Perspectives
Financial Markets

Annual outlook 2025

Interest rates & bonds

Good total return expectations for credit in 2025

Overview of bond yields and investment-grade credit spreads

	10-year government bond yield			Investment grade credit spread		
	Current	Nov/Dec 2024*	Year-to-date*	Current	Nov/Dec 2024*	Year-to-date*
US	4.3%	4 bps	45 bps	75 bps	-9 bps	-24 bps
Eurozone	2.2%	-18 bps	18 bps	99 bps	-5 bps	-39 bps
UK	4.4%	-8 bps	83 bps	101 bps	-7 bps	-38 bps
CH	0.3%	-7 bps	-38 bps	68 bps	-1 bps	-14 bps

10-year government bond yield eurozone = DE, bps = basis points.
* Change as at 12 December. Source: Bloomberg

USA

- As a result of the US elections, expectations for US real GDP growth and inflation in 2025 have increased, but they remain somewhat lower than for 2024, consistent with a "soft landing" scenario.
- Market expectations for the number of rate cuts in 2025 declined after the US election, from 5 to 3. In 2025, we expect 4 rate cuts by 25 bps each.

Eurozone

- For 2025, we expect growth in the Eurozone to be significantly lower than in the US. This is mainly due to weak dynamics in Germany, Italy and France.
- Inflation should therefore ease further in 2025. We expect 6 rate cuts by 25 bps each in 2025 by the ECB.

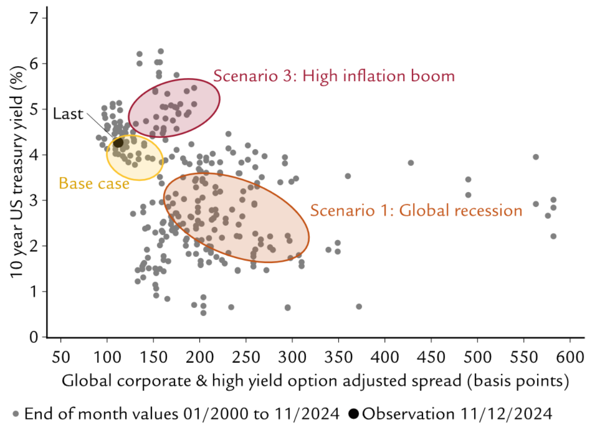
UK

- After the presentation of the UK budget in October 2024, growth and inflation expectations for 2025 increased. Nevertheless, we expect inflation to ease enough for the Bank of England to become less restrictive.
- Overall, we expect five policy rate cuts by 25 bps each in 2025.

Switzerland

- We expect low but steady GDP growth in Switzerland and a further decline of inflation towards 0% in 2025.
- In December 2024, the SNB cut its policy rate more than expected to 0.5%. We expect another cut by 25 bps in 2025.

Credit spreads and rates in different economic scenarios



Sources: Bloomberg, ICE BofA, Macrobond, Swiss Life Asset Managers. Last data point: 11/12/2024

In 2024, US GDP growth and inflation were higher than initially expected. Despite many challenges, the global economy was resilient and risky assets performed well. Year-to-date, credit spreads declined in the US, Eurozone and UK as the asset class enjoyed large inflows. After mid-September US markets started to anticipate the election of Donald Trump with 10-year US Treasuries yields raising from their 2024 lows and ending up being higher compared to the beginning of the year. In Europe, rates remained rather stable. Due to high all-in yields and tightening spreads, credit enjoyed solid returns of 5.4% (EUR IG), 8.2% (EUR HY), 4.6% (USD IG) and 8.9% (USD HY). For 2025, the market prices a scenario for both lower growth and inflation, which should lead to a further easing of monetary policies (base case). In this scenario, IG credit is still an attractive asset class. Above-average yields and chances for lower interest rates positions credit again for potentially good total returns (in local currencies). If upcoming data deviates from this scenario, this could lead to significant volatility in rates and spreads. In scenario 3, both inflation and growth exceed expectations, which could be detrimental for investors as spreads and rates would likely rise from current levels. A global recession could still generate attractive returns, as any increase in credit spreads is expected to be counterbalanced by a more pronounced decrease in interest rates (scenario 1).

Equities

Two strong years end, outlook constructive

Overview of equity market performance

	Nov/Dec 2024*	Year-to-date*
USA	6.6%	28.4%
Eurozone	2.9%	11.0%
UK	2.8%	11.2%
Switzerland	-0.7%	6.5%
Emerging Markets	-0.4%	11.2%

MSCI net total return indices in local currency.
* Performance as at 12 December. Source: Bloomberg

US

- In 2024 (all data as of 12 December), the market was up almost 30% and the performance of the last two years marks only the seventh time in history with two consecutive years above 20%.
- Key for the strong US performance were again big tech stocks that are up by almost 70% in 2024.
- The US market is expensive and valuation much higher than all the other markets.

Eurozone

- In 2024, the European stock market underperformed the US market (in local currency terms) by almost 20%. This is the second-largest underperformance in the last 30 years.
- Key drivers of the weak performance were subpar growth and the fears of adverse effects from tariffs.
- The valuation of the European market is still neutral, but a trigger for a higher valuation (absolute and relative to the US market) is missing.

UK

- In 2024, the UK market performance and its problems were very similar to the Eurozone.
- The UK market still benefits from a low valuation.

Switzerland

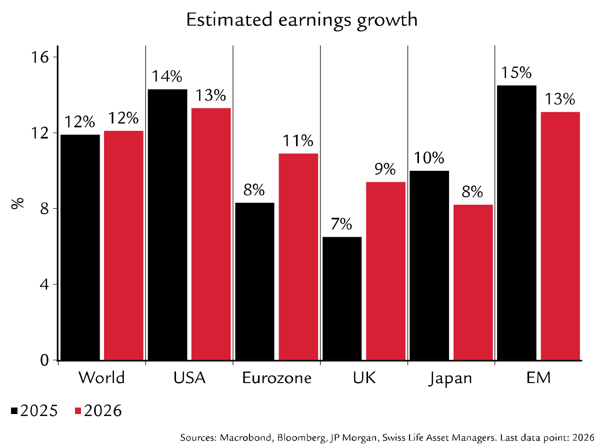
- The Swiss market was the weakest performer in 2024. The key reason was the poor performance of the three index heavyweights. Nestlé has a weight of 23% in the SPI and lost more than 20% in 2024.
- The Swiss equity market valuation is at the upper end of the neutral range.

Emerging markets

- The rally in September was not sufficient for a good relative performance. Especially Latin American stocks and South Korea were very weak in 2024.
- The valuation discount is big, but like for European stocks, a trigger for higher valuations is missing.

Outlook 2025

We think that 2025 can be another good year for equities, but with lower returns than in 2023 and in 2024. The key reason for our positive assessment is that the combination of strong US-growth and loose monetary conditions provide a fertile ground for sales and earnings growth. Below, we outline the positive and negative aspects for next year.



The key negative is valuation, notably for US (and by implication developed markets) equities. No matter what valuation metric we use, these two markets are very expensive. A second negative is that there has been no meaningful correction in 2024 and stock market optimism is very elevated. Due to the high valuation, mid- and longer-term return expectations for the US-market are below historical averages. The key positive is the benign economic environment: growth (especially in the US) is strong, financial conditions are loose and central banks are expected to ease further. In this environment, earnings growth of around 10% is quite likely for 2025. Other positives are stimulus packages in China and the expected tax cuts and deregulation in the US. Finally, valuations outside the US are broadly neutral. These positive factors are expected to outweigh the negative factors in 2025. A wildcard is AI: it is possible that the positive effects are currently underestimated and the boost to productivity is higher than markets price. In sum, we have a positive outlook for the coming months and 2025. In our base case scenario, we expect a total return between 5% and 10% in line with earnings growth (and without expansion of multiples). In a negative scenario where the global economy slips into recession, we would expect negative returns while in a very optimistic scenario with no trade war, we would expect returns above 10%.

Currencies

"King Dollar's" global rein continues

Overview of major currencies

	Nov/Dec 2024*	Year-to-date*	View 2025
EUR/USD	-3.8%	-5.2%	↘
EUR/CHF	-0.7%	0.5%	↘
GBP/USD	-1.8%	-0.5%	↘
USD/JPY	0.4%	8.2%	↗

* Performance as at 12 December. Source: Bloomberg

USA

- In 2024, USD strength was only temporarily interrupted during the summer months. Strong US growth and monetary policy expectations were the main drivers of USD strength. On the lower end of the performance scale, Latin American currencies like the Mexican peso suffered from trade war risks.
- We expect USD strength to continue in 2025. Interest rate differentials, the so-called "carry", should remain the main driver. While the Federal Reserve will also be able to cut rates further, it should do so at a slower pace compared to the ECB, keeping the carry advantage for the USD alive.

Eurozone

- The EUR depreciated sharply against the USD and GBP in 2024 but appreciated against the other major currencies.
- We expect the EUR to remain weak in 2025 due to low economic momentum, looser monetary policy and trade uncertainty.

UK

- The relative resilience of the GBP in 2024 was driven by stronger-than-expected growth and less monetary policy easing than expected.
- We expect some reversal in GBP/USD 2025 and therefore see the currency pair moving lower.

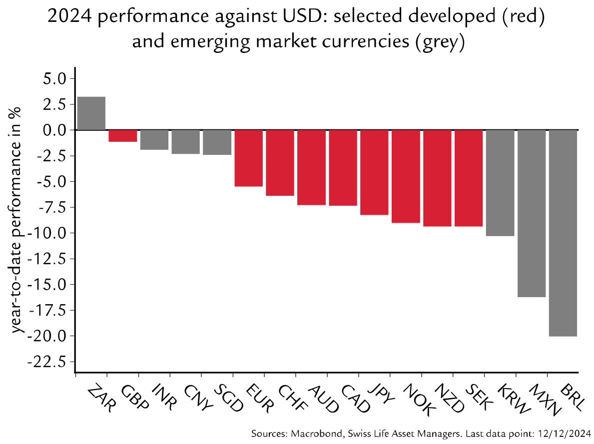
Switzerland

- In 2024, CHF remained almost flat against the EUR.
- We expect EUR/CHF to move slightly lower in 2025, because the inflation differential remains in favour of additional CHF strength.

Japan

- USD/JPY had a volatile 2024 due to large swings in monetary policy expectations for the Bank of Japan.
- For 2025, we see USD/JPY higher despite the expectation of further monetary policy tightening in Japan.

2024: embracing the US dollar era



One year ago, we predicted 2024 to be a year of USD strength. Indeed, after the year 2023 with mixed USD performance, the return table for 2024 (see above) shows USD outperformance across the board. The odd one out is the South African Rand (ZAR) as the only currency in this coverage which managed to appreciate against the greenback. Most of the ZAR resilience can be attributed to a decline in political risks after the elections in May which led to a more nationally united government. Otherwise, across-the-board USD strength was driven by strong economic growth in the USA and interest rate differentials moving in favour of the USD. We expect this trend of USD strength to continue in 2025. With Donald Trump moving back into the White House in January, the market expects looser fiscal policy due to planned tax cuts and at least some targeted tariffs, which should reinforce USD strength. In Europe, political uncertainty due to domestic political turmoil in Germany and France remains elevated and should remain in place for a few more months, weighing on the EUR. Additionally, eurozone economies are underperforming the US structurally and are likely to be hurt further from new US trade tariffs. We thus think that the ECB has more reason and room to deliver more policy rate cuts in 2025 than the Fed, resulting in interest rate differentials that remain supportive of the USD. This so-called "carry advantage" remains the main reason for our constructive view on the USD in 2025. USD strength should also remain broad-based, not only against the EUR, but also against GBP, and JPY. For CHF we see safe-haven-flows to fade over the coming quarter given the recent developments in the middle east, while the Swiss economy is expected to remain solid.

Asset allocation

Moderate positive 2025, but expect a rough ride

Review

- Financial markets in 2024 surprised us. Bond yields were expected to fall rather than to increase and equity markets performed well despite their lofty valuations. Credit spreads, which were already tight, tightened even more.
- These developments can be explained by the resilience of the US economy, the slower-than-expected fall of inflation, the potential of Artificial Intelligence to increase productivity and the US elections: Financial markets focus on further growth, which is expected to be very robust. This means, however, that markets put a very low weight on fundamental valuations, expecting that earnings growth will justify the high valuations.

Current asset allocation views

Asset class	Active weight
Global Government Bonds	neutral
Global Investment Grade Credit	underweight
Emerging Market Bonds	underweight
Global Equities	overweight

Source: Swiss Life Asset Managers

- We nonetheless expect financial markets in 2025 to deliver moderately positive returns to a diversified investor. Looking at equities, we note that the expensive valuation is mainly the result of the lofty prices of a few very large companies, with many other segments being cheap. There will be volatility given the many significant (geo-)political risks and high valuations. However, in our base case scenario of solid economic growth, any correction might be perceived as a buying opportunity, likely leading to fast recoveries, especially in the cheaper segments of the equity market like small caps and European stocks.
- We are cautious on corporate bonds, as the low spreads lead to asymmetric risks: the potential for even tighter spreads is limited in a positive economic scenario, while the potential for spread widening is significant in an adverse economic scenario. Having to choose between overvalued equities or overvalued credit, we therefore prefer equities.
- Bond yields are attractive, especially for US and to a lesser extent for EUR bonds, while those in CHF are unattractive. Our expectation is for US yields to only fall moderately in the base case. However, government bonds should protect to a certain extent for the risk of an equity market correction.

Surprisingly strong 2024, volatile but positive 2025

For 2024, we expected strong bond returns and moderately positive equity returns. The year, however, has developed somewhat differently, as bond yields (except for CHF bonds) have increased, and global equity markets have performed strongly. The table illustrates the simulated return in 2024 for a portfolio investing 50% in bonds and 50% in equities for CHF and EUR investors.

Simulated performance of a 50% bonds/50% equity portfolio

Portfolio Currency	Return 2024 year-to-date*
CHF	12.5%
EUR	13.4%

Allocation: 40% domestic government and investment grade bonds, 10% global investment grade credit bonds (currency hedged), 20% in «domestic» equities and 30% in «global» developed markets equities (unhedged). The calculations are based on indices and do not include any cost.

* Performance as at 11 December. Source: Bloomberg, Swiss Life Asset Managers

CHF Portfolio

- The CHF balanced portfolio performed well in 2024 thanks to an unexpectedly good year for CHF bonds and the strong global equity market, partially compensating for the weak performance of Swiss equities, the low return of global corporate bonds and impact of CHF appreciation.
- In our base scenario, we expect a significantly lower but positive return for this portfolio, as CHF bonds are likely to perform worse than in 2024, while global equity markets returns should be more moderate than in 2024. In addition, the CHF will continue to experience some appreciation pressure, notably against EUR.

EUR Portfolio

- The EUR portfolio performed better than the one in CHF, as the lower EUR bond returns were overcompensated by a much better relative performance of the EMU equity market and the positive impact of a weaker euro.
- In our base case scenario for 2025, returns should be significantly lower than in 2024 but positive. Bonds in EUR are likely to profit from falling yields and the Eurozone equity market could do better thanks to its attractive valuation, supporting the performance of such a portfolio.

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