Six key themes

Insights into macroeconomic trends and market shifts for 2025

Benoit Anne

Many consequential shifts are on the cards for 2025, be it the impact of trade policies, the ongoing US productivity shock, growing monetary policy divergence or transformational scientific advancements.

As investors look to 2025, a number of key themes—from a second Trump administration to record US corporate profitability to widespread adoption of groundbreaking scientific advances—are expected to shape macro and market conditions. Under a second Trump administration, investors expect that the United States will undergo several major policy shifts around trade, tariffs and immigration, to name a few. These shifts will not only have major ramifications for the local macro and market environment but also on the rest of the world.

A key feature of the US equity market's strength has been the recent profit margin dynamics. Margins are near historical highs and there is no sign of a major profit margin correction on the horizon. Could corporate America be experiencing a profit margin structural shift? Time will tell, but sometimes too much of a good thing can be bad for markets. One risk to watch is the economy and markets running so hot that a no-landing scenario arises in the US. If that scenario were to take hold, there is a possibility that inflation would resurface as a major macro risk, with broad implications for the policy outlook of the US Federal Reserve.

While a no-landing outcome would mean that the US has moved to a higher growth trajectory, it would also imply that market rates may stay higher for longer. Meanwhile, the challenges facing China appear to be very different in nature. China's structural headwinds remain considerable. These include the highly distressed property sector, substantial local government debt burden, elevated deflation risks, systemic overcapacity in the industrial sector and adverse demographics. Aware of these challenges, the Chinese government is trying to revive the economy through a broad policy package, but we remain sceptical that these issues will be effectively addressed.

Looking at the global backdrop, we are standing ahead of the great bifurcation, with growth and monetary policies showing increasing signs of divergence, a propitious environment for active global asset managers. Finally, a key sectoral theme we are watching is the advancement of game-changing lifestyle pharmaceuticals (GLP-1s) that may produce a transformational impact extending beyond healthcare.

1. Trump 2.0 and the impact

The US is expected to undergo major policy shifts, with significant macro and market implications. During his campaign, President-elect Donald Trump advocated for pro-growth policies such as extending the 2017 Tax Cuts and Jobs Act, reducing corporate tax rates for domestic production and repealing green energy tax credits. A significant focus of his campaign was a commitment to impose steep tariffs on imports. With the GOP's majority in Congress, substantial policy changes are anticipated. Trump's policy mix of low taxes, extensive deregulation and heightened trade barriers is likely to have varying, but significant, macroeconomic effects.

Risky assets, higher rates and tariff risks

The post-election market response has been quite positive for risky assets. This is partly because investors have started to price in higher growth expectations and, to a lesser extent, potentially higher inflation risks, especially if the new government engages in further fiscal spending. Overall, we believe that Trump 2.0 may promote an equity-friendly macro environment while also contributing to rates potentially staying higher for longer. As for the US dollar, the outlook now appears considerably stronger for the period ahead. On the risk front, the main threat to global risk sentiment is likely to come from the prospect of steep tariffs.

Howard Lutnick, Trump's nominee to head the Commerce Department, and Jamieson Greer, his choice for US Trade Representative, will spearhead this initiative. Greer advocates for a strategic decoupling between the US and China. Widespread tariffs could trigger higher inflation, and US producers face potential retaliatory tariffs from global partners, creating a negative economic feedback loop. Trump's tax plan is expected to modestly increase the already stretched deficit by $3 trillion over the next decade. However, widescale deregulation, potential tariff revenues and the prospect of leaner government operations could act as a counterbalance.

Winners and losers

Under this new regime, energy companies, particularly fossil fuel producers, are likely to face less regulatory pressure. The automotive industry, especially domestic manufacturers relying on pickup truck sales, could benefit from a rollback of EV mandates, though trade tensions could create headwinds for their Mexican and Canadian operations, which are highly integrated in the production process of US vehicles. Additionally, financials stand to gain from lighter regulation and increased capital markets activity.

1. Actions to consider

- Small- and mid-cap stocks, which tend to be less exposed to tariffs may benefit from tax reform and deregulation.
- US equities could benefit from Trump's policy mix more than non-US equities.

2. On the margin: Corporate profitability remains strong

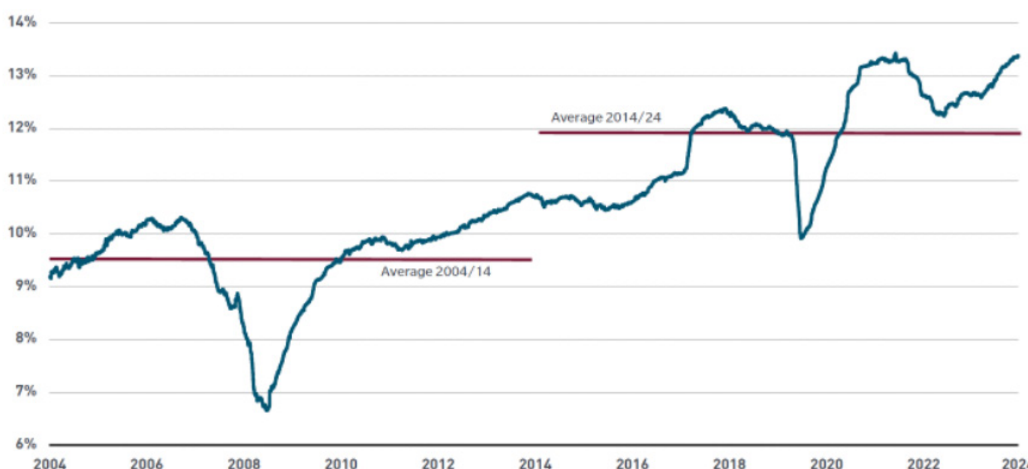
Time to revisit the old theory?

The theory of profit margin mean reversion goes that as an industry achieves extreme levels of profitability, new entrants, eager to earn outsized returns, will enter and competition will drive lower profits. Those industries experiencing poor levels of profitability will take the opposite tack, with companies exiting less profitable markets, lowering competition and bolstering margins. A small change in profit margins can lead to a big change in corporate earnings, making them critical to any business. However, US profit margins have remained elevated for several years, causing investors to consider what might have changed. See Figure 1.

The structural downward shift in costs

US profit margins are near their highs and, while concerning, there are good reasons why they could stay elevated. First, when interest rates were near zero from 2020 through 2022, many companies refinanced their debt, lowering overall debt services costs and pushing out maturity dates. Unless restructured, these benefits accrue for the life of the bond. Second, following the Tax Cuts and Jobs Act of 2017, corporate tax rates were lowered to 21%, providing a one-time change in the tax

Figure 1. Have profit margins reset higher?



Source: Factset. S&P 500 net margins 19 November 2004 to 31 October 2024

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The quote

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rate for many companies, flowing directly to the bottom line. This is a structural change to corporate income statements and could drop further under the second Trump administration. Third, massive amounts of fiscal stimulus have been pushed into the economy over the past four years, flowing through to corporations directly through government programs supporting companies or indirectly through consumer stimulus spending. More fiscal stimulus is expected under the new administration.

The positive impact of the productivity shock

We are at the dawn of a new technological era, with the application of artificial intelligence and breakthroughs in quantum computing. Many office jobs are likely to be replaced or heavily augmented by artificial intelligence, which can handle massive workloads and is easily scaled. This is likely to benefit firms across industries, even in manufacturing where breakthroughs in smart manufacturing can mitigate production delays. A machine telling you it needs a replacement part before it breaks will create incredible efficiencies, which reduce costs and boost margins.

Some differentiation needed

Importantly, margins at the individual company level will always be idiosyncratic based on the merits of its business strategy, management talent and position in the industry, among other attributes. Markets may also price in elevated future profit margins through higher valuations. So, while aggregate profit margins may remain elevated, security selection will likely always remain paramount.

2. Actions to consider

- Consider corporate margin levels in the context of structural changes to corporate financials, which could mean a sustainable shift higher.
- Equity markets may be pricing in higher levels of future profit margins through elevated valuations, we do not think investors should be deterred by higher aggregate profit margins.
- Security selection will be critical, even as aggregate profit margins remain high.

3. Hot economy could force the fed's hand

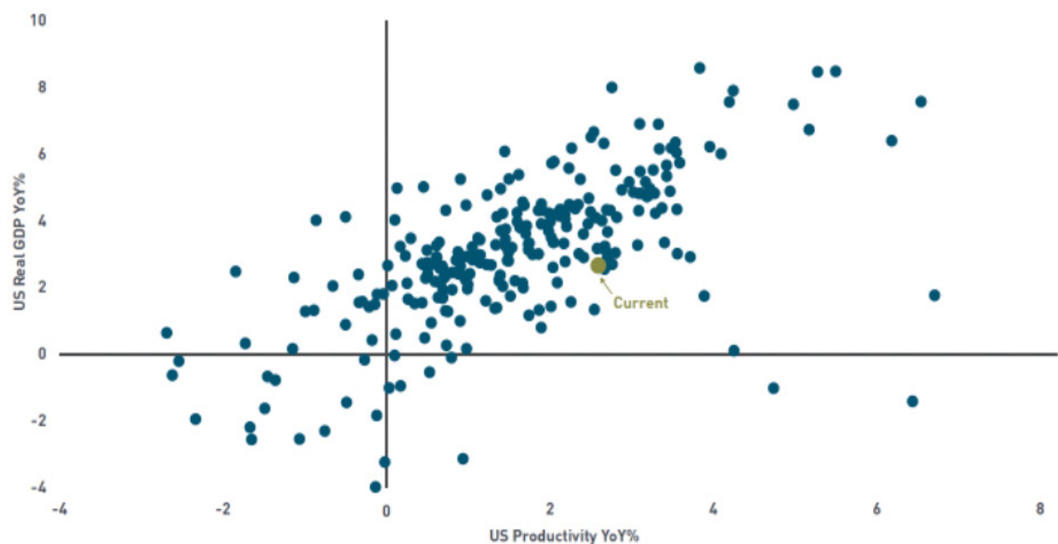
Watch for the risk of no-landing

A soft landing for the US economy has been the consensus expectation over the past year. However, a new economic path has emerged—a no-landing scenario where economic growth re-accelerates without a notable downturn. This scenario seems increasingly likely as the Trump administration, largely seen as pro-growth, lays out its economic plans. This re-acceleration in growth could potentially cause the economy to overheat, triggering a resurgence in inflation and compelling the Fed to resume rate hikes.

A virtuous loop for growth expectations

A resilient Labor market, improved productivity and strong consumer spending are increasing the probability that a no-landing occurs. The labour market remains solid, with new jobs continually added and unemployment rates near historical lows. Productivity, measured by per-employee output, has increased

Figure 2. Higher productivity tends to lead to higher economic growth



Source: Haver Analytics. Quarterly data from 31 March 1960 to 30 September 2024.

significantly since 2020, due in part to new business creation and the adoption of new technologies. This productivity surge has contributed to wage increases and enhanced living standards for many in the US: refer to Figure 2. Moreover, a thriving labour market and higher wages have spurred consumer spending. Fundamentally, this creates a virtuous loop where strong job growth enhances productivity, leading to increased consumer spending, which then fuels economic growth. This stronger economic growth generates more jobs, perpetuating the cycle but also increasing the risk of inflationary pressures.

But overheating is a risk, with monetary policy implications

If the robust economic growth and above-target inflation persist, the Fed is likely to maintain rates in restrictive territory for an extended period. Typically, stronger-than-expected growth coupled with moderate inflation can elevate corporate profits and bolster investor confidence, propelling asset prices upwards. Conversely, a higher-for-longer rate outlook pressures wages, increases the cost of capital and can adversely affect residential and commercial real estate. It also exerts upward pressure on the back end of the yield curve, where yields have recently risen, even as the Fed cuts the policy rate. While a no-landing scenario might stimulate risk appetite, it is crucial to recognise its potential to overheat the economy, possibly leading to higher inflation and reduced real investment returns. Thus, while such a scenario presents opportunities for wealth generation, it also introduces risks that require careful management by investors.

3. Actions to consider

- A no-landing scenario widens the range of outcomes on how the Fed reacts to economic conditions and how investors may think about their risk assets.
- In a higher-for-longer rate environment, investors may want to consider high dividend yielding value sectors, including industrials and financial services.
- In fixed income, we prefer neutral to short over long-duration and higher quality bonds given tight spreads in the corporate bond market.

4. China: Back against the wall

China's structural headwinds remain considerable

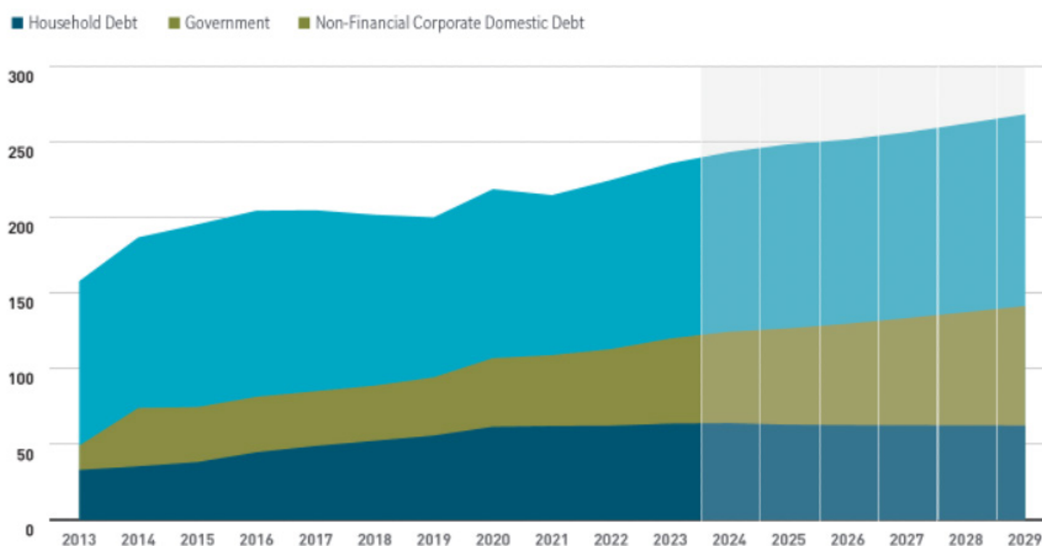
China's economic challenges are myriad, including debt and default issues in the highly distressed property sector, local government debt, elevated deflation risk, systemic overcapacity in the industrial sector and adverse demographics, refer to Figure 3. In addition, China faces a more challenging geopolitical backdrop as well as the renewed threat of US and European tariffs, which may drive a need to further reorient its place among global trade flows. Moreover, local government balance sheets are severely impaired due to excessive borrowing through off-balance sheet instruments such as the local government financing vehicles (LGFVs), which were used to pursue infrastructure and urban development agendas. On growth, the challenge revolves around structural headwinds for domestic demand and private consumption.

The emergence of a strong middle class and a solid social safety net were the keys to success for China's growth

The quote

We remain sceptical on the Chinese economy, but we believe selective investment opportunities can be found.

Figure 3. China's total debt



Source: IMF 2024 Article IV Press Release on China. Annual data from 2103 through 2029 are forecasts.

model to transition to a more sustainable, consumption-driven economy. However, progress has been slow on this front, and looming demographic challenges may make this more difficult to achieve. The median age in China is now over 40, compared to 38 in the US and 29 in India. Meanwhile, weak inflation and even deflation have become increasingly entrenched, weighing on household and corporate balance sheets.

Aware of these challenges, the Chinese government is trying to revive the economy through a broad policy package. In November, China released plans for a 10 trillion yuan ($1.4 billion) local debt package, but the lack of direct stimulus fell short of expectations. One key development to monitor will be the March National People's Congress (NPC) when details of the fiscal program should be released. We have doubts that further policy support packages will be successful in addressing these structural headwinds, with concerns over its size, timing, coordination and effectiveness. While fiscal policies are most effective when implemented at the local government level, this is also where the financing constraints are most dire.

Overall, we remain sceptical on the Chinese economy, but we believe selective investment opportunities can be found. Given the very slow nature of structural reforms, sector selectivity is key, in our view. Looking ahead, a focus on the targeted sectors that may benefit from the forthcoming fiscal stimulus appears to be an appropriate strategy to us. These sectors include consumer staples such as food and alcoholic beverages and online gaming and communications, all of which are seemingly unlikely to be exposed to external tariff threats.

4. Actions to consider

- Closely monitor government policy announcements, including around the NPC in March.
- Establish a stance on assets that are exposed to potential trade protection actions.
- Sectors and companies that may directly benefit from the fiscal policy stimulus

5. The great bifurcation

An unsynchronized global macro backdrop

Economic growth appears ready to further bifurcate in 2025. In the US, the resilient consumer, a healthy corporate sector and the impact of potential tax cuts under the new presidency should keep economic growth on a strong path. On the other hand, countries like Germany, France and China are facing significant growth headwinds in the form of political uncertainty, deflation risks and manufacturing recession. With inflation fears mainly behind us, we anticipate that the growth outlook is going to play a bigger role in central bank policy-making decisions in the period ahead.

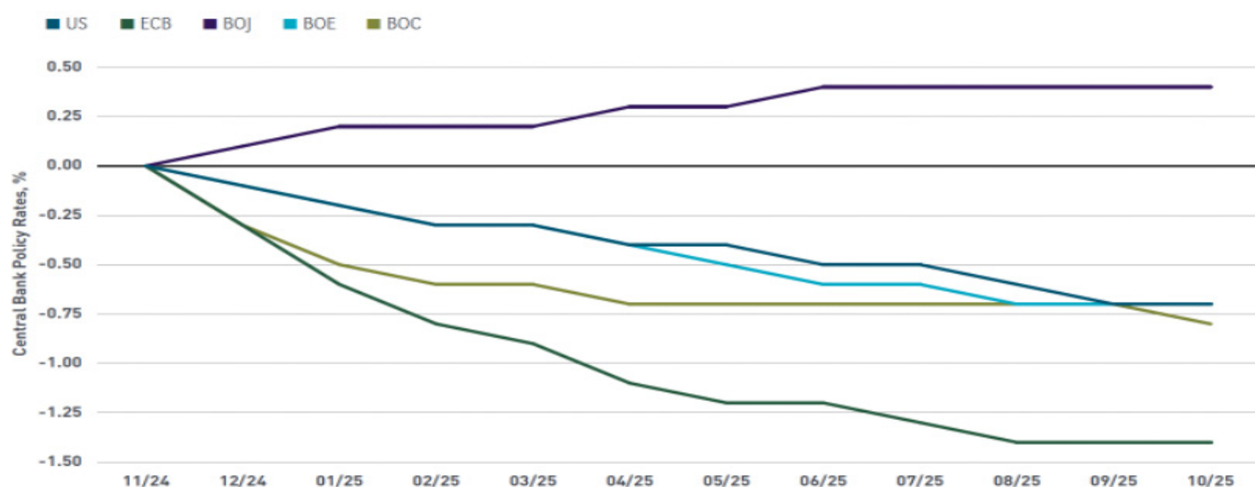
Increased signs of global monetary policy divergence

While central banks around the globe are expected to stay in easing mode going forward, with just a few exceptions, the magnitude and the speed of rate cuts is likely to be quite different from one country to the next. In other words, we have entered a new territory of divergent policy easing, refer to Figure 4. Some central banks, like the Fed, will, at best, target a return of its policy rate to the neutral rate—that is, the rate that would prevail if the economy were at full employment and stable inflation, keeping both in balance. Others, like the European Central Bank, may consider easing well beyond their neutral rate, and therefore promote considerably more accommodating monetary conditions.

Fertile policy environment for active global fixed income managers

Given the divergence of policies and growth dynamics, we anticipate some dislocation and relative value opportunities to emerge in the year ahead. If macro conditions remain robust in the US, as we anticipate, the case for being long US duration may be somewhat challenged. In contrast, regions characterised by weaker growth prospects and expectations of more aggressive central bank responses, like the eurozone, may be more attractive from a strategic long-duration perspective. Meanwhile, in emerging markets (EM), central banks may also come under pressure to slow their easing cycles due to

Figure 4. The divergence of global monetary policies: Market pricing or future rate changes



Source. Bloomberg. Based on federal funds futures and local forward cash curves. Data as of 20 November 2024.

weakening currencies and the impact of higher US market rates. With the fundamental backdrop being differentiated from one EM country to the next, sovereign debt may provide interesting alpha generation opportunities for asset managers who actively engage in country/region selection. Finally, the divergence of monetary policy may also have a major influence on the outlook for hedging costs, creating both challenges for some investors and opportunities for others. Overall, we expect the period ahead to remain top-down heavy, with macro developments, macro policies and macro risks playing a major role in investor outcomes.

5. Actions to consider

- Increasing exposure to a global fixed income allocation may help you take advantage of global dislocations.
- Overweight duration in regions that exhibit the greatest deceleration in growth and inflation, as is currently the case in Europe.
- Take advantage of favourable hedging cost shifts to potentially increase portfolio yield.

6. Game-changing lifestyle pharmaceuticals (GLPs)

Another historical breakthrough in medicine?

Previous advancements in public health like clean water infrastructure and medicines such as antibiotics have diminished the impact of diseases that had formerly weighed on the health of people around the world. These innovations have extended life expectancy, improved productivity and lifted living standards globally. Today, obesity, a co-morbidity for many diseases and a leading cause of numerous illnesses, including cancer and heart disease, presents a significant healthcare challenge. GLP-1s, first created to combat type-2 diabetes, have demonstrated efficacy in promoting weight loss, and may prove to be the 21st century's first drug development with similar implications for both human life and the economy.

A transformational impact extending beyond healthcare

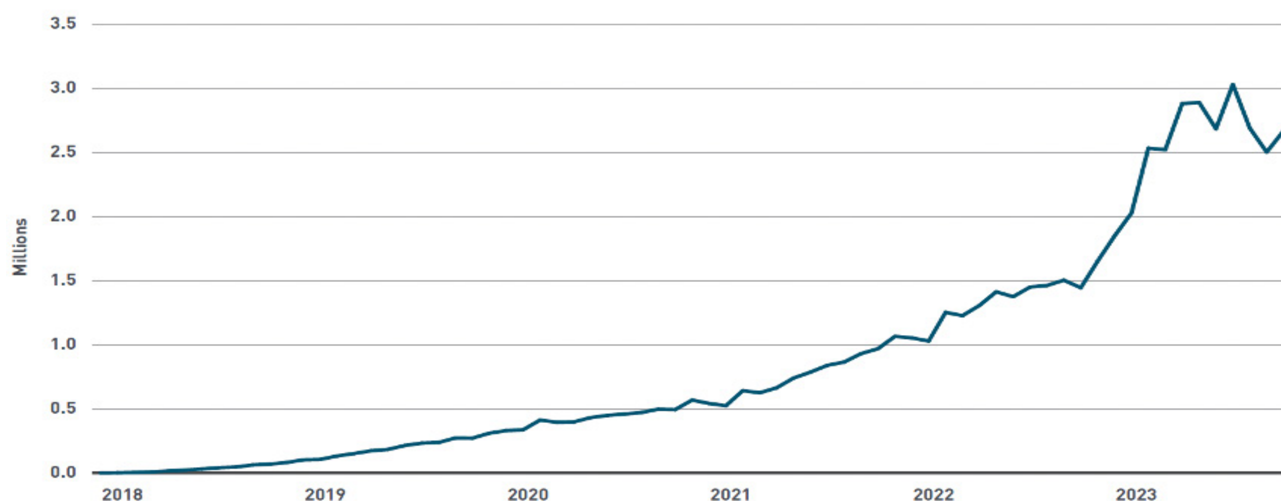
Rapid adoption of GLP-1s has the potential to be transformative and has already contributed meaningfully to revenue growth for the dominant drug manufacturers in the space. Robust demand for these drugs is being met with new manufacturing capacity, refer to Figure 5. Medical device companies and those involved in drug delivery also stand to profit from increased use. Outside of obvious names, mainstream acceptance of weight loss treatment will have implications for many sectors and industries including healthcare, fitness, food and beverage, clothing, wealth management and perhaps even transportation.

GLP-1 induced weight loss may reduce overall caloric intake, shifting consumption trends and lowering demand for fast food, consumer spending patterns could shift with decreased healthcare costs. Clothing demand may increase as consumers lose weight and then must purchase new, smaller clothes. Increased longevity may result in greater need for long-term care facilities and wealth management services. Overall economic productivity could benefit as well. However, the development and adoption of these drugs is still underway. As with any disruptive technology or discovery, determining who the long-term winners will be and having the conviction to hold them through periods of disruption requires deep fundamental research, intellectual curiosity and discipline.

6. Actions to consider

- GLP-1s may prove to be the answer to a modern healthcare problem that results in increased longevity, worker productivity and economic growth.
- Look outside of GLP-1 manufacturers to other sectors or industries that may stand to benefit or are disadvantaged from the rapid adoption of GLP-1s. **FS**

Figure 5. Total GLP-1 prescription count



Source: Bloomberg Intelligence. Monthly data as of 1 January 2018 to 30 November 2023.