Zuger Kantonalbank

Review & outlook

January 2025

Review of 2024

Positive start to the year

2024 got off to a good start for equity investors. US economic data raised hopes of a soft landing, while inflation remained stable. In Switzerland, declining rates of inflation temporarily removed some of the heat from the foreign exchange markets in the first quarter of the year. Economic data from the US remained predominantly positive, while in Europe the process of normalisation continued at a low level. In addition, the labour market proved persistently stable, which had a positive impact on consumer sentiment. We positioned ourselves for a constructive growth environment with falling rates of inflation, and increased equity exposure further in the first half of the year. Aside from a few minor adjustments, we stuck to this positioning throughout the year.

Subdued global growth environment

The global economy grew at a modest rate overall in 2024. In its October forecasts, the International Monetary Fund (IMF) reiterated its prediction that the global economy would maintain a consistent growth rate of 3.2% in 2024 and 2025, which is on a par with growth in 2023. This figure is below the historical average of 3.8% recorded over the period 2000–2019. In addition, growth was spread unevenly from a geographical perspective: while Asia and North America remained stable, Europe and Latin America struggled in the face of challenges.

Inflation declines without accompanying recession

The most significant development in 2024 was without doubt the taming of inflation. According to the IMF, this fell globally from the peak of 9.4% recorded in the third quarter of 2022, and is predicted to be 3.5% by the end of 2025. If so, this would actually put inflation slightly below the average level recorded over the two decades prior to the outbreak of the COVID pandemic. This decline was facilitated by more stable energy prices and improvements to supply chains. Moreover, the decline in inflation occurred without any accompanying slide into recession.

> “US technology stocks clearly dominated global equity markets. Central banks embarked on a new rate-cutting cycle globally, which worked to the benefit of bond investments.”
>
> Alex Müller, Chief Investment Officer

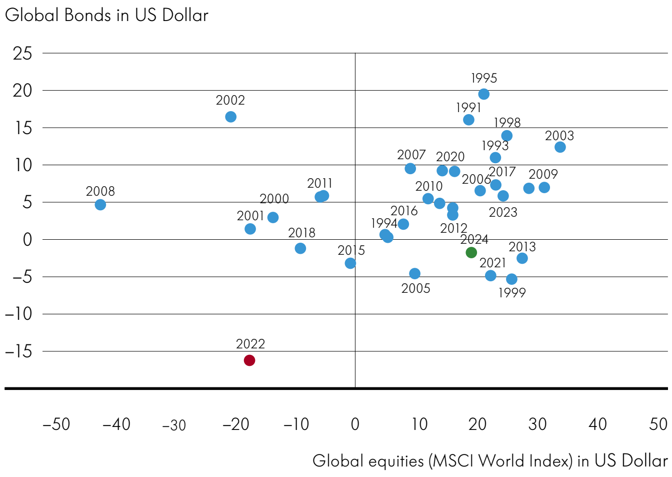
US economy resilient

In the US, growth weakened somewhat as the year progressed. On an annualised basis, US economic output grew by 2.8% in the third quarter, down slightly from 3.0% in the second quarter. Once again, it was consumer spending that made the greatest contribution to growth. The data revealed two things: firstly, that the US economy had lost some momentum and, secondly, that the US was not sliding into recession. Both government spending and consumer expenditure played a supportive role. Wage costs rose less sharply than in previous quarters and the unemployment rate remained low, which testifies to the adaptability of the US economy.

SNB acts as “first mover”

In Switzerland, the inflation rate surprised on the positive side right at the start of 2024, amounting to 1.3% in January, which was within the SNB’s target bandwidth. This pleased the markets, which had expected a rate of 1.7%. The strong franc had the effect of mitigating inflation imported through higher commodity prices. The SNB therefore reduced the key interest rate by 0.25 percentage points in March, June, and September. Finally, in December, it lowered the rate again by 0.5%. Over the year as a whole, the Swiss economy drew support from the services sector, whereas manufacturing put in a lacklustre performance in keeping with the ailing European economy.

Performance equities vs. bonds (in percent)



Source: Zuger Kantonalbank, MSCI

ECB in supportive mode

The European Central Bank (ECB) cut interest rates four times in 2024 starting in April. As in other regions, the sharp decline in inflation gave the ECB the freedom of manoeuvre to pursue their plans. ECB President Christine Lagarde stated that the mission to bring inflation rates under control is on the right track. This helped European stock markets make further advances, despite the subdued economic environment. Relatively low equity valuations and hopes of brighter economic horizons stimulated the buying mood among investors.

Fed delivers

This interest rate trend reversal was initiated in the US, too, in 2024. Inflation momentum picked up only briefly in the summer. When combined with higher oil prices and rising interest rates, this made equity markets nervous. The US Federal Reserve subsequently lowered the key interest rate in September for the first time since 2020, by 0.5 percentage points. This was followed by another rate cut of 0.25% in December.

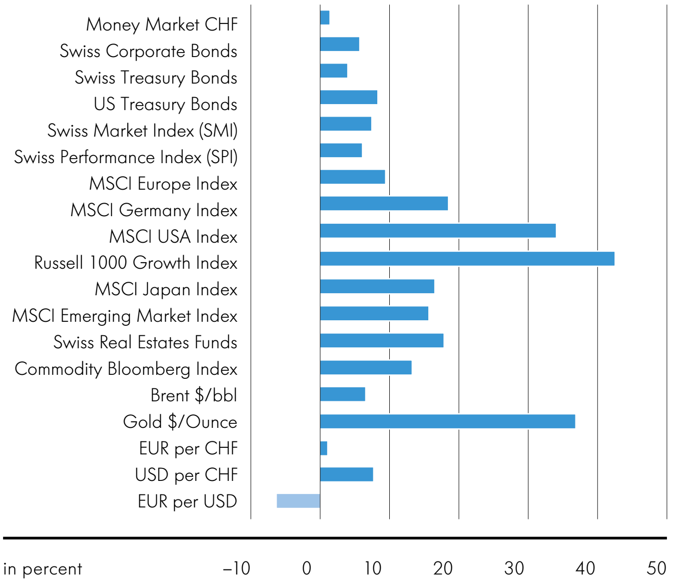
Turbulence on the political front

"Political markets are short-lived" is an old stock market adage. In other words, markets typically recover quickly after political turmoil. That said, the current geopolitical conflicts look to be more complex than their predecessors, and are having a deeper impact. The election of Donald Trump as the next US president will shape the economic policy and geopolitical direction of the United States for the next four years. This in turn will have an impact on financial markets. A lack of unity and ability to forge a consensus, which characterises many governments in Europe at the moment, was particularly apparent in the collapse of the "traffic light" coalition government in Germany. Unfortunately, it does not look like fresh elections will deliver a wave of reform. France is now also facing problems in its executive branch. At the same time, the major source of stimulus for global export activity – China – continues to falter. Here, the real estate crisis and weak economic growth are weighing on the confidence of investors. In the Middle East too, there was no evidence of any improvement in the situation at the turn of the year.

Remaining invested proved worthwhile once again in 2024

The events of the last 12 months have once again brought it home to investors that a broadly diversified portfolio offers good protection in times of political uncertainty and general market turbulence. As we have explained, the global economy managed to deliver growth once again in the second half of 2024, the US successfully avoided a recession and corporate earnings continued to rise. This backdrop clearly worked to the benefit of investors. This is our starting point for 2025.

Return Asset Class (in CHF) year to date (as of 30.12.2024)



Source: Zuger Kantonalbank, Bloomberg L.P., MSCI, SIX Index AG, Frank Russell Company

Outlook for 2025

Differences in the pace of global growth

As set out above, global economic growth will again prove modest in 2025, with varying rates between the regions. Whereas the US continues to grow robustly, benefiting from a strong labour market, Europe is lagging behind in terms of economic development. China's recovery is likely to be slow, with the trajectory of the upturn heavily dependent on fiscal measures taken in Beijing and the degree to which the real estate market stabilises.

"Trumponomics" to feed through with a time lag

The term "Trumponomics" is basically used as a catch-all term for the various measures that will be taken by the new administration as it focuses on "America First": lower corporate taxation rates, tighter restrictions on immigration, the removal of various regulations, and the introduction of tariffs on imported goods. Against a backdrop of Republican dominance in US politics, the following narrative came increasingly to the fore at the end of the year: higher inflation, more restrictive monetary policy, and thus weaker growth. Will that prove to be accurate?

> "2025 is upon us: the new investment year once again presents opportunities for mixed investment portfolios. The different regions of the world will grow at different tempos in the new year. This calls for an active positioning, which includes taking account of dynamic developments on the geopolitical front. The global economy will grow in 2025 too, an argument in favour of equity exposure."
>
> Alex Müller, Chief Investment Officer

2025 a defining year for the US economy

In our view, this linear line of argumentation is likely to be only partially correct. There is no doubting that 2025 will be a key year for the US. The economy is growing and can be expected to enjoy a further tailwind in 2025 thanks to supportive policy. The broad direction of the Trump administration appears to be clear, but the precise repercussions are more difficult to evaluate. The extent to which Trump's policies will drive up rates of inflation in the US and potentially push the Fed off its rate-cutting path is unclear. Investors will therefore have to adapt to changing parameters dynamically in 2025.

US equities still attractive

US equities remain a preferred asset category as 2025 gets underway. Both growth and the framework parameters look good. Technology stocks will continue to benefit from the ongoing theme of artificial intelligence and will be boosted by lower interest rates. We believe US equities will remain popular with investors against this background. We are recommending an overweighting of US equities once again as the new year gets underway.

European economy growing slowly

Europe's economies are likely to remain dogged by subdued growth in 2025. The leading indicators for both the manufacturing and services sectors proved very weak at the year-end. Accordingly, the economic headwinds facing the EU are showing little sign of abating even after several disappointing quarters. We are not expecting a wave of reform and deregulation in Europe (and in Germany in particular), despite the collapse of Germany's traffic light coalition and the European elections in 2024.

European equities

This said, attractive valuations and less restrictive monetary policy could provide equity markets with further support. We are expecting a further normalisation in sentiment. Consumer confidence is on the rise, even though its development is proving volatile. Real wages are rising against a backdrop of declining rates of inflation. Savings rates will probably decline. Despite choppy waters, European equities should continue to play a role in the portfolio.

China's slow recovery

China's economy will probably slowly recover, driven by government stimulus measures. However, the real estate sector remains an Achilles heel, and structural challenges such as an ageing population and weak exports could hold back growth. Consumer sentiment remained subdued at the year-end. Here too, the nature of the fiscal measures to be taken by China remains to be seen.

Switzerland takes its cue from elsewhere

The Swiss economy is being influenced by global developments. Swiss equities and bonds continue to offer stability, supported by competitive companies and moderate inflation. Swiss government and corporate bonds are benefiting from low rates of inflation and stable ratings. Given the global rate-cutting cycle, these investments should continue to deliver positive returns while posing relatively little risk. Moreover, by focusing on Switzerland the investor can avoid the high cost of hedging foreign currencies.

Interest rates continue to decline

We believe central banks will continue their rate-cutting cycle in order to support growth and ensure alignment with the decline in inflation. This is creating a favourable environment for risk assets for the time being. For its part, the Swiss National Bank (SNB) is likely to keep its interest rate policy flexible in order to keep tabs on inflation and above all the development of the franc.

Tightening of strategic positioning

Against this backdrop, we have carried out a comprehensive review of our strategic asset allocation. As a result, we have increased our weighting of Swiss bonds as well as our gold exposure. Where equities are concerned, Switzerland and the US remain our core markets, with a slightly smaller quota allocated to Europe and the emerging markets. This allocation reflects our view of 2025.

Gold as additional portfolio element

Gold will remain a key asset in 2025, supported by a number of key factors. Geopolitical risks – including tensions in the Middle East, the Russia-Ukraine conflict and possible conflict between China and Taiwan – are driving up demand for gold as a safe haven. Central banks all around the world are increasing their gold holdings, particularly to diversify their dollar reserves, a phenomenon further strengthened by growth in the emerging markets. Despite the perception that gold is rather expensive given the current level of real interest rates, any normalisation of real yields could provide a further tailwind for the gold price, as the negative correlation between real interest rates and gold should hold over the longer term.

Fragmentation and geopolitics

The geopolitical landscape remains fragmented, dominated by conflicts such as those in the Ukraine and the Middle East, along with the ongoing rivalry between the US and China. This fragmentation is affecting trade routes, supply chains and investments. Quite how the Ukraine war will develop in 2025 remains to be seen. But what is apparent is that Europe will have to position itself even more clearly on this issue over the coming year. We believe the pressure will persist, and not just from the US but also from Moscow.

The advice for 2025 is once again to stick to a steady course despite rough seas. What does this mean for investors? Remain invested and take advantage of the opportunities arising in the financial markets. A robust and broadly diversified investment strategy is the best recipe for success.

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