

Investment Views

January 2025

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A Year Defined by Technology and Politics

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Resilient Growth Amid Monetary Easing

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America First

A Year Defined by Technology and Politics

- US election result echoes 2016
- Equities strongly outperform bonds
- AI to remain a key theme for 2025

The US election was a defining moment in another action-packed quarter to finish off an eventful year.

In many ways, the US election result shared similarities to when Trump won his first term. While the economic backdrop in 2016 and 2024 was very different, financial markets reacted to Trump's victory in a similar fashion. US bond yields rose (prices fell), US equities rallied and the US dollar appreciated. This capped a strong year for US equities, with positive returns in all four quarters. In total, the S&P 500 returned 25.0% over 2024. US equities were already outperforming global equities heading into the fourth quarter, but the election result proved to be a catalyst for further outperformance.



In 2016, Trump's victory was largely due to a lack of economic growth and opportunity, but in recent years inflation has been a more salient issue for voters. While inflation rates have fallen significantly from their 2022 peak, consumer prices have remained high. Wage growth has also moderated, but real wage growth turned positive last year (wages rose more than inflation). However, the cumulative impact of inflation has taken its toll on consumers. According to calculations by the Financial Times, for the first time ever, every governing party facing an election in a developed market last year saw their share of votes drop.

Trump's policy platform is an "America First" agenda, which has several pillars, but is broadly seen as positive for economic growth. It is expected that the 2017 tax cuts, which are set to expire soon, will now be extended. The prospect of lower corporate taxes is beneficial for equities and makes the region a more attractive destination for investment, all of which has been positive for the US dollar. The Trump administration has also focused on deregulation, particularly in Energy and Financial Services, which is a tailwind for US growth and stock markets.

The two major risks for markets in the incoming administration's platform are tariffs and expanding the budget deficit to a degree that causes a detrimental rise in bond yields. Trump has a long history of believing that tariffs will benefit America and help counteract trade imbalances. Academic research on tariffs conclusively shows that consumers in the country imposing the tariffs ultimately bear the costs. However, some members of the administration believe that a stronger US dollar can offset the tariffs. This is true to a degree but leaves a lot of uncertainty around whether tariffs will be used as a negotiating tool or actually imposed in a meaningful way.

Global equity markets underperformed the strong US market in the first nine months of the year, but still saw healthy double-digit gains. The fourth quarter proved more challenging due to the result





STRATEGY

of the election. The risk of tariffs, more protectionist US policies, higher US rates, and a stronger US dollar weighed on overseas markets, especially Europe and Emerging Markets. Politics was also a theme outside of the US. The summer election in the UK brought a wave of optimism, but that dissipated in the second half of the year due to tax hikes and a downbeat economic message.

Another key market theme in 2024 was technology, specifically Artificial Intelligence (AI). The launch of ChatGPT in late 2022 sparked an investment super cycle in the technology enabling the new revolution. Nvidia has been the primary beneficiary as it sells the hardware (semiconductors) and software (computing platform). Other Mega Cap Technology stocks, such as Amazon, Google, Meta, and Broadcom also performed well. We are already seeing real-world benefits of AI, such as Walmart managing its supply chain and inventory. However, the market will look for more evidence next year that the technology spending can be monetised to justify the significant investments being made by technology companies.

It was a mixed year for Fixed Income, as sovereign bond yields rose (prices fell). At the short end of the yield curve, this was offset by coupon income, while longer-dated bonds saw losses. Gold recorded its biggest annual price increase in 14 years in 2024, soaring 27%. Gold has benefited from central bank buying and a fractured geopolitical backdrop. Gold traded sideways in the fourth quarter, but was more resilient than following Trump's previous victory, when it fell 12.8% in the fourth quarter of 2016.

Looking ahead, policy will be a key driver of markets in 2025. Attention will be focused on the extent to which the US cuts taxes and imposes tariffs, and the way in which consumers, business and other countries react to changes in US policy.

Resilient Growth Amid Monetary Easing

- Fed eases but US treasury yields climb
- Currency volatility spikes as dollar rallies
- High-yield credit spreads at tightest since 2007

The US Federal Reserve's (Fed) controversial decision to cut the federal funds target rate by 50 basis points (bps) in September set the tone, reinforcing market expectations of a prolonged easing cycle. This dovish shift, coupled with softening employment data, initially fuelled a sharp rally in bonds. However, the enthusiasm was short-lived as stronger-than-expected economic data—including steady wage growth and resilient consumer confidence—challenged the depth of the easing trajectory. By November, the market recalibrated its expectations, pricing in a 4% terminal rate, up from the lows of 3.25% earlier in the quarter. As a result, longer-dated yields climbed and the curve steepened, with the US 10-year Treasury yield surging nearly 80bps to close the quarter at 4.57%.



The move in yields was mirrored globally, albeit with regional variations. In Europe, German Bund yields rose as the ECB continued to signal further rate cuts amid lacklustre growth. Meanwhile, 10-year UK Gilt yields rose to 4.56%, reflecting concerns over stagflation and expansionary fiscal policy. Chinese government bonds rallied sharply, with 10-year debt falling 50bps to 1.67% as growth expectations collapsed, underscoring diverging monetary policy trajectories among major economies.

Geopolitical and fiscal developments added layers of complexity. The US election result temporarily unsettled bond markets before stabilising with the appointment of Scott Bessent as Treasury Secretary. His “3-3-3 strategy”—aiming to reduce the budget deficit to 3% of GDP by 2028, boost real GDP growth to 3% through deregulation, and increase US energy production by 3 million barrels per day—reassured investors. Markets also began pricing in deregulation and corporate tax cuts, which buoyed high-yield credit spreads to their tightest levels since 2007, at 253bps over Treasuries. The MOVE Index—a measure of bond market volatility—rose sharply prior to the US election, reflecting uncertainties around fiscal and trade policy, but ended the year at its long-term average, which led to tighter mortgage spreads.

Inflation expectations oscillated throughout the quarter. Short-term US breakevens surged as energy markets stabilised and US growth expectations recovered, with 2-year inflation breakevens climbing 78bps to 2.54%. However, long-term expectations remained reasonably anchored, suggesting confidence in the Fed’s ability to manage inflation. Commodities played a subdued role in shaping inflationary pressures. Natural gas prices surged amid seasonal demand fluctuations, while gold edged higher to \$2,641 per ounce on macroeconomic uncertainty. Copper, a barometer of industrial activity, also declined amid concerns over global growth. A modest recovery in WTI oil prices, following geopolitical tensions in the Middle East, had limited spill over into inflationary pressures, as weak demand from China offset supply-side risks.

Macroeconomic data painted a mixed picture, with pockets of strength offset by regional weaknesses. The Atlanta Fed GDPNow forecast for US growth remains above-trend at +2.5% in Q4,

supported by robust services activity and resilient consumer spending. In contrast, Europe continues to struggle, with the UK tipping into a near-recessionary environment and Germany grappling with stagnation. China’s economic indicators suggest a fragile recovery, spurred by targeted stimulus, but growth remained subdued relative to historical norms.

Currency markets experienced significant volatility, driven by the US dollar’s resurgence and a recalibration of global monetary policy expectations. The US dollar index soared and saw its strongest two-month streak in years. This strength was amplified by expectations of fiscal stimulus and higher tariffs under the incoming Trump administration, pushing the euro, pound, and Canadian dollar to new lows. Notably, despite hawkish monetary policy, the Australian dollar and Japanese yen faced very sharp declines.

As the quarter progressed, portfolio positioning in our US dollar bond funds reflected a cautious yet opportunistic approach. Duration was managed actively, with underweight positions reduced as longer dated US Treasury yields approached 4.5%, levels deemed attractive given prevailing growth and inflation dynamics. Inflation protection was pared back in favour of nominal bonds, while corporate credit exposure remained defensive, emphasising quality over yield. In currencies, our US dollar overweight was tactically trimmed, though it remained a core position, supported by fiscal and monetary tailwinds.

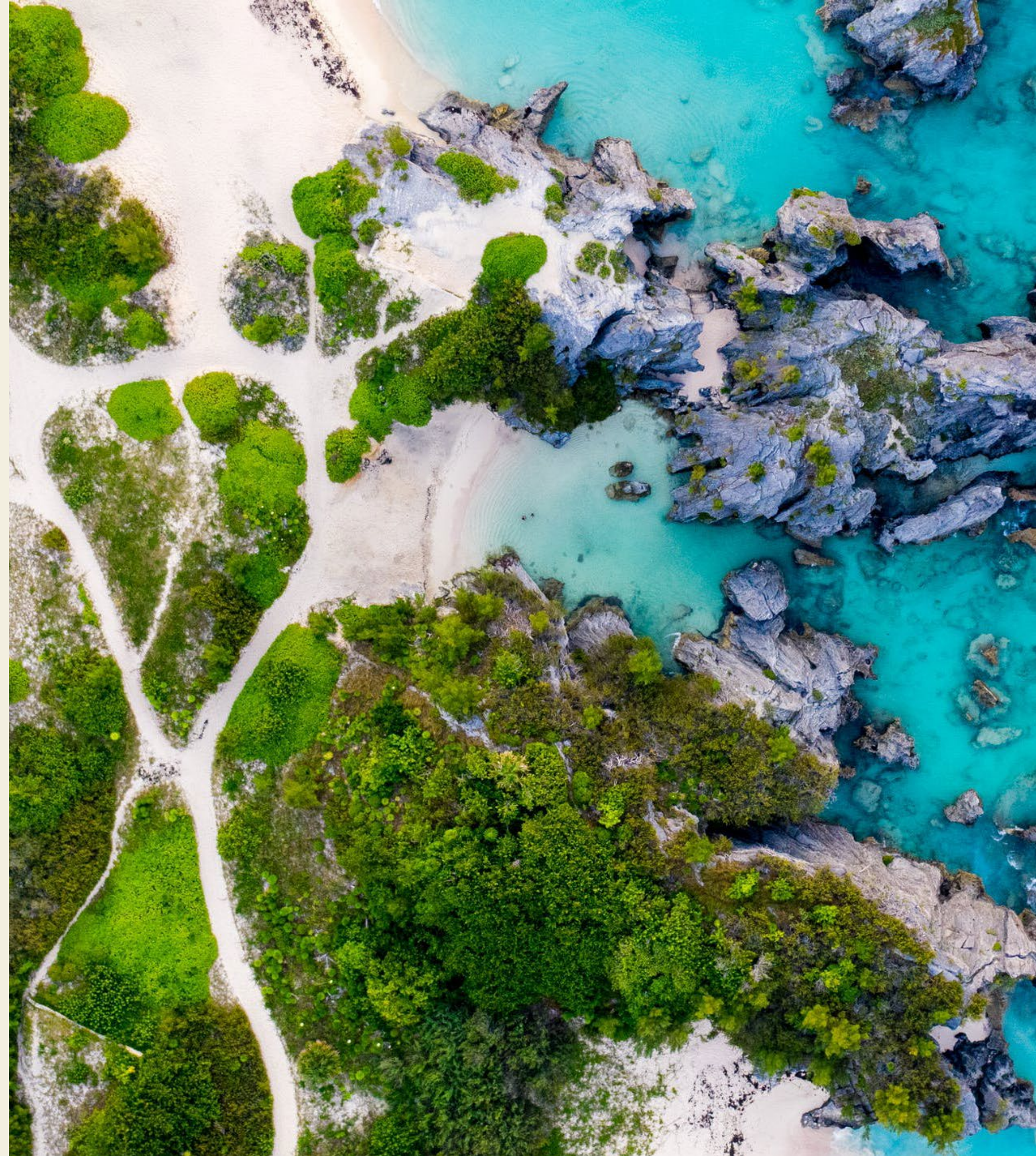
Looking ahead, the balance of risks remains delicately poised. The juxtaposition of easy financial conditions, elevated risk-asset valuations, resilient US growth, and a large fiscal deficit raises the spectre of a policy pause or even a hawkish pivot in 2025. Meanwhile, shrinking central bank balance sheets, geopolitical risks, and the potential for further currency volatility could challenge markets. Against this backdrop, maintaining a nimble and diversified approach will be paramount.

America First

- Very strong year for US equities
- Artificial Intelligence driving returns
- Stronger dollar and tariffs present headwinds for global equities

The MSCI World Index of global equities saw a flat return of 0.2% in the fourth quarter. Equity markets had a strong November, returning 4.6%, driven higher by US equities responding positively to the US election result, but experienced losses in both October and December. US equities significantly outperformed during the quarter, with the S&P 500 returning 2.3%, while the MSCI World Excluding the USA fell 7.4%. This was one of the largest quarters of outperformance for US equities versus equities outside the US in the last 30 years. The only two quarters with larger outperformance were during the Global Financial Crisis (third quarter of 2008) and the Asian Financial Crisis in late 1997.

The appreciation of the US dollar due to the election result created a challenging environment for Emerging Markets, which saw



weakness and significant dispersion. Country-specific factors, not just the US election, played a role in the varying returns. Equity markets in India and Mexico fell 11.3% and 10.6%, respectively, while equities in Brazil dropped 19.4% in US dollar terms over the fourth quarter. Equities in China, which have been moving more independently from global equities in recent years, held up a little better, but still fell by 7.7%. This followed a very strong third quarter for Chinese equities, as policymakers announced a range of stimulus measures to support both the economy and financial markets.

The incoming Trump administration introduces an uncertain environment for global trade, which is critical for many Emerging Markets. The extent to which tariffs will be imposed versus used as a negotiating tactic, remains unclear. Some countries are more exposed than others, with China particularly vulnerable due to bipartisan sentiment in the US favouring measures to reduce the trade deficit. Mexico is also exposed to potential tariffs and the renegotiation of existing trade agreements. Some countries are better positioned to counter these tariffs. For example, China can retaliate with export restrictions on critical materials, whereas Mexico may be more amenable to a constructive negotiation.

Turning back to the US, the S&P 500 returned 25.0% in 2024, marking the second consecutive year with returns greater than 20%. This is well above the expected long-term annual return for equities and is the first time since the peak of the Dot -Com bubble in 1998 and 1999 that the market has seen back-to-back annual returns exceeding 20%. Over the full year, 2024 earnings growth for US equities is estimated to be around 12%. Based on that, just over half of the US equity market return was due to earnings. Dividends accounted for around a 1.3% return, with the balance coming from higher valuation multiples; the forward price-earnings ratio rose from 19.8x to 21.8x over the year. Large -cap equities are expensive compared to their historical averages, but medium and small companies are less expensive.

25%

The percentage that the S&P 500 returned in 2024.

34%

The percentage that JP Morgan calculates the “Magnificent 7” will generate in earnings growth for 2024.

A major theme over the year was the outperformance of the so-called “Magnificent 7” stocks. These are very large, technology-oriented companies that have come to dominate the S&P 500. As of the end of 2024, Apple, Nvidia, Microsoft, Amazon, Meta, Alphabet, and Tesla accounted for a substantial 33% of the index. All these stocks have a technology theme and stand to benefit from the Artificial Intelligence revolution to varying degrees. The market has been willing to pay a premium valuation for the superior earnings growth associated with AI-related stocks. According to calculations by JP Morgan, the “Magnificent 7” will generate earnings growth of around 34% for 2024, which is much higher than the estimated 3% growth for the S&P 500.

So far, Nvidia has been the primary beneficiary of the AI revolution, as other technology companies have been buying semiconductors. The demand for computing power from the AI revolution has meant these large companies see it as imperative to be at the forefront of computing power and capability. Last summer, Sundar Pichai, the CEO of Alphabet (Google), stated, “The risk of under-investing is dramatically greater than the risk of over-investing for us here.” This has led to a substantial increase in capital expenditures, much of which has been focused on data centres. These are highly complex construction projects, and other industries such as construction, climate management, and energy have benefited from this trend.

The incoming Trump administration presents both opportunities and risks for different companies and sectors. An extension of the 2017 tax cuts is positive for economic and earnings growth, and deregulation may benefit Financials, Energy, and Utilities. However, tariffs, immigration restrictions, and potential rollbacks of the Inflation Reduction Act pose risks. We will closely monitor incoming policy developments while continuing to focus on identifying attractive companies and themes at reasonable valuations.

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Tel +(441) 299 3817
www.butterfieldgroup.com/Investments

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Tel +(345) 949 7055
www.butterfieldgroup.com

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Tel +44 (0)1481 711521 Fax +44 (0)1481 714533
www.butterfieldgroup.com

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Global Asset Allocation

The chart below details our 6-12 month tactical investment strategy

