Investing in challenging times

Sandra Haurant explores what lies ahead for investment markets in 2025

Summary

- The watchword for 2025 is uncertainty – the world is waiting to see what policies the new US administration puts into play, and how they will ricochet around the markets.
- Many anticipate that Trump's policies will be inflationary – despite a promise to reduce inflation having been central to his campaign promises.
- While the US might provide a 'bright spot' in equities, some foresee a positive year for China and for parts of Europe.
- In pension schemes, appetite for fixed income will continue to be strong, while sustainable investing may dip.
- Asset allocation will be central to navigating another interesting year.

More than half the population of the globe might have headed to the ballots last year, but in 2025, one elected president is likely to dominate the news agenda. Donald Trump is set to begin his second term in office on 20 January 2025, taking the helm at a time when geopolitics all over the world look complicated, to say the least.

With huge developments galloping ahead in artificial intelligence and other areas of technology, the climate crisis creating ever-more global challenges, conflict in Ukraine and Israel, upheavals in the Middle East and infighting and other challenges for European governments, Trump's second crack of the whip comes at a time of great uncertainty. We look at how pensions investment may fare in the year ahead.

A potential bright spot

In the current context, it could be said that the only thing we can be sure to expect in 2025 is that there are more challenges to come. And, says RBC Global Asset Management chief economist, Eric Lascelles, we have at least had some answers to historical questions. "Questions from past years regarding central banks' capacity for quantitative easing have now been significantly answered," he says. However, he adds, those have been swiftly replaced by a new set of political questions. "There are still big questions about what the Trump presidency will mean for both US and global markets," says Lascelles.

Still, concerns around a hard landing in the US have largely been seen off, he says, with central banks finally cutting rates, removing the most significant challenge to growth in recent years. In fact, Lascelles is upbeat: "The US economy should be a bright spot, given the policy mix of deregulation, tax cuts and rising spirits that the New Year will usher in."

Highs and lows

Of course, decisions made by the Trump administration and a move towards greater degrees of protectionism could negatively impact affect other parts of the world – and ultimately that could come back to bite the States.

IFM Investors chief economist, Alex Joiner, says: "A second Trump presidency is poised to introduce higher tariffs, particularly targeting China, which could lead to trade tensions and affect global trade dynamics. This could slow economic growth in the US, and globally, if met with retaliatory measures."

And while low inflation was part of Trump's campaign patter, SKAGEN Funds CIO, Alexandra Morris, says: "Most predict his agenda will be inflationary, with labour shortages due to deportations driving up wages and tariffs pushing up import prices. The cost of living became a key election issue and the risk for Trump is that any reignition of inflation could derail his own economic agenda."

"Trump's policies on immigration and expansionary fiscal strategies could also lead to higher inflation and interest rates," agrees Joiner. "For the moment, markets are buying the rumour, and this is supporting equity markets and seeing bonds sell-off. We will need to see if economic performance can underpin earnings and support this rally, in the absence of any dislocation caused by geopolitical events."

There are some who anticipate a smoother ride for US inflation, though. "We expect core measures of inflation to continue to moderate in 2025," says Payden & Rygel chief economist, Jeffrey Cleveland. "We can dissect core inflation in the US into three major groups: goods, housing, and non-housing services. Goods prices have been in deflation, dragging down overall consumer prices. Meanwhile, housing costs and non-housing services remain sticky. Over the next year, though, we expect housing costs to moderate further and non-housing services – everything from haircuts to health care – to moderate as the labour market cools." And by mid-2025, Cleveland says: "We expect core inflation in the US to dip close to 2 per cent year-over-year, consistent with the Fed's target."

Beyond the States

While all eyes are on the US, there is plenty to consider in other parts of the world. "The biggest unknown is the second-order effects. How will countries, policies and corporates around the globe adjust and find ways to combat the negatives?" says Morris. "As stock-pickers, we know that companies are agile and can find ways to adapt and find opportunities. Investors should also not forget that non-US markets offer attractive bottom-up opportunities as part of a well-balanced and long-term portfolio."

"An area that could surprise to the upside is Europe. Despite its structural headwinds, there's scope for better-than-expected performance," Russell Investments chief investment strategist, Andrew Pease, says. "Europe is trading on the biggest valuation discount in the history of the Eurozone. Bank lending growth has already picked up, and if that trend continues, it could boost economic activity and markets."

However, some parts of Europe are struggling. "Germany's economic stagnation is an area for concern, with its zero GDP growth since 2019 reflecting deep structural issues, from poor manufacturing bets to unfavourable demographics," Pease says. "Additionally, trade policy uncertainty under a second Trump administration could further weigh on European economies."

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When it comes to fixed income, too, Payden & Rygel director, Timothy J Crawmer, sees similar risks. "Any tariffs that get implemented in the US could be negative for Europe. Europe's obviously more reliant on trade with China, so a continued slowdown in China is also going to weigh on Europe," he says.

And, of course, continued conflict will also play a part. "There isn't really an end in sight for the Ukraine crisis," says Crawmer. "While Europe will benefit from a stronger US economy, there are going to be stronger headwinds for Europe than in the US."

Despite Trump's tariffs, Pease believes Chinese equities could be promising, stating: "In the last year, we have seen a corporate governance shift, with a big focus on buybacks and earnings growth seeing less dilution. MSCI China is up by over 18 per cent this year, highlighting its potential resilience, and if China pivots to a consumption-based stimulus, potentially encouraged by Trump, its markets could perform better than expected."

But emerging markets is still an area of concern, says Pease. "The US dollar will perform strongly in 2025," he says. "Emerging markets remain vulnerable to a strong US dollar. These markets rarely outperform in a dollar appreciation environment, and that's unlikely to change."

Careful choices

For pensions funds, the coming year could be testing. Joiner says: "We suspect that setting an appropriate asset allocation will be key in the coming year, as valuations are stretched in equity markets and fixed income returns are likely to be modest."

That means not just thinking about short-term economic and geopolitical cycles, but also the 'secular trends' that are shaping investment outlook. "We see the value of private market assets in insulating portfolios against unanticipated swings in the economic cycle that may be caused by geopolitical and policy risks," Joiner says.

According to a recent DB survey by Russell Investments, fixed income assets are in favour, and there is an increase in appetite for infrastructure and other secure income assets, as schemes seek "enhanced returns and increased, predictable, cashflow generation." As for sustainable investment, Russell Investments head of fiduciary management, Simon Partridge, says: "Focus on sustainable investing might continue to diminish into 2025 as DB schemes focus on improving or maintaining funding levels, managing market risk and de-risking towards endgame."

Written by Sandra Haurant, a freelance journalist