 2025 may bring:

- **Consider broader diversification** – building a widely diversified portfolio can help avoid too much correlation, where asset classes perform in the same way, and protect portfolios from major downside risks.

It may also be worth considering assets such as gold, private markets or catastrophe bonds (that pay the issuer in the event of a disaster) as these follow different performance cycles to fixed income and equities. Complementing an asset allocation with derivatives can also help capture asymmetries and opportunities while protecting the portfolio from tail risks.

- **Stay invested through volatility** – even with volatility in markets, staying invested is the best way to build up wealth in the long run. One way to manage volatility is by balancing portfolios so individual years do not significantly influence long-term outcomes. This idea, known as “time diversification,” suggests that each year should have a similar risk impact. The aim is to address situations where diversification fails, such as in 2008 and 2020 for equity markets, or in 2022 for bonds.

Following these principles can help to mitigate risks and capture opportunities that may come along. We think active management will be critical to negotiating a global economy where being selective can make a difference.

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January 2025