

ANNUAL OUTLOOK: 2025 EDITION

“EVERYTHING’S CHANGED”

Such was a common refrain heard across C-suites in the days following the election – it also sums up the 2025 outlook nicely. But “how” everything has changed is the key question. Leaving the standard outlook to the monthly *Market Stance*, we use this annual outlook to answer specific questions and provide portfolio ideas.

Tectonic shifts in technology, geopolitics and world trade will create several opportunities (and risks). We believe AI will accelerate just as the world is dealing with potential geopolitical upheaval and the biggest shake up in world trade since the 1944 Bretton Woods agreement.

Areas for investors to consider include: 1.) micro-cap stocks, where investing in a basket of such securities, we believe, will be akin to holding a stack of potential winning lottery tickets; 2.) specific non-U.S. investments across select countries that may be able to buck the trend of international underperformance; and, 3.) lower-credit quality bonds, which we expect to continue their recently strong momentum.

For full-year 2025, we expect 3.9% from the rate markets (as proxied by the Bloomberg US Treasury Index), 7.2% from credit (Bloomberg US Corporate High Yield Index) and 8.9% from equities (Russell 3000). While last year’s equity market return will be hard to match, we do believe the risk to our forecast is to the upside in both equity markets as well as in credit markets (return forecast details can be found on page 4).

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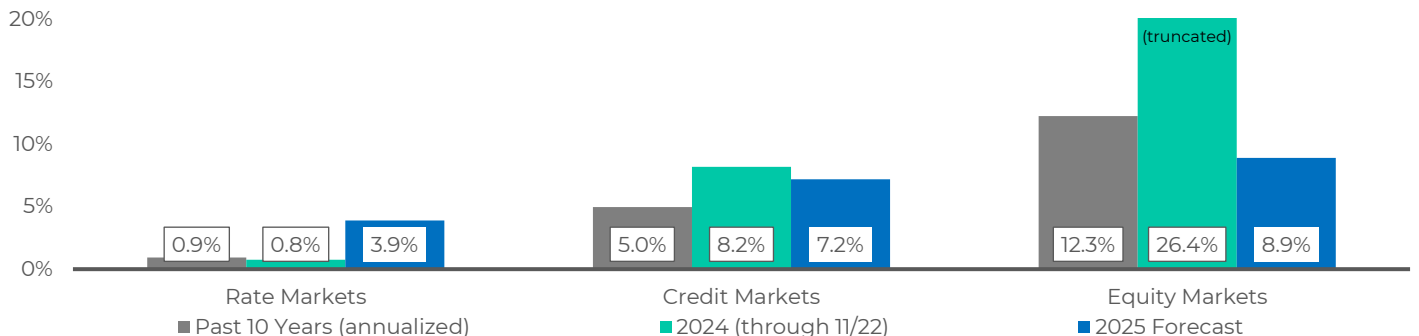
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AFTERGLOW?

We expect equity market momentum to continue – but not at 2024’s pace.

FINANCIAL MARKET RETURNS - PAST, PRESENT AND FUTURE



Source: SMArtX Investment Solutions, Bloomberg. 10-year historical return data as of 10/2024. Equity Markets proxied by Russell 3000 Index; Credit Markets proxied by Bloomberg US Corporate High Yield Index; Rate Markets proxied by Bloomberg US Treasury Index.

MACRO QUESTIONS

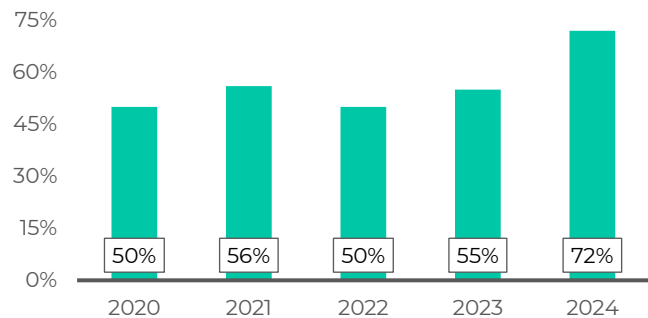
AI ACCELERATION?

There are areas within artificial intelligence (AI) that will take years of regulatory coordination, but there is also a good deal of low-hanging fruit. We believe there is a good chance that AI will have a quicker and more profound impact on economic functioning than the market expects. There are several “easy button” efficiencies that can be brought to us by AI – from taking well-written business meeting notes to summarizing thousand-page bills in Congress – all enabled by an administration keen on making changes.

I GET BY WITH A LITTLE HELP FROM AI

AI is increasingly being used as a workplace tool.

% OF ORGANIZATIONS USING AI IN AT LEAST ONE BUSINESS FUNCTION



Source: SMArtX Investment Solutions, McKinsey & Company.

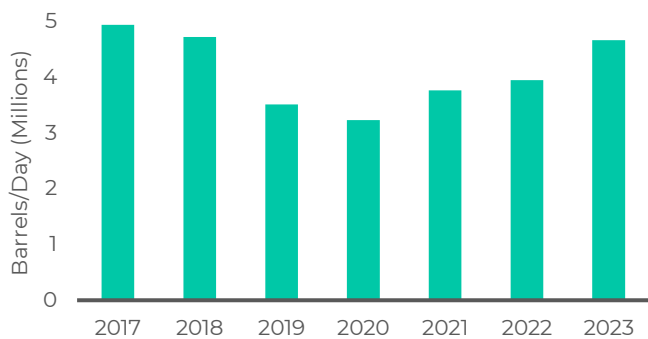
GEOPOLITICAL UPHEAVAL?

A second Trump presidency – and his disruptor-in-chief modus operandi – may serve as the catalyst for geopolitical change. And nowhere is riper for disruption than the Middle East. Trump’s focus on energy production could push some countries toward modernization (Saudi Arabia) while pushing others toward bankruptcy (Iran). Meanwhile, Trump’s full-throated support for Israel may reenergize and expand the Abraham Accords – which today involve four Muslim countries (UAE, Bahrain, Sudan and Morocco).

IRAN OUT OF GAS?

Iran may see its oil production curbed again.

IRANIAN OIL PRODUCTION



Source: SMArtX Investment Solutions, Statistical Review of World Energy. Data through 2023.

THE REVERSE GIANT SUCKING SOUND?

Ross Perot used the phrase “giant sucking sound” in 1992 to describe the impact the North America Free Trade Agreement (NAFTA) would have on jobs headed to Mexico. Today that vacuum may be in reverse. Trump has made it clear that, to do business in the US and gain access to the ~\$20 trillion+ US consumers spend per year, companies (domestic or foreign) must produce in the US. And, to produce in the US, you must invest in the US – requiring US dollars. Currency traders have certainly taken note.

THE ALMIGHTY DOLLAR

The dollar has broken out of its two-year range.

DOLLAR INDEX



Source: SMArtX Investment Solutions, Bloomberg. Weekly data as of 11/22/2024.

PORTFOLIO IDEAS

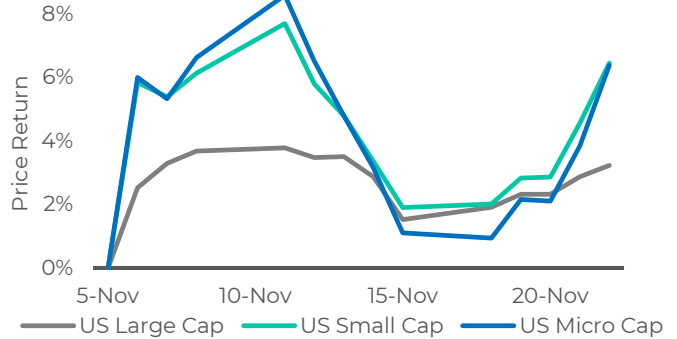
MICRO-CAP OPPORTUNITIES

The Republican sweep prompted us to overweight small cap equities in our portfolio recommendations – but those looking to really press the bet should explore micro-cap stocks. Here, diversification is key – as not all will win, but we bet more will win than lose. Supporting this portfolio idea is the expected economic strength in the US (vis-à-vis international economies) and the likely rollback of US federal regulations – both of which could be a huge boon for smaller US companies, notably micro-cap companies.

RIDING THE WAVE

It's been a wild post-election ride for smaller stocks.

EQUITY MARKET RETURNS



Source: SMArtX Investment Solutions, Bloomberg. Daily data from 11/5/2024 through 11/22/2024.

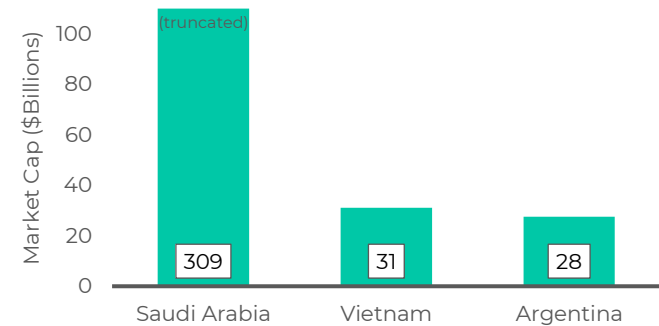
INTERNATIONAL WINNERS

While the future does not look as bright outside the US, there are areas that can take advantage of the newest world order. Argentina – already up 100%+ this year thanks to economic reform promises – has quickly become a big Trump ally. Saudi Arabia is rapidly modernizing and could become the economic center of the Middle East. Vietnam looks set to be a large beneficiary of the shift out of China. Small market size (notably in Vietnam and Argentina) mean stock prices can be pushed higher with even small inflows.

SMALL TARGETS, BIG RETURNS?

Small inflows can mean big price movements.

STOCK MARKET CAPITALIZATION - SELECT COUNTRIES



Source: SMArtX Investment Solutions, MSCI. Data as of 10/31/2024.

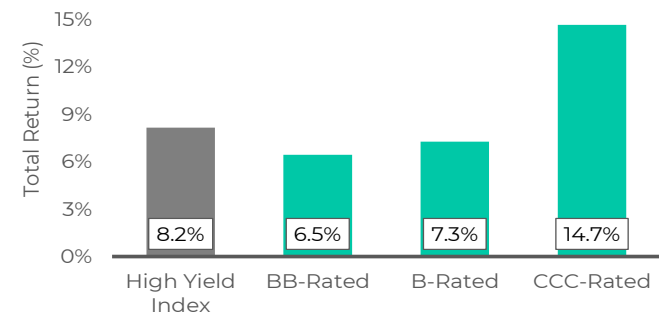
LOWER QUALITY CREDITS

We've been recent advocates of higher allocations to high yield fixed income given lingering inflation (easier to pay off debt) and continued economic growth (easier to make money to pay off debt) – but those who want a momentum play should consider a dedicated CCC-rated bond allocation. CCC returns broke away from the rest of the credit world in August – but, despite being up ~15% on the year, they still sport a 9.9% yield (for comparison, CCCs started 2024 with a 12.1% yield). If the economic backdrop continues, so too should CCC outperformance.

GIVE ME SOME CREDIT

Credit has done well this year – notably CCCs.

CREDIT MARKET RETURNS - YEAR TO DATE



Source: SMArtX Investment Solutions, Bloomberg. Return data through 11/22/2024.

2025 RETURN FORECASTS

	Rate Markets	Credit Markets	Equity Markets
Index Proxy	Bloomberg US Treasury	Bloomberg US Corporate High Yield	Russell 3000
Return Forecast	3.9%	7.2%	8.9%
Lower Range	0.6%	1.6%	-1.5%
Upper Range	7.2%	12.8%	19.3%
Risk Skew	Downside	Upside	Upside
Comments	We expect interest rates to continue on their bumpy path as Fed easing ends (we expect a cut on 12/18 and two more cuts in 2025). The higher-yield starting point helps returns, while the risk is rates go even higher.	We forecast high yield total returns to match current yields. Lower-quality credits (CCC, B) should outperform as economic growth and elevated inflation support risk assets – with further upside if rates stay range bound.	Our equity return forecast assumes 12% 2025 earnings growth that modestly eats into current valuations (28x). We see upside risk in the form of continued multiple expansion (in similar fashion to the late-90s experience).

Note: Upper and Lower ranges are based on a 0.67 standard deviation, designed to capture 50% of outcomes.

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