19 December 2024

Outlook 2025 (IV): Summary for the capital market 2025

Just before Christmas, the US Federal Reserve threw a little spit in the markets' soup at its December 18th interest rate meeting, reminding us that scenarios that were thought to be certain sometimes have to be revised. This can also be interpreted as a reminder to always exercise a certain amount of humility when making capital market forecasts. For this reason, we do not want to claim that our price targets and scenarios are set in stone in this, the final installment of our capital market outlook for the coming year. Outlooks and scenarios can only ever indicate the framework within which developments are highly likely to take place - no more and no less.

But first back to the last Fed meeting of the year: on the surface, the Fed delivered exactly what was expected - the market was in agreement that the Fed would cut interest rates by 0.25% to between 4.25% and 4.5%, and that is exactly what happened. However, irritation was caused by the fact that the Fed's outlook had changed. In anticipation of an aggressive tariff policy by the incoming Trump administration, the Fed had raised its inflation expectations for 2025 and pointed out that interest rate cuts would no longer be automatic from now on, especially as a neutral interest rate was not far away. From the combination of various statements by Fed Chairman Powell and the Fed members' infamous “dot plot”, it can be deduced that the Fed considers two interest rate cuts of 25 basis points each in the coming year to be appropriate and realistic. This should not really have come as a big surprise. Without wishing to sound too know-it-all, we would like to point out that this is in line with the US policy scenario we have been advocating for some time. The reasoning behind this is not rocket science, but actually quite logical: the US Federal Reserve must assume that inflation is likely to pick up again against the backdrop of rising tariffs; at the same time, US economic growth will be so positive that supporting monetary policy with low interest rates does not seem necessary. In addition, the central bank needs to prove its independence right now - this can only be done by driving in stakes right away and not announcing a major interest rate cut in anticipatory obedience, which Trump would certainly have been very pleased about.

Be that as it may, the majority of the market obviously did not have this Fed behavior in mind and more or less fell out of bed when the Fed outlined its interest rate path for the coming year. As a result, (implied) volatility on the stock markets exploded, while share prices fell sharply. Does this change our main scenario for 2025? The short answer is no. We are still moderately optimistic about the equity market, although we still expect slightly greater performance potential in the USA than in Europe. However, we are concerned about the extreme concentration on the stock markets. Very few stocks are increasingly determining the performance of entire indices, and it is objectively difficult for active asset managers to find an adequate response here. A few days ago, we calculated that more than 75% of conceivable portfolio structures in international equity portfolios have underperformed the benchmark since the beginning of 2020, and this trend has been even more pronounced in recent weeks. This effect is amplified by inflows into ETFs, which in turn have to invest the largest sums in the already largest companies. This development is definitely not an eternal one-way street, but there is no reason to assume that this trend will change substantially and abruptly in the coming year. However, it would be plausible to assume that under Trump and in the context of the planned deregulation and further tax cuts, medium-sized companies are likely to benefit disproportionately, so that 2025 could perhaps go down in the history books as the year in which the extreme dominance of very large companies began to come to an end.

On the bond side, we firmly believe that the ECB will have to cut key interest rates significantly more than in the US in the coming year and will hopefully find the courage to do so. However, this should not leave any major traces at the long end of the maturity spectrum. We assume that German government bonds with a remaining term of ten years will be quoted slightly below the current yields of around 2.3%, and ten-year US Treasuries in the USA are also likely to be marginally below the current level of 4.5%. Furthermore, we do not expect spreads on corporate bonds to change massively relative to the status quo.

This suggests that 2025 will be a comparatively calm year on the capital markets. Unfortunately, the catch is that capital market assessments are sometimes overlaid by developments that cannot be easily grasped using traditional analytical approaches. These include, for example, assumptions about the extent to which future changes in productivity growth are priced in. In principle, it can be said that labor productivity and total factor productivity (which indicates how “intelligently” the factors of production are used) are not subject to major fluctuations from year to year. However, there are phases in which productivity systematically increases faster over several years than the long-term average. If there is a consensus in the market that we are in such a phase, this inevitably leads to higher and rising valuation levels, which are not evidence of a bubble, but of a favorable economic fundament. From our perspective, it could be argued that we are at the beginning of such a phase, and the reason for this lies in the rapid progress of AI technologies. In recent years, additional value has been created, particularly by companies that develop and sell AI tools. In the meantime, artificial intelligence capabilities have reached such a level of maturity that productivity effects should now be visible across the economy. 2025 will probably also be the year in which AI systems in the economy begin to be able to take decisions themselves instead of supporting decision-makers in their decisions. In the coming years, we will witness how entire professional fields will change dramatically. Many activities can be carried out by fewer people, who can then be deployed in other areas in a very value-adding way against the backdrop of demographic developments and a shortage of skilled workers. In the USA, growth is already above the trend of recent years - perhaps this is the first harbinger of this development. If our assumption is confirmed, then despite all the uncertainty and respect for the markets, there is even additional upside potential, even if we will probably have to get used to fundamentally higher volatility again.

In addition to this particularly favorable scenario, however, it should not be forgotten that crisis scenarios are also conceivable in 2025 that deviate from our main constructive scenario. One example would be the collapse of the Ukrainian defense forces. Should Russian troops succeed in breaking through the front at several points, a military domino effect would be conceivable, as a result of which massive and very rapid territorial gains by Russian troops could be expected. This would mean that Russia would not be prepared to start peace negotiations. Quite the opposite - all available resources would be mobilized to create facts and permanently occupy large parts of Ukraine. The result would be a second major wave of refugees and a significantly tense geopolitical situation. Such a situation would not leave the capital markets unscathed. However, as Christmas is always a time of hope, we do not want to end our outlook with negative thoughts. Experience shows that markets recover more quickly than we often imagine, even after a low point. A good dose of basic optimism is therefore always appropriate. With this in mind, we wish you a Merry Christmas and all the best for a successful and healthy New Year!

Dr. Christian Jasperneite

Market data

Stock marktes	As of 20.12.2024 10:44	Change versus 13.12.2024 -1 week	19.11.2024 -1 month	19.09.2024 -3 months	19.12.2023 -1 year	29.12.2023 YTD
Dow Jones	42342	-3,4%	-2,1%	0,8%	12,7%	12,3%
S&P 500	5892	-2,6%	-0,4%	3,1%	23,6%	23,5%
Nasdaq	19373	-2,8%	2,0%	7,5%	29,1%	29,1%
DAX	19733	-3,3%	3,5%	3,8%	17,9%	17,8%
MDAX	25231	-4,9%	-3,3%	-3,9%	-7,1%	-7,0%
TecDAX	3396	-3,6%	2,5%	1,7%	1,9%	1,8%
EuroStoxx 50	4817	-3,0%	1,4%	-2,6%	6,3%	6,5%
Stoxx 50	4272	-2,7%	0,6%	-4,3%	4,8%	4,4%
SMI (Swiss Market Index)	11279	-3,5%	-2,3%	-6,5%	1,2%	1,3%
Nikkei 225	38702	-1,9%	0,7%	4,2%	16,5%	15,7%
Brasilien BOVESPA	121188	-2,7%	-5,5%	-9,0%	-8,1%	-9,7%
Indien BSE 30	78196	-4,8%	0,8%	-6,0%	9,5%	8,2%
China CSI 300	3928	-0,1%	-1,2%	22,9%	17,8%	14,5%
MSCI Welt	3696	-3,2%	-1,1%	0,2%	17,2%	16,6%
MSCI Emerging Markets	1082	-2,3%	-1,2%	-1,7%	8,3%	5,7%
Bond markets						
Bund-Future	133,91	-73	158	-41	-349	-331
Bobl-Future	118,10	-20	-53	-151	-96	-118
Schatz-Future	107,11	3	34	16	74	56
3 Monats Euribor	2,85	1	-16	-60	-107	-106
3M Euribor Future, Dec 2024	2,86	1	3	-15	46	56
3 Monats $ Libor	4,35	1	-27	-45	-108	-105
Fed Funds Future, Dec 2024	4,47	-1	-5	15	48	64
10 year US Treasuries	4,56	16	16	84	63	69
10 year Bunds	2,31	6	-3	18	32	31
10 year JGB	1,06	2	0	20	41	44
10 year Swiss Government	0,28	3	-14	-20	-37	-42
US Treas 10Y Performance	590,96	-1,3%	-1,0%	-5,6%	-1,1%	-1,7%
Bund 10Y Performance	566,92	-0,5%	0,5%	-0,4%	0,2%	0,3%
REX Performance Index	454,38	-0,2%	0,4%	0,2%	1,0%	1,5%
IBOXX AA, €	2,99	9	-3	-5	-12	-8
IBOXX BBB, €	3,41	8	-7	-14	-40	-34
ML US High Yield	7,64	25	20	42	-30	-15
Commodities						
MG Base Metal Index	406,17	-2,9%	-1,9%	-4,5%	5,8%	3,9%
Crude oil Brent	72,16	-2,7%	-1,0%	-3,7%	-9,1%	-7,1%
Gold	2605,04	-2,2%	-0,8%	0,9%	27,5%	26,1%
Silver	28,90	-5,2%	-7,3%	-7,0%	19,9%	19,2%
Aluminium	2464,10	-4,0%	-5,9%	-2,6%	11,6%	5,1%
Copper	8770,41	-1,9%	-2,2%	-6,6%	3,2%	3,6%
Iron ore	104,08	-1,2%	2,1%	13,1%	-22,7%	-23,7%
Freight rates Baltic Dry Index	976	-7,1%	-40,0%	-50,6%	-56,0%	-53,4%
Currencies						
EUR/ USD	1,0379	-1,3%	-1,9%	-7,0%	-5,3%	-6,1%
EUR/ GBP	0,8303	-0,2%	-0,7%	-1,1%	-3,7%	-4,2%
EUR/ JPY	162,64	0,7%	0,0%	1,9%	2,8%	4,0%
EUR/ CHF	0,9300	-0,9%	-0,3%	-1,7%	-1,8%	0,4%
USD/ CNY	7,2993	0,3%	0,8%	3,2%	2,5%	2,8%
USD/ JPY	157,45	2,5%	1,8%	10,4%	9,5%	11,6%
USD/ GBP	0,80	0,9%	1,4%	6,0%	1,9%	2,0%

Source: Refinitiv Datastream

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