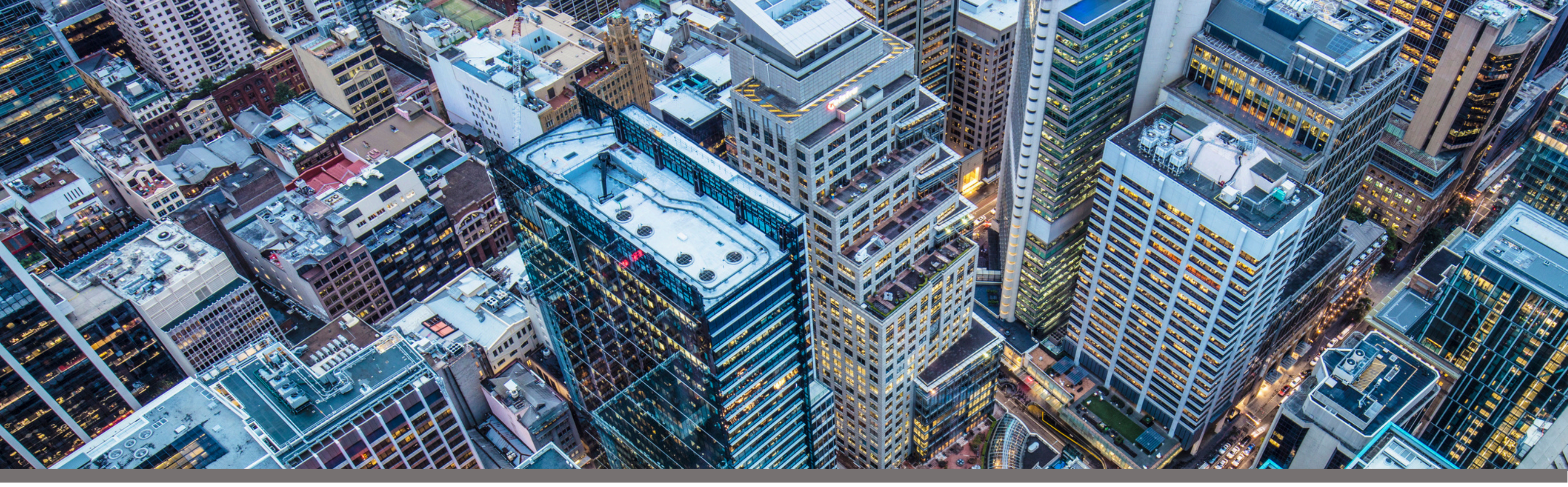


FOUNDED IN	EMPLOYEES	LOCATED IN	ASSETS DIRECTLY UNDER MANAGEMENT	ASSETS INDIRECTLY UNDER MANAGEMENT
1988	**80+**	**10+** COUNTRIES	**US$1.1** BILLION	**US$9.7** BILLION

ICM Monthly Outlook

JANUARY 2025

Market Review

Happy New Year, everyone. 2024 was another prosperous year for anyone who went long and stayed long risk assets, just like in 2023. The US economy showed remarkable resilience in 2024, confounding the chorus of doomsayers proclaiming an imminent recession for much of the year. The Sahm Rule trigger in July 2024 was a false flag for a recession. The Sahm rule says that when the three-month average of the jobless rate climbs by half a percentage point at least from its low over the previous 12 months, the economy is at the beginning of a recession. It is just another example of how this cycle is not behaving like previous cycles.

In 2024, the S&P 500 returned 23% versus 24% in 2023, notching up fifty seven all-time closing highs along the way. For comparison, the Euro Stoxx 50, Europe's leading blue-chip index for the Eurozone, returned 8.27%, while the FTSE 100, the London stock exchange, returned 5.69% - empirical evidence of American exceptionalism. In 2024, the S&P 500 would have beaten 2023 had it not been for that pesky volatility in the last three trading sessions of December, which cost 1.85%. Even the Teflon tech stocks sold off on the prospects of higher-for-longer interest rates. The Magnificent 7 mega caps slid 4.1% after the Federal Reserve Bank meeting in December and another 2% after the Non-Farm Payrolls release in January, a total decline of 6.2% from its peak. The Magnificent 7 still returned 65% in 2024, lest we forget.

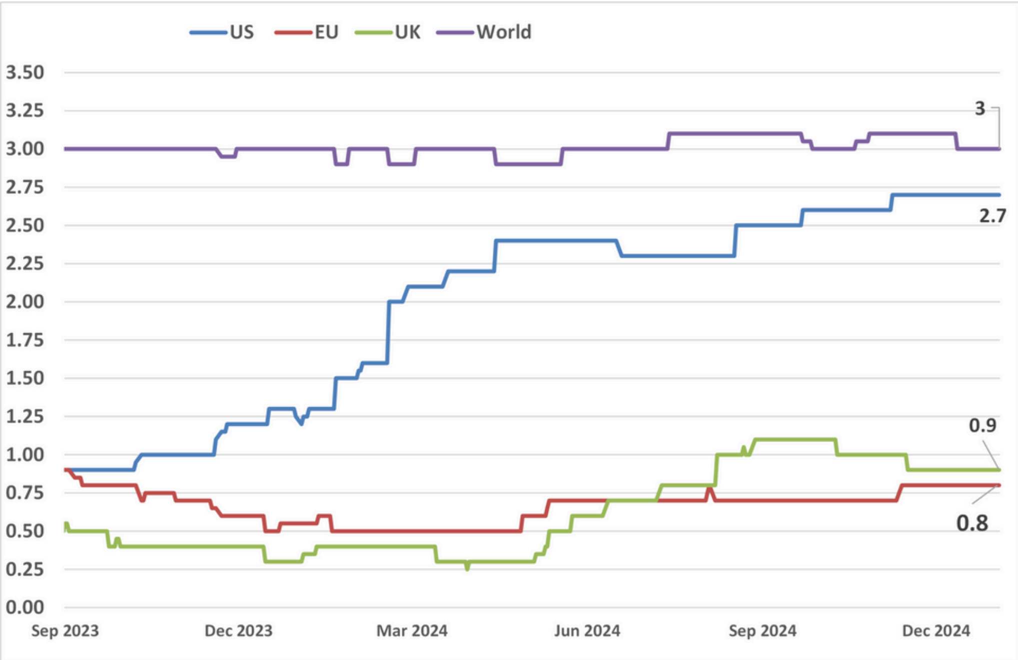
In December, the US Federal Reserve Bank cut interest rates as expected. Chairman Powell's subsequent commentary tempered expectations for more near-term rate cuts, causing the equity markets to slip. US inflation is now dormant, not extinct. The Federal Reserve Bank's concern for inflation hinges on President Trump's policies from here. We are buying the dip, as we will explain now.

Market Outlook

Despite the rocky start, we expect 2025 to be another positive year for financial markets, albeit it is unlikely to be another 20%+ year. We do not believe investors will live dangerously by staying risk-on. In our letters over recent months, we have highlighted plenty of challenges facing the global economy, all of which are already in the price to some degree. It is an unforeseen banana skin that will upend returns for 2025.

Bloomberg's global economic forecasts suggest good economic growth in 2025, although the disparity between regional growth will be high. The US will grow significantly faster than the other major developed market economies.

GDP Forecasts



Source: Bloomberg

We see many catalysts for another positive year, the main ones being 1) a Chinese economic recovery after its property bubble malaise of the past few years, 2) US corporate competitiveness thanks to AI-related productivity gains, 3) US tax cuts and other policy initiatives from President Trump, 4) US Federal Reserve Bank cutting interest rates at the back end of the year due to gradually declining inflation and a softening of labour markets due to AI-related labour force reduction, and 5) EU fiscal stimulus to combat weak economic growth in the Eurozone area.

While not a catalyst per se, cryptocurrencies could be another source of alpha for asset allocators in 2025 after President Trump pledged to make the US the crypto capital of the planet and the "Bitcoin superpower," including a Strategic Bitcoin reserve.

Away from financial markets, we expect a peace deal in Ukraine if President Trump is true to his word. We must caveat that President Trump is backsliding on his sophistry to secure a peace deal in one day. Now, he says it might take six months.[1] Similarly, Elon Musk is backsliding on his promise to cut government spending by USD 2 trillion when he runs the Department of Government Efficiency.

Chinese stimulus and growth

Chinese stimulus is straightforward. We expect more of the same from the Chinese government with various stimulus measures to reignite its economy. To counteract the continuing headwind of its housing downturn, we expect fiscal and monetary stimulus to support the housing market and shield the Chinese economy from the negative impact of US tariffs. Increased government spending should increase commodity demand and support the broader global economy.

Artificial Intelligence

We still see plenty more gains for AI adoption. Productivity gains are another way to think about Artificial Intelligence. AI will lift all companies' efficiency. Investing in AI is both a momentum and a defensive theme, depending on whether you invest in the creators or the adopters. There are many ways for investors to benefit from AI outside of Nvidia, Alphabet, Facebook, etc. AI is here to stay. Businesses and consumers are locked in, and the applications are constantly expanding. Adopt or die! Consider Fintech, for example. In April 2024, we quoted Jamie Dimon, who said that AI has the transformational potential of electricity, among other things. In April, the primary beneficiaries of AI euphoria were the creators and enablers. We suggested that the broader economy had yet to benefit fully from AI adoption. This week, Bloomberg published an article saying that global banks expect to cut at least 200,000 jobs (3% of the workforce) in three to five years due to AI adoption. More than a quarter of respondents predicted AI would replace between 5 - 10% of their employees in the coming five years. Citigroup predicts AI will replace more jobs in banking than any other sector. Examples include "bots" replacing customer service staff for routine or repetitive tasks. Banks have already made considerable progress using bots to prevent fraud and money laundering. That alone will save banks significant amounts of money. To soften the blow of the hard-hitting report, Bloomberg suggested that AI will result in workforce “transformation!” Our old friend Jamie Dimon said AI would augment jobs, not replace them, but he carried on telling the next generation they would work 3.5 days per week only. So much for Mr Dimon’s earlier comment of “aggressively retraining and redeploying talent to ensure we are taking care of our employees if they are affected by this trend." Whether 3% or 10%, the result will be the same: AI will cut costs and should feed through to higher earnings and boost share prices. Eventually, AI adoption will draw significant scrutiny from politicians due to falling income-tax receipts, societal pushback, and its invasion of privacy, but that is unlikely to happen during President Trump’s presidency. All this before President Trump loosens the reins of regulation.

Trump policies

We do not expect President Trump to self harm the US economy through tariffs; tariffs will be targeted, albeit with possible unintended consequences. President Trump’s tariffs did not unduly hurt the US economy during his first term. We take solace from President Trump’s nominee for Treasury Secretary, Scott Bessent, who fended off several other high-profile candidates to win the job.

Mr Bessent (62) is an investor and global macro hedge fund manager, formerly a partner at Soros Fund Management. Mr Bessent wowed President Trump with his advice and fundraising during President Trump’s second election campaign. Mr Bessent produced the “3-3-3” plan for President Trump: a 3% budget deficit by 2028 (versus 6% today), 3% GDP growth per annum during President Trump’s second term through deregulation and pro-growth policies, and 3 million additional barrels of oil per day from US energy resources (16.5 million[2] versus 13.5 million per day today).

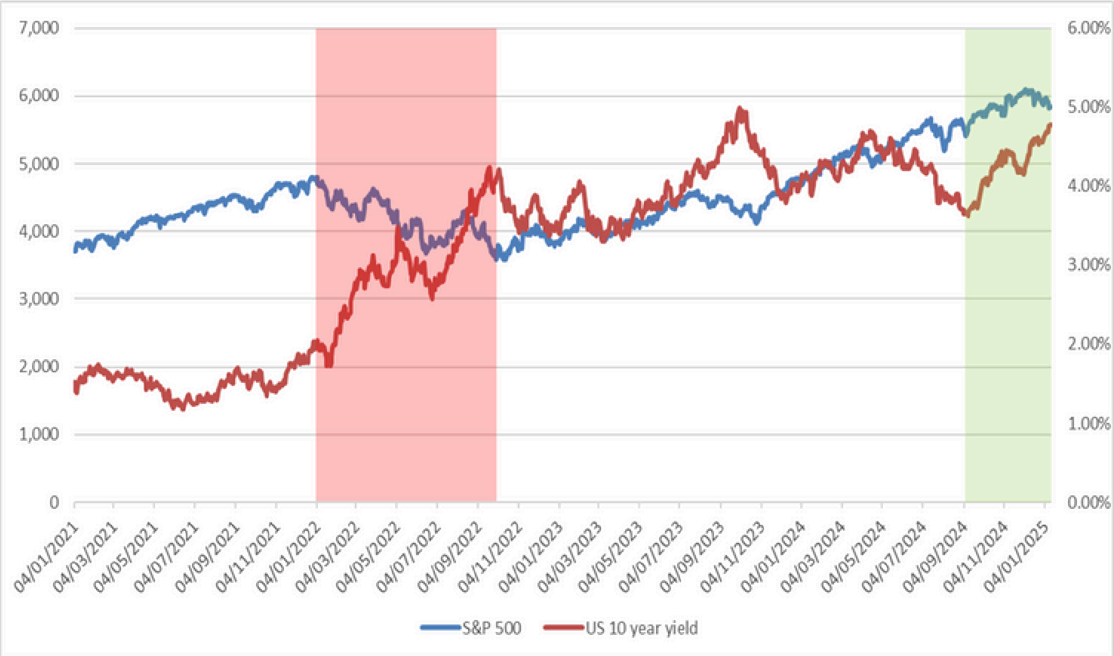
We believe Mr Bessent’s plan will rely on successfully implementing the energy element. In our November newsletter, we discussed how increasing energy production would be a cornerstone of President Trump’s plan to boost economic growth. Mr Bessent is the man with the plan and is now empowered to execute it. Lower oil prices will keep inflation low. Energy and gasoline prices are key elements of household budgets, reflected in inflation measurements. Beyond the initial disinflation benefit, Mr Bessent believes that forward guidance on oil production (a lower-for-longer oil price) will increase business and consumer confidence and lead to higher private sector investment.

Subject to the success of this plan, the US Federal Reserve could cut rates due to falling inflation. Coupled with increased investment and continuing reshoring investment to take advantage of lower corporate taxes, the US should easily hit Mr Bessent’s 3% GDP goal. Mr Bessent believes that deregulation can boost growth.

Encouragingly, Mr Bessent wants to tackle the trajectory of US Government debt. Today, the US national debt is $36 trillion and rising steadily.[3] Mr Bessent rightly believes that GDP growth can only assuage investors' concerns about the US’ spiralling debt burden for so long, and he wants to slow down the rate of growth in the US’ indebtedness. Mr Bessent has stated that he will target “The Green New Deal” to save USD 1 trillion over 10 years and look for more value from money in Medicaid. Mr Bessent also suggested that Social Security and Medicare entitlements are major drivers of budget deficits. While Mr Trump is unlikely to tackle entitlements reform from the get-go, colloquially known as the “third rail”[4] of US government spending, Mr Bessent has identified it as an area for action. In the fiscal year 2024, the US government spent more than $5.3 trillion on Social Security, health care, defence, veterans’ benefits, and interest on the debt. Mr Bessent wants to cut back on discretionary spending except for defence. Mr Bessent rightly believes that the US’ high deficits mean the country has limited room for manoeuvre if faced with another crisis.

If successful, Mr Bessent’s plan will boost financial living standards. However, other aspects of living standards will deteriorate due to the climate impact of burning more hydrocarbons, anecdotally evidenced by the current wildfires in California. Europe’s Copernicus observation agency reported that 2024 was the hottest year on record, with average surface temperatures 1.6c above preindustrial levels after greenhouse gas emissions hit new highs.[5] According to the latest estimates, the estimated insurance bill to rebuild the devastation in California is USD 150 billion. Americans should brace themselves for higher insurance premiums going forward. For his part, President Biden is trying to pre-empt some of the potential environmental damage by banning offshore oil and gas drilling, which will also have limited effect due to limited prospects. Also, in the dying days of his administration, President Biden imposed new, stricter sanctions on the Russian oil industry, including two major Russian oil producers and shipping companies - the so-called Dark Fleet - which are estimated will cut daily exports from Russia by 300k - 800k per day.[6] You will remember from our June 2024 letter how President Biden turned a blind eye to Russian chicanery because it suited the US to have a lower oil price to drive down inflation. Some say President Biden’s decision is a cynical move to stoke inflation for President Trump. No matter, the Brent oil price has jumped to $80+ from $75, its highest price since August 2024.

US Monetary Policy
Now, cast your mind back to 2022, an annus horribilis for investors, when equity markets fell significantly as yields rose due to Federal Reserve hikes to combat inflation. The section in red below shows equity markets declining while yields rose during 2022. The section in green below shows that the S&P 500 has not declined or reacted significantly to the rise in the US 10-year yields since September 2024. Since September 2024, the 10-year US treasury bond yield has increased to 4.75% from 3.6%. In that time, equity markets have rallied.



Source: Bloomberg

Unlike in 2022, the rise in yields is not against a backdrop of rising inflation - not yet, anyway - but against a backdrop of strong economic data and optimistic growth forecasts. The January Non-Farm Payroll figure was strong - and stronger than expected, at 256k versus the consensus estimate of 165k, with only one forecaster predicting a higher number, 268k. According to Deutsche Bank, January was the 48th successive positive payroll print, the joint second longest positive streak over 85 years. Healthcare, the government, leisure, and hospitality did the heavy lifting, with 112k jobs in aggregate. The unemployment rate fell to 4.08%. Also in January, the ISM services index rose by 2% to 54.1% versus 52.1% in December. All four component indices (business activity, new orders, employment, supplier deliveries) contribute to the composite ISM services index rising, which indicates expansion in the services sector. The ISM services index indicator shows the service sector continues to grow, as it has done for 22 of the past 24 months. The most notable part of the latest ISM services report was that 15 of 18 industries reported increased prices. The index rose to 64.4 from 58. The market is concerned that disinflation in the service sector may not continue as they would like. Some businesses ramped up spending in December before Trump tariffs, so the increase was somewhat expected, but it highlights the market's concerns about inflationary policies.

Over the medium term, assuming inflation continues declining and unemployment ticks up due to the rise of bots, the data dependent US Federal Reserve Bank will have no choice but to cut interest rates to create employment and provide price stability.

Market Implications

Financial markets should do well against the backdrop that we have outlined above. A resplendent US economy and a renascent Chinese economy have the political and economic nous to carry the world along, albeit at different speeds. We expect the US equity markets to continue growing and the US corporate bond market to remain stable thanks to solid earnings and stable balance sheets. Any uptick in corporate defaults in the US due to higher interest rates will impact the weaker corporates and not impact rated debt. The Russell 2000 could be set for a stellar year. The NASDAQ should continue to benefit from the continued AI movement. Emerging markets will benefit from Chinese stimulus and cheaper oil from the US. We think more downside in US government bonds is limited from current levels. Indeed, we think pricing has become overstretched, and we would expect US yields to gradually rally from here as mean reversion sets in. Most concerns about sticky inflation seem fully priced in. Yesterday's CPI data for December was good news for the US Federal

Reserve Bank, given CPI ex-food and energy was down to 3.2% from 3.3% in November.

The bond market is President Trump's greatest threat. No amount of tariffs or sabre rattling can intimidate the bond market; it is a true leviathan. On the contrary, the bond market can intimidate President Trump if he steps out of line. For now, we expect the bond market will give President Trump a honeymoon period thanks to the existing positive economic momentum and the promise of more positive momentum. President Trump's cabinet picks are pro-growth and appear sensible. That said, he fired sensible people for dissent during his first term. Not known for his soft-soaping, we expect President Trump to forcefully encourage the US Federal Reserve Bank to cut rates faster and harder than they would want if the economy showed signs of weakness. For example, one early indicator to keep track of is the uptick in delinquent credit card loans, suggesting financial strain among lower-income consumers. US lenders wrote off over $46bn in delinquent credit card loans during the first nine months of the year, a 50% increase from the same period in 2023. The US consumer is crucial to a strong economy.

We should see a few more interest rate cuts this year but it will take a significant employment shock or precipitous fall in inflation for the US Federal Reserve Bank to begin cutting rates aggressively again. We also maintain a watchful eye on inflationary policies that will result in higher yields, increasing mortgage rates and more expensive corporate debt.

For the time being, roll on the everything rally.

Have a good year.

Kind regards,

Conor Spencer
16 January, 2025

Source Data: ICM, Bloomberg as of 16 January, 2025.

[1] I am already reminded of his first-term penchant for bringing big solutions in "two weeks." (YouTube it)
[2] Bloomberg, USOILPRD.
[3] https://www.usdebtclock.org/
[4] Third rail (politics) - Wikipedia https://en.wikipedia.org/wiki/Third_rail_(politics)
[5] https://www.copernicus.eu/en/news/news/copernicus-global-climate-report-2024-confirms-last-year-warmest-record-first-ever-above
[6] Treasury Intensifies Sanctions Against Russia by Targeting Russia's Oil Production and Exports | US Department of the Treasury, https://home.treasury.gov/news/press-releases/jy2777

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