

2025

INVESTMENT OUTLOOKS



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Changing of the Guard: Investing Implications for 2025 and Beyond

Outlook 2025

Markets remain in a late-stage cycle where global economic paths are diverging. A changing policy mix is likely to lead to a more volatile environment for risk assets. We favor U.S. equities over bonds and believe cash, foundational and antifragile assets can play an increased role in portfolios.

As we approach the close of 2024, markets are ending the year on a resilient, if somewhat turbulent, note. The cap-weighted S&P 500 has risen +25%, while the equal-weight S&P 500 gained +12%, Russell Value is up +13%, and U.S. small caps returned +11%. In fixed income, the U.S. 2-year yield remains steady at 4.25%, the U.S. 10-year yield increased by 60 basis points (bps) to 4.53% and the U.S. Home Mortgage Rate increased by 56 bps to finish 7.28%. Notably, despite a 100-bps rate cut by the Federal Reserve, both long-term U.S. Treasury rates and home mortgage rates moved higher—an unusual dynamic that reflects the complexities of balancing the market expectations of growth versus inflation.

Yet, 2024 will likely be remembered less for market performance and more for a defining "changing of the guard." Milestone elections across major economies—including the U.S., United Kingdom, France, South Korea, and Japan—have set the stage for a new era of policy direction, governance, and economic recalibration.

Led by the United States, policy redirection is squarely focused on reducing government spending, addressing immigration, and recalibrating international trade policies. These initiatives reflect a broader generational realignment in governance, signaling a departure from the past.

A Generational Shift in Policy and Its Economic Implications

The driving force behind these changes is a younger voting cohort, burdened by the fiscal and economic imbalances inherited from previous generations. This group demands a departure from legacy policies that have contributed to stagnant real wages, rising living costs and the growing inequities of globalization.

The disparity is stark: since 1980, real U.S. median residential property prices have risen by 96.6%, while real U.S. median wages have increased by only 15.8%. During this same period, U.S. trade deficits have effectively resulted in lost income for workers, totaling an

estimated \$41 trillion in today's dollars, according to Richard Koo, Chief Economist of Nomura Research.¹

The World Trade Organization (“WTO”), the governing body of “free trade” and once seen as the engine of globalization, is no longer considered an effective policy body for ensuring ‘fair trade’. Many US representatives now express regret in supporting China’s membership into the WTO in 2001, stating that it resulted in an unfair cost to the U.S. economy. Two decades on, China has continued to enforce significant barriers to market entry and has tacitly enabled, if not actively facilitated, intellectual property theft through entities like Huawei and ZTE Corp.²

This reckoning has profound implications, particularly as tariffs re-emerge as a central policy tool. While tariffs can steer trade, protect domestic industries, and generate federal revenue, their success hinges on managing the collateral damage of potential trade wars—industry disruptions, economic inefficiencies and costs (or in economic parlance, “deadweight loss”). If history is any guide, the pursuit of tariffs does not have a compelling history of success but more so, one of unintended consequences. Take the Smoot-Hawley Tariff Act in the 1930s. During this time, tariffs spurred retaliatory tariffs which led to a trade war. The result, a dramatic drop in global trade among key trading partners, higher import prices paid by both corporates and consumers, lower growth and industry failures.^{3,4} During this period, the resultant drop in global trade, lower growth, and economic hardship led to a more isolationist and uncertain world; a world where security and defense mattered even more.

Looking out into 2025, the pursuit of more protectionist leaning policies to ensure ‘fair trade’, will lead to diverging economic paths; a reflationary one for the U.S. and a deflationary, lower growth one for Europe and China. Markets remain in late-stage cycle influenced by easier monetary policy and perhaps, a net tighter fiscal policy (certainly if the DOGE committee, led by Elon Musk, is successful in cutting \$2 trillion in 2 years).

¹ Nomura Research, “Trump, Tariffs, and Exchange Rates: The Message of Elections in US and Japan”. Richard Koo, Chief Economist.

² Politico, “China joined the WTO, then Broke the Rules”, 12/09/2021 by Phelim Kine

³ Foundation for Economic Education, “Smoot-Hawley and the Great Depression”. Dr. Thomas Rustici, Department of Economics, Center of Public Choice, George Mason University

⁴ Fordham Journal and Corporate and Financial Law, “History of Tariffs in the United States and the Dangers of their Use Today”. Author, Mzacharias

As the pendulum swings toward this policy mix, successful investing in 2025 will require greater emphasis on protecting purchasing power and maintaining a long-term perspective through a likely higher volatility backdrop. Key thoughts and strategies to consider:

- **Policy and Regulation:** Markets have embraced the incoming Trump Administration’s approach a more pro-business regulatory environment, but for certain industries relating to climate change, the potential reduction of subsidies is likely to be a setback for innovation. However, we do not think any reduction of subsidies will change the long-term demand dynamics for sustainable clean energy solutions.
- **Volatility Ahead:** Prepare for increased market volatility as policy transitions unfold. The importance of cash should not be underestimated in uncertain times. It can act as a safe harbor from volatility, serve as a ballast for riskier portfolios, offer decent yields, and provide a key source of funding for opportunities as they arise.
- **Inflation Persistence:** Expect inflation to remain persistent at around 3%, driven by deglobalization, tariffs, and potential labor shortages, due in part to tightening immigration policies on the one hand, offset by lower more disinflationary global growth outlook.
- **Focus on Foundational, Antifragile Assets:** consider exposure to assets like gold, bitcoin, certain natural resources including conventional energy and foundational assets such as infrastructure, certain utilities.
- **Minimize Exposure to Vulnerable Sectors and Regions:** Reduce investments in areas most susceptible to trade disruptions (automotive, heavy machinery, and consumer electronics, particularly those that rely on imported components).
- **Identify Resilient Growth Opportunities:** Aligning portfolios with secular growth stories that can withstand the shifting economic landscape (see Long-term Growth Opportunities takeaway below).

Inflation, Interest Rates, and Fixed Income

The Federal Reserve’s latest 0.25% rate cut (16th December 2024) elicited a cautionary market reaction, with equities selling off and borrowing costs rising. Markets are uneasy about the Fed’s guidance of two additional cuts in 2025, interpreting it as an implicit shift towards normalizing a 3% neutral inflation target while quietly abandoning the old 2% target. For bond investors, a higher neutral (inflation) rate represents a “margin

squeeze” on capital, effectively signaling to the markets that inflating their way out of debt is an unspoken policy goal. **With current U.S. Federal debt as percent of GDP over 120%⁵ entering a danger zone,⁶** the bond market will need to see ‘line-of-sight’ for real U.S. long term fiscal sustainability. Key income **strategies to consider:**

- **Short Over Long Duration:** Favor shorter-duration bonds to mitigate risks from persistent inflation and fiscal imprudence. It will be critical for the bond market to see the incoming U.S. Administration deliver a glidepath towards fiscal sustainability, in our view.
- **Floating Over Fixed Rates:** Increase exposure to floating rate notes, which are less vulnerable to the risk of rising rates should inflation remain firmer than expected, as we think.
- **Sector Positioning:** Focus on credit sectors less exposed to potential trade war risks, while selectively adding exposure to high-yield debt amid peak rates and declining defaults.
- **Credit:** Credit spreads remain tight relative to history. Maintain short duration high yield exposure as it provides scope for relative outperformance vs. investment grade. 2024 rate cuts have supported lower financing costs for the high yield issuers and led to surge in refinancing this year, alleviating concerns about the refinancing wall.^{7,8} In addition, high yield corporate interest coverage ratio (ICR), a key measure of a company’s ability to pay debt, is stable and sits well above 3.⁹

Equities: Balancing Stability and Growth

Technology stocks drove over 50% of the S&P 500’s returns in 2024, fuelled by AI-driven demand for GPU chips and server optimization. However, the supply bottleneck that supported this surge has eased, and a softer first half for technology in 2025 is likely.

⁵ St. Louis Fed. [Federal Debt: Total Public Debt as Percent of Gross Domestic Product \(GFDEGDOI88S\) | FRED | St. Louis Fed](#)

⁶ Bloomberg News, Goldman Sachs Economics Research Note, “Goldman Now Sees US Debt-Cost Ratio Rising into Danger Zone”, 22 May 2024, Economist Manuel Abecasis and David Mericle

⁷ **Typically, when corporates issue bonds to refinance their existing debt, it lowers the probability of default.**

⁸ Allianz Global Investors. “Forget the High Yield Myths”, July 2024, Exhibit 2 shows the proportion of proceeds being used by high yield issuers for refinancing has hit a record higher in 2024.

⁹ Most analysts consider an ICR above 3 a strong indication of a company’s stable financial position and their ability to easily meet debt obligations and avoid the possibility of default.

For long-term investors, short-term pullbacks are welcome. They provide attractive entry points, particularly as AI adoption continues to expand.

AI demand and climate change is converging and the era of flat demand for electricity is over. Over the next 5 years, grid planners nearly doubled the 5-year load growth forecast from 2.6% to 4.7%.¹⁰ This means they expect peak demand growth of 38GW through 2028 aided by data centre growth to exceed \$150 billion through 2028. Exposure to foundational infrastructure-related companies remains attractive investment proposition for long term investors.

International equities may appear to offer a compelling value proposition, but in our view, they remain structurally undervalued for good reason. Former ECB central banker Mario Draghi succinctly outlined Europe's structural challenges in a recent speech, describing a vicious cycle of weak domestic demand, depressed investment, low productivity, and higher production costs relative to the U.S. Adding to the concern is Europe's lack of cohesive leadership, exacerbated by the vulnerabilities in Germany's economic model, which hinges on cheap Russian gas to produce cars for export to a struggling China. While China faces challenges in absorbing its overproduction, India stands out as a notable exception. Given these dynamics, investors should prioritize overweight allocations to U.S. and Indian equities over those in Europe and China. Equity strategies to consider:

- **Equity Allocation:** Equities' inflationary characteristics provide a hedge absent in bonds. At the sub-asset level, we believe overweighting dividend growth equities relative to intermediate to long duration bonds, emphasizing quality growth and dividend stability.
- **Sector Rotation:** shorter term, expect a shift from technology toward stable cash flow-driven sectors like consumer staples in early 2025, offering earnings stability amid increasing volatility.
- **Regional Exposure:** Remain overweight US, India versus problem economies of Europe and China.
- **Dividend Growth:** Well-managed dividend growth funds remain a haven of stability, provided managers avoid overreaching for high yielding dividends at the expense of long-term appreciation.
- **Long-Term Growth Opportunities:** Technology and AI is on its own cycle. Reinvest in technology during pullbacks, capitalizing on the growing need for large language

¹⁰ Grid Strategies: Clean Grid Initiative. U.S. Federal Energy Regulatory Commission (FERC) 2023

models (“LLM”) retraining and server optimization as data sets go through their updating cycles.¹¹ (For more details other long-term growth opportunities - emerging India, rise of AI and biotechnology, global defense, cyber needs, rebuilding global infrastructure and the growing needs for small/micro and advanced nuclear solutions – please reach out to us).

Conclusion: Navigating the Pendulum Shift with Resilience

As we enter 2025, the global economic and political landscape is undergoing a profound transformation. The pendulum of policy is swinging toward tariffs or threat of tariffs, fiscal recalibration, and generational realignment, bringing both opportunities and risks for investors. This evolving environment demands not only a clear understanding of the forces at play but also a disciplined approach to portfolio construction.

To succeed in this new paradigm, investors must prioritize resilience. This means protecting purchasing power, embracing volatility as an opportunity rather than a threat, and aligning with assets and sectors poised to thrive amid uncertainty. The persistent undercurrent of inflation, trade disruptions, and potential policy missteps will challenge traditional strategies, but they also reinforce the value of diversification and adaptability. In times of change, those who adapt will lead. We look forward to working closely with investors and navigating the shifting tides of 2025 while helping their portfolio staying aligned with long-term objectives.

¹¹ LLM stand for large language models that represent the breakthrough in artificial intelligence and employ neural network techniques for advanced language processing.