Five Investment Themes for 2025

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The Trump Win Means America First: Five Investment Themes for 2025

With the election of President Trump in the US, we may be facing both political and market regime changes in the coming year. Politically, the Trump win and the Republican sweep of Congress means a dramatic change is possible in how the US economy is managed and how it engages with its trade partners. Market regime changes are possible depending on policies pursued by the new administration as these could affect inflation, economic growth and risk appetite. The US economy has been much stronger than expected over the past few years, mainly due to robust consumer spending. After the election, there has been a rise in both consumer and business sentiment so spending and investments may continue to support robust economic growth. However, this has resulted in stubbornly high inflation which could persist for now. Trump policies on tariffs, taxes, immigration and deregulation could have wide ranging repercussions for the economy, the jobs market, and inflation but as these policies are unknown, the outlook is highly uncertain. This uncertainty means that the US Fed and other Central Banks will need to closely monitor Trump's policies to determine the appropriate policy responses. We had been expecting that the Fed would need to pause in its rate cutting cycle in 2025 due to persistent inflation and believe this to be the case even more with the Trump win as his policies could be even more inflationary. The strength in the US economy stands in contrast to other major regions and countries. China has been in or near deflation for the past 1.5 years with economic growth slowing. Europe has had very weak economic growth and the outlook is bleak. With all of this in mind, we highlight five investment themes we believe investors should keep in mind in 2025.

Post-election economic policies … America First

The US election results with President Trump returning to office and the Republicans sweeping Congress could result in a dramatic change in US economic and trade policies. The central theme will be "America First" as officials focus on supporting the US economy, often to the detriment of others. At the extreme would be Trump's threatened 60% minimum tariffs on all Chinese products and 10-20% on all other countries. Trump has also promised a hard immigration crackdown and mass deportations of illegal aliens. In any scenario, there will be additional tariffs and a reduction in immigration but we are hopeful that the most extreme levels will not be reached. Our base case is for some additional tariffs, especially against China, but with more transactional trade deals being agreed with other countries. However, this view is more due to our hopes that the new administration will be rational and act similar to that of Trump 1.0. This is by no means guaranteed and we would not be surprised by a move towards the more extreme scenario. Governments around the world are waiting to see what the actual policies will be and are forming strategies for how they will respond. Financial markets, as well, will be highly impacted by these policies and this will be one of the key areas of focus for investors heading into 2025.

Are Artificial Intelligence and Crypto changing the world?

Since the release of ChatGPT in 2022, Artificial Intelligence based on large-language models (LLM) has been a focus area for companies, governments and investors. Hundreds of billions of dollars have already been spent by large technology companies in building out their AI capabilities and the spending looks to continue increasing. While the future is undeniably one where AI will be integrated into everyday life, key questions have yet to be resolved. It is unclear if or when the large technology companies will be able to make a sufficient return on these immense investments to justify the expenditure. From a macroeconomic perspective, the question is whether AI can increase productivity, just as the advent of the Internet did in the 1990s. If so, it could lead to higher economic growth with lower inflation, the ideal situation for economies which are facing slowing growth and stubbornly high inflation.

Bitcoin has recovered from the $15,500 level at the end of the "Crypto winter" of 2022 and has surpassed $100,000, including a nearly 50% rise just in November. This marks a significant shift in investor perceptions of cryptocurrencies from fringe investments to viable alternative investments. The election of Trump and a likely crypto friendly administration could shift perceptions even further. Trump has stated that he wants to make the US the "Crypto capital of the planet" and he wants to create a national Bitcoin reserve. Such a move would have far reaching implications for global finance. We believe other countries would start establishing similar national reserves and the buying pressure could drive the price of Bitcoin up even further. Also, if the US government were to back Bitcoin, this would open the door for institutional investors and others to adopt Bitcoin and cryptocurrencies as legitimate assets in their investments.

China faces challenges beyond tariffs

China's immediate focus will be on the results of the US Presidential election and what a Trump win means for tariffs on Chinese trade, but there are also structural issues which will limit China's growth in the medium to longer-term. A weak housing market is one of the largest domestic challenges and could drag the economy to much lower growth. However, we believe the government will do whatever is necessary to avoid an economic collapse as there is still room to expand central government debt to provide economic stimulus. It has already announced several policy adjustments to support the economy while further stimulus should be approved in 2025. The government's longer-term challenge is to increase productivity in the economy to offset population declines in order to improve the growth outlook. However, moves by the government so far do not suggest fundamental changes to the underlying economy are likely, so we believe the longer-term growth outlook remains weak.

High geo-political risks and economic fragmentation will continue

Last year we highlighted the wars in Ukraine and Israel/Gaza as significant geo-political risks. Since then, the situation has deteriorated even further with Ukraine taking territory within Russia and North Korean troops reportedly fighting alongside Russia troops. In the Middle East, Israel has expanded its war as it battles directly with Hezbollah in Lebanon and trades drone and missile volleys with Iran. And just recently, Syria's long civil war took a dramatic turn when rebel forces made rapid advances and forced Syria's President Bashar al-Assad to flee to Russia. The power vacuum in Syria could lead to further instability in the region. Trump has claimed he will end the war in Ukraine in one day and bring peace to the Middle East. We doubt this will be the case immediately but are hopeful that some fair resolutions are achieved. Investors should not be surprised if other conflicts arise in the future leading to spikes in market volatility as they occur.

Protectionist trade policies, economic competition, and outright military conflicts mean fragmentation of global trade into multi-polar trading blocs will continue. Depending on the Trump trade policies, this could accelerate and fragment further with the US increasingly pursuing an America First strategy. Overall, this means less efficient economies, lower economic growth and higher inflation on a global scale as global supply chains are fragmented. However, the fallout will be uneven with some countries benefiting while others lose out. Geographic and sector level investment will thus become more important in the coming years as this trend continues.

In search of terminal rates

The outlook for central bank rates remains volatile as inflation remains stubbornly high while economic growth prospects are uncertain. For the US, the situation is especially complex. Economic growth has remained strong and inflation seems to be steadying in the 3% range rather than continuing down to the 2% target. The US election results complicate things further as policies Trump has favored are all inflationary to some degree. A sharp increase in tariffs would indicate a jump in inflation but it could also mark the start of a global trade war which we believe would inevitably lead to a global recession. The US Fed (and other central banks) would respond with rate cuts as the economic slowdowns became apparent. Limited tariffs combined with tax cuts and deregulation could result in stronger economic growth but also higher inflation which could force the US Fed to raise rates somewhat in the medium-term. Rate path and terminal rate expectations may remain fluid in the coming months as the Trump administration comes to power and reveals its economic policies and priorities. We expect the Fed to cut rates by 0.25% in its December meeting and then a further 0.50% in the first half of 2025 and then pause as it assesses the path of inflation.

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