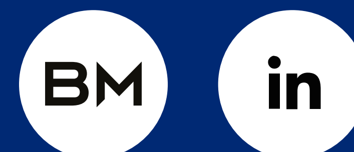
BROOKS MACDONALD

FOR PROFESSIONAL ADVISERS ONLY

Asset *Allocation* Overview

December (Q4) 2024



Navigating a turbulent world

- The global equity market hit a record high during calendar Q4 2024, but the period was not without its risks.
- November's US election result saw a Republican clean sweep of power, heralding significant change for markets.
- We continue to prefer equities over bonds, looking for a broadening of performance beyond megacap tech in 2025.

During Q4, the global equity market scaled record highs. The period was not without its risks however, including a UK budget, the political breakdown of French and German ruling government coalitions, and a ratcheting up of geopolitical tensions across the Middle East and Russia-Ukraine. The biggest impact on markets, however, was the unexpected Republican sweep of the US presidency and both chambers of Congress. With it comes a higher probability that much of US President-elect Trump's policy agenda will be put into action, impacting not only the outlook for US domestic assets, but globally too.

The Republican clean sweep has the potential to materially shape the investment outlook. One example is the negative impact that a Trump administration is expected to have on decarbonisation initiatives by choosing to prioritise hydrocarbon energy production instead. As such, the Asset Allocation Committee chose to exit the Decarbonisation theme during Q4. As we look forward, there is the risk of more consequences, both intended and unintended, that we will need to remain alert to. Responding thoughtfully to these, while remaining focused on our longer-term investment objectives, continues to be our goal.

In 2024, we stayed constructive on equities which we prefer to bonds, and we are sticking to that view as we look forward to 2025. We hold to our view that a US recession is unlikely, that global economic growth will continue more broadly, and that inflation pressures will continue to moderate. But at the same time, we keep conviction about what we want to own within equities – just as we have seen at times some evidence of rotation from megacap tech to small and mid-sized parts of the equity market emerge as a theme during the second half of 2024, we think we will see a lot more of this in 2025.

In bonds, we see no reason currently to shift from our short duration (short average-weighted-maturity) focus in fixed income markets: bond yield maturity curves are still relatively flat, and, in our view, investors are not being paid enough to take on additional interest rate sensitivity. We also have a balance between sovereign and corporate (largely investment grade) debt allocations: in our view the additional premium for taking on more speculative, higher risk corporate debt is not attractive at the current time. Overall, governing our thinking behind this asset class is not only the expected returns – just as importantly, this asset class can also offer a counterbalance to the risks we take elsewhere.

Lastly, our alternative allocations, which include property, uncorrelated assets, and structured products provide a crucial third leg to our asset allocation framework. They can provide a different expected capital return and yield mix to equities and bonds, and in doing so deliver valuable diversification to portfolios. Structured products have historically provided superior yields to bonds and can at times offer clients a degree of predictability in terms of expected returns.

Our top three investment risks

- **Inflation.** Should inflation pressures see a resurgence, this could curtail central banks' room for manoeuvre. Despite recent rate cuts, this scenario could risk a re-tightening of monetary policy, leaving interest rates higher and for longer than expected.
- **Geopolitical risk.** Any escalation in either the current theatres of conflict (Middle East and Russia-Ukraine), or indeed future risks of potential conflict (China-Taiwan), could have a significant impact on the global economic and investment outlooks.
- **Policy error.** Governments and central banks continue to face unintended policy error risk, with fiscal policy in focus as governments attempt to navigate electoral calls for continued deficit spending while hoping to keep financial markets onside.

Asset class	Outlook	Change since previous quarter	Rationale
Equities			
UK	Positive	No change	The UK equity market index derives around three-quarters of its revenues from outside the UK, making it sensitive to global trends. These trends still point to constructive economic growth and an easing inflation picture. UK equities are a key part of our investment mix. We focus on value stocks in sectors like resources and financials, which balance our growth investments in other regions.
US	Positive	No change	US corporate results continue to show a robust economy in which resilient consumers are still benefiting from a relatively strong job market. A pivotal event for markets in Q4, the US election result and Republican clean sweep of power creates both positive as well as negative risks. Finally, the US Federal Reserve's interest rate cuts could boost smaller and mid-sized companies, which we increased exposure to in the past year.
Developed Europe (excluding UK)	Neutral	No change	With European natural gas prices much lower than the early days of Russia's invasion of Ukraine, cheaper energy is helping improve the inflation outlook. This could lead to further interest rate cuts and provide relief for businesses and households. Although long-term issues exist between the euro area's monetary and fiscal policies, the medium-term outlook is more positive, thanks to relatively attractive valuations.
Japan	Neutral	No change	Japan's main stock exchange has been working to make companies more efficient. Along with the welcome return of inflation after years of slow economic growth, this has boosted the outlook for Japanese equities, especially in the financial sector. However, Japan still faces challenges like high public debt and an ageing population, which pose risks as the Bank of Japan raises interest rates from very low levels.
Asia Pacific (excluding Japan)	Neutral	No change	Our neutral regional outlook disguises a more cautious outlook towards China. China faces significant structural challenges, not least a heavily indebted property market and high youth unemployment which will take time to resolve. Increased US-China geopolitical tensions will not help. Given these challenges, we see China more as a potential investment risk than an opportunity, and the market outlook could worsen before it improves.
Emerging markets	Negative	No change	China, despite calls for major stimulus, has been cautious about using aggressive infrastructure spending to boost its economy, impacting resource-export-led Emerging Markets (EM). China's move to effectively export its excess manufacturing capacity could also challenge the profitability of companies in emerging markets. Finally, a resurgent US dollar poses risks for dollar denominated debt and EM investment flows.
Equity Themes			
Technology	Positive	No change	With a focus on profitable, cash generative technology exposures, we see long-term growth from technology's ability to identify, enter and disrupt new markets, creating new revenue streams and barriers to entry. More recently, generative Artificial Intelligence (AI) has catalysed revenue and earnings forecasts for the sector as companies seek to lift their productivity.
Healthcare	Positive	No change	Western health-care systems are geared toward long-term elective care and demographic tailwinds, where growth in weight loss drugs is the latest example. Highlighting the overlap between our Healthcare and Technology themes, generative AI has the potential value across drug discovery, clinical trial design, and customer engagement.

POSITIVE NEUTRAL NEGATIVE

Asset class	Outlook	Change since previous quarter	Rationale
Fixed Income			
UK sovereign	● (Positive)	No change	Higher yields on gilts, reflecting the current interest rate outlook, can play a more constructive role in asset allocation. Recognising inflation and interest rate uncertainty, we prefer shorter-dated bonds in order to manage interest rate sensitivity. Furthermore, for taxable client portfolios, it is worth noting that UK gilts are exempt from Capital Gains Tax (though interest on gilts are liable to income tax)
UK Credit	● (Positive)	No change	We have a positive outlook on UK corporate debt, in part given the expected yield pick-up available and versus yields elsewhere globally. We prefer investment grade over high yield debt, where the latter is more vulnerable to any weakening in the economic outlook as well as greater sensitivity to adverse liquidity and market stress events.
International sovereign	● (Neutral)	No change	Our neutral outlook disguises a more cautious outlook towards conventional US Treasury bonds, where as a result of the US election outcome, we see a risk that yields could move higher, and stay higher, across the curve. Balancing this risk of a re-emergence in inflationary pressures, we have a positive view on US Treasury Inflation Protected securities.
International	● (Neutral)	No change	Credit spreads versus sovereigns are some way below past episodes of significant market stress. Corporate balance sheets are relatively well-capitalised, but we prefer investment grade over high yield debt, where the latter can prove more sensitive to changes in the economic outlook as well as relatively weaker liquidity characteristics.
Alternatives			
Alternatives	● (Neutral)	No change	Within the Alternatives asset class, we have allocations (dependent on the risk band in question), to Directional Multi-Assets, and/or Alternative Income, and/or Uncorrelated Assets. These assets can be expected to provide a degree of counterbalance to more directional risk exposures elsewhere in our asset allocation.
Property	● (Neutral)	No change	The inflation / interest rate outlook has continued to moderate, lifting sentiment, though central bank policy is still in restrictive territory. Longer-term, the sector offers both generalist and specialist investment opportunities, while valuation discounts to net asset value provide some cushion against any downward estimate revisions.
Structured investments	● (Neutral)	No change	While structured investments have historically provided superior yields to bonds, returns can become more correlated with equities if markets suffer a significant correction. In addition, pricing of structured return products can vary at times, in part given issuer appetite as well as expected market volatility levels going forward.

● POSITIVE ● NEUTRAL ● NEGATIVE

Important information

Important information. All data provided as of 2 January 2025 unless otherwise stated. Past performance is not a reliable indicator of future results. Investors should be aware that the price of investments and the income from them can go down as well as up and that neither is guaranteed. Investors may not get back the amount invested. Changes in rates of exchange may have an adverse effect on the value, price, or income of an investment. Investors should be aware of the additional risks associated with funds investing in emerging or developing markets. The information in this document does not constitute advice or a recommendation and you should not make any investment decisions on the basis of it. This document is for the information of the recipient only and should not be reproduced, copied, or made available to others. Brooks Macdonald Asset Management Limited is regulated by the Financial Conduct Authority. Registered in England No 3417519. Registered office: 21 Lombard Street, EC3V 9AH. Brooks Macdonald Asset Management (International) Limited is licensed and regulated by the Guernsey Financial Services Commission. Its Jersey Branch is licensed and regulated by the Jersey Financial Services Commission. Brooks Macdonald Asset Management (International) Limited is an authorised Financial Services Provider, regulated by the South African Financial Sector Conduct Authority. Registered in Guernsey No 47575. Registered office: First Floor, Royal Chambers, St. Julian's Avenue, St. Peter Port, Guernsey GY1 2HH.

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