PRINCIPAL

Investment Report Q1 2025

Prelude to a new era in the financial markets

At the beginning of the 4th quarter, investors eagerly followed the US presidential elections. Relieved by the unambiguity of the result, the prices of risky asset classes rallied at the beginning of November. Protecting the profits by mid-December, a revision of the policy forecast by the US Federal Reserve marked a temporary phase of consolidation. At the end of the year, financial markets were quite volatile.

In the 4th quarter, global equity markets retreated by -1.22%. Upon closer examination, however, a diverging picture is revealed. While US equities in the form of the S&P 500 index continued to show new all-time highs (+2.07% in USD), European stocks (-2.09% in EUR) and Asian emerging markets gradually lost value (-7.89% in USD). With regard to investment styles and sectors, cyclical and large-cap growth stocks as well as consumer discretionary, communication services and information technology stocks dominated the market. As a result, the observed market concentration has increased since the beginning of the year.

Similar to the movement in the global stock markets, bond prices fell (-5.60% in USD). Vice versa, the yields increased significantly, e.g. the yield of the 10-year US government bond rose by +78 basis points to 4.56%.

In the same period, gold marked a new all-time high at USD 2'788 per ounce at the end of October. However, among the remaining quarter, the precious metal relinquished its profits and was listed almost unchanged at USD 2'624 by the end of the year.

Resilience of the US economy

The US economy is very resilient. In the 3rd quarter, US GDP grew by an impressive +3.1% p.a. Thereby, 76% of the S&P 500 index companies exceeded earnings and 61% sales forecasts.

For the new term under the designated US President Donald J. Trump, experts expect a moderate slowdown of the US economy. However, growth surprises seem more likely than the emergence of a recession.

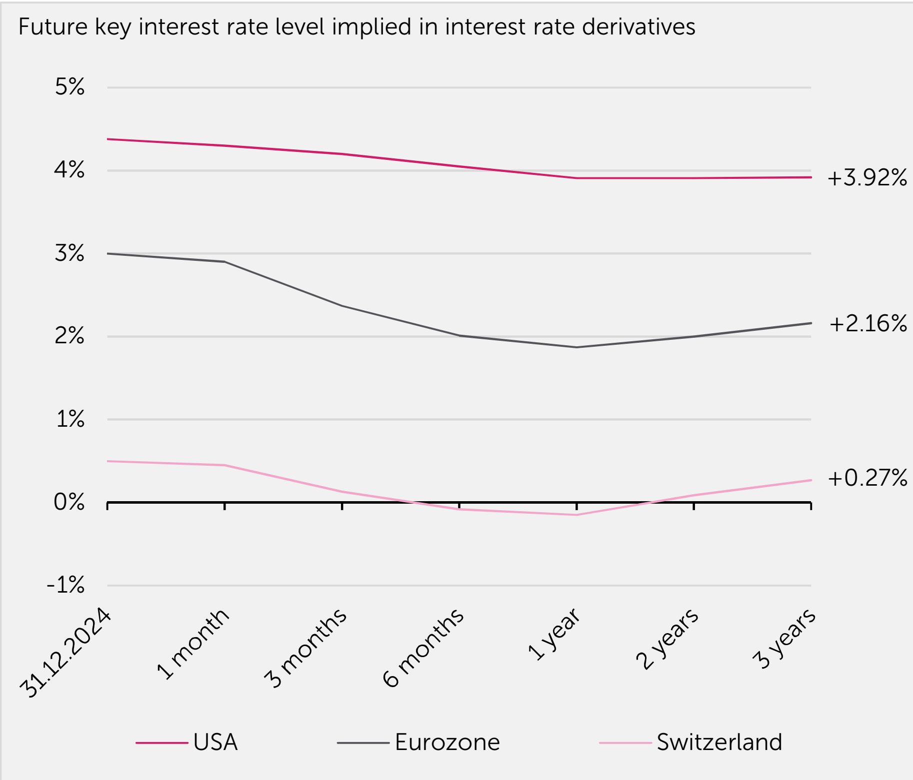
Revision of interest rate expectations

In December, the Federal Reserve cut the key interest rate for the 3rd time in a row to a range of 4.25% to 4.50%. Furthermore, it published its projection materials, revising expectations for the coming years. In September, the watchdogs signalled 4 rate cuts of 25 basis points each in 2025. In its latest forecast, however, the Federal Open Market Committee (FOMC) signals only 2 interest rate cuts for the new year. The Fed's reluctance was justified by the recent rise in inflation and the emerging uncertainty from the new Trump administration.

As a result, market participants revised their expectations. US interest rate derivatives imply 2 rate cuts for the coming 12 months, followed by two years of rate stability.

Our expectations of fewer interest rate cuts by the Fed appear to be coming true. With regard to long-term yields, we have revised our medium-term forecasts upwards, but still expect these to fall to a lower level in the long-term.

PROJECTED TRENDS IN KEY INTEREST RATES



Fragile growth in continental Europe

While the US economy is thriving, Europe is doing everything it can to prevent a stagflation. Eurozone interest rate derivatives are implying at least 4 interest rate cuts this year. If these expectations are fulfilled the euro is likely to depreciate against numerous currencies following the 'carry trade' theory. In anticipation of this movement, the Swiss National Bank (SNB) lowered its key policy rate by 50 basis points on 12th December. If the SNB continues to follow this path, it is likely that the Swiss policy rate will reach zero this summer. At the end of the year, negative interest rates could be observed.

Conclusion

Given the resilience of the US economy, we do not expect a market disruption in the coming weeks. However, a correction is always possible. For Europe, our optimism is limited. The new elections in Germany on 23rd February 2025 should result in a coalition consisting of CDU/CSU and SPD. With regard to the emerging markets, the situation should be considered differently. We believe that India and Vietnam should profit from the growing tensions between the USA, China and Europe.

Gold as proven portfolio stabiliser

Driven by the strategic gold purchases of Asian central banks to diversify their US dollar foreign exchange reserves, the gold price initially marked a new all-time high. Despite a consolidation over the last weeks, gold outperformed global equities in 2024. As part of our strategic asset allocation, the gold exposure fulfils the function of a stabiliser in the event of geopolitical tensions. In the current macroeconomic environment, we maintain a high weight of the precious metal within the portfolios.

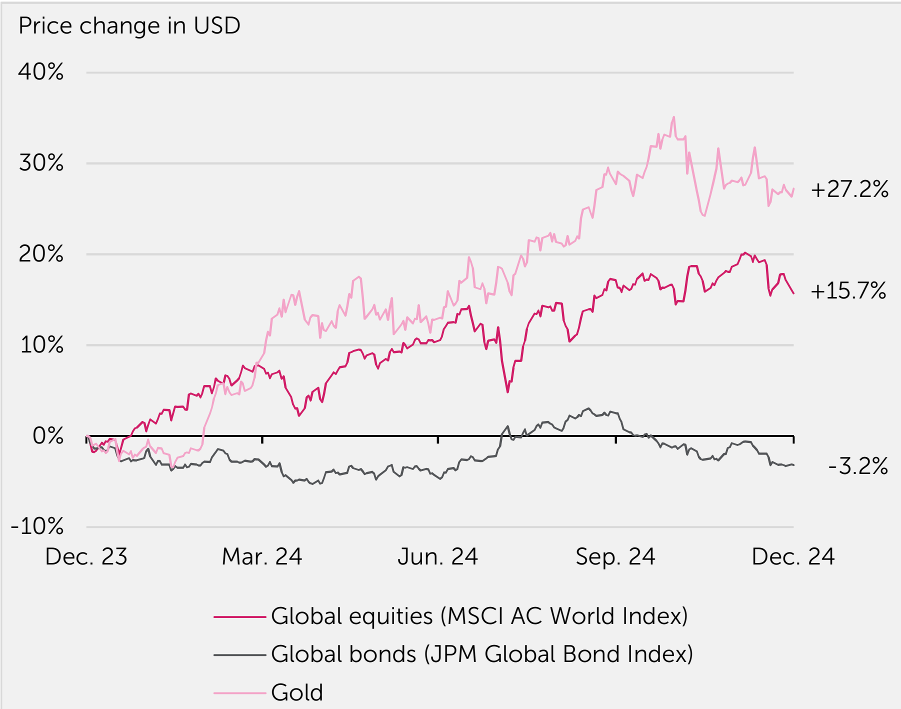
Current insights into portfolio management

Managed portfolios benefited in the 4th quarter from a high allocation to US equities and the underweight of stocks of the Eurozone. As in the 1st half of the year, the implemented capital-weighted passive investments in US equities and investments in large-cap growth companies as well as the sectors communications services and information technology showed a significant outperformance against the global stock market. The investment managed by a quantitative approach to selecting US sectors also continued the positive price trend unabated.

Against the backdrop of the narrowed market breadth, the secular investment themes energy and health science as well as the equal-weighted US equity investments participated little in the rising US stock market in the 4th quarter. Additionally, investments in India and Vietnam lost some of their gains.

Given the resilience of the US economy and the new US administration's announced stimulus, we are adhering to our accentuated allocation of US equities in the managed portfolios.

PERFORMANCE OF VARIOUS ASSET CLASSES IN 2024



Maintaining the overweight in the US Dollar

At the end of September, the US dollar index had successfully tested the support at the lower end of the trading range and was able to appreciate against the euro and Swiss franc by +7.5% and +7.3% respectively. We expect the high interest rate differential from the USD to the euro and franc to widen further in the near future.

Longer duration of euro bonds

Given the announced economic stimulus of the Trump administration, we believe that a positive growth surprise in the US is more likely than a recession. Therefore, we took advantage of the decline in US long-term yields at the beginning of December and reduced exposure to long-dated USD bonds. We are focusing on actively managed short-duration corporate bond investments and made an investment in the Pilatus Invest Income Fund in the 4th quarter. This fund invests in high-quality corporate bonds.

Given the prevailing economic stagnation and deflationary tendencies in the Eurozone, we will remain invested in longer dated liquid euro bonds, which provide protection in the event of increasing growth concerns or fears of a recession. In the managed portfolios, our bond investments outperformed the global bond index in 2024.

Special topic: Implications of the US presidential election

Unrestricted use of power against the time

As the 47th President of the United States, Donald J. Trump will be sworn in on 20th January 2025. With the 'red sweep' in Congress, i.e. a majority of Republicans in the House of Representatives and the Senate, it will be possible for the designated US President to fulfil many electoral promises. The main legislative changes are likely to be introduced in the first two years with the support of Congress. In the course of the 'midterms', the entire House of Representatives and one third of the members of the Senate will stand for reelection as early as 3rd November 2026.

Potential winners from the US presidential election

One of the core aspects of Trump's electoral programme is the extension of the Tax Cuts and Job Act (TCJA). In addition, a further reduction in corporate taxes is planned from the current level of 21% down to 15%. If this plan is implemented, even if only partially, it will generate a massive tailwind for US equities. Moreover, deflationary tendencies resulting from a moderate slowdown in growth could justify further cuts in key interest rates. This should in particular boost the prices of small- and mid-capitalized stocks. Tax and rate cuts will primarily benefit companies from the growth segment and the IT and communications sectors. Deregulations also favours banks, insurance companies and hedge funds as well as cryptocurrencies.

Potential losers from the US presidential election

However, the change of power in the White House does not favour all companies. Together with the economic slowdown, the granting of new oil production rights and the construction of extensive pipelines should reduce the price of crude oil and natural gas. Whether the product of the increased volume and lower price level will exceed current sales depends on numerous other factors.

With the nomination of the coronavirus anti-vaxxer Robert F. Kennedy Jr. as Minister of Health, the introduction of a price ceiling for many drugs is considered a certainty. This will benefit consumers on the one hand, but will put pressure on company profits on the other hand. As a logical consequence, shares in the pharmaceutical industry are unlikely to garner investors' favour in the coming months.

The control of the yield curve

For the 2nd half of 2025, we expect the trade war between the USA, China and Europe to intensify. In combination with an expansionary, debt-financed fiscal policy, this is likely to result in a renewed increase in inflation. The growth in government debt and rising inflation rate imply a higher level of long-term US government bond returns. At the front end of the yield curve, it ties the Fed's hands with regard to further rate cuts. Rather, the Federal Reserve, as a 'buyer of last resort', is likely to reduce long-term yields by a new 'quantitative easing' programme and, following the example of the Bank of Japan, control the steepness of the yield curve.

In view of falling real interest rates, high geopolitical risks and strategic ambitions of different emerging market countries, we also expect a further rise of the gold price.

Depreciation of the US dollar supports US exports

For more than 40 years, the monetary value of imports into the USA has exceeded that of exports. In literature, this imbalance is referred to as a trade deficit. The growing US trade deficit was already a thorn in Donald Trump's side in his 1st term in office. During this period, the US dollar lost more than -10% in value. The announced trade policy points in a similar direction. In our view, the US dollar is more likely to depreciate than strengthen in the coming years.

Conclusion

Donald Trump's 2nd term in office opens up numerous opportunities in financial markets. We believe that US equities, in particular small- and medium-caps as well as growth stocks and shares in the IT, communications and financial sectors, will benefit the most from the protective US policies. Furthermore, we expect lower yields in the bond market in the long term as well as a further rise of the gold price.

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