Life \ Pensions \ **Investments**

December 2024
Quarter in review

more **INVESTED**

EQUITIES TO NEW ALL-TIME HIGHS

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Global equities rose to new all-time highs in the fourth quarter of 2024, amid expectations of growth-supportive policies from the incoming US administration. Stocks then fell towards the end of the period as the potential for fewer Federal Reserve (Fed) interest rate cuts in 2025 weighed on sentiment. Global activity data continued to indicate divergence, with US data showing economic strength while there were some mixed signals in the Eurozone. The main event over the quarter was the US election, which resulted in Donald Trump being re-elected as President and the Republicans winning a 'clean sweep'.

US

US third-quarter GDP rose by 3.1% quarter-on-quarter (QoQ) annualised, up from 3.0% in Q2. This was driven by increases in personal consumption (3.7%) and business fixed investment (4.0%), while government spending (5.1%) was also supportive. Household consumption was healthy in Q4 too. Retail sales growth accelerated to 0.7% month-on-month (MoM) in November, from 0.5% in October.

This backdrop was likely supported by favourable labour-market data conditions for most of Q4. October hiring was weak due to hurricanes and labour strikes. However, November non-farm payrolls rose by 227k, while previous months' data were also revised up and the unemployment rate remained low at 4.2%. Average hourly earnings rose by more than expected (0.4% MoM), suggesting healthy labour market conditions, while October job openings exceeded consensus forecasts. Meanwhile, positive sentiment continued in the services sector, with the December PMI in expansionary territory. By contrast, that for manufacturing was in contractionary territory.

Robust activity data suggests inflation pressures could remain, and Fed Chair Powell stated in November that the central bank did not "need to be in a hurry to lower rates" given the strong economic backdrop. In November, headline consumer prices rose by 2.7% YoY while core prices were up by 3.3%. The Fed's preferred inflation measure (PCE) also stayed above the bank's 2% target, rising by 2.4% YoY (headline) and 2.8% (core).

The Fed cut its policy rate by 25 basis points (bps) to a target range of 4.25-4.50% at its December meeting, but its updated projections showed a median of two 25bps reductions in 2025 among the committee, which was less than previously forecast. This was informed by predictions of strong growth of 2.1% in 2025 and increased estimates of both headline and core inflation to 2.5% for 2025 (up 30-40bps from estimates in September).

In November, politics took centre stage as the US election gave Donald Trump victory and the Republicans won a majority of seats in both the Senate and the House of Representatives. This 'clean sweep' for the Republicans was seen as allowing for implementation of president-elect Trump's agenda, which included tax cuts, deregulation, stricter immigration controls and tariffs.

Europe

Eurozone third-quarter GDP rose by 1.7% QoQ annualised, more than double the Q2 figure of 0.7%. This was driven by rises in household consumption (2.7%) and government spending (1.9%), while a rebound in fixed investment (8.4%) was also supportive. This suggested that the growth backdrop may be somewhat better in the second half of 2024.

Business sentiment data was mixed in Q4, with the composite PMI in contractionary territory. The services sector expanded while the manufacturing PMI indicated falling output in December. Weak manufacturing in the region is being driven by Germany, with industrial production and factory orders down in October and the former still comfortably below pre-pandemic levels.

Meanwhile, inflation remained well-behaved, with November headline consumer prices rising by 2.2% YoY in the Eurozone while core prices were up by 2.7% with signs of decelerating inflation pressures, which would support the case for further rate reductions. The ECB lowered its deposit rate by 25bps to 3.00% in December. 2025 GDP growth and headline inflation projections were revised down to 1.1% YoY and 2.1%, respectively. This has increased consensus rate-cut expectations for this year from the ECB, with President Lagarde stating that "the direction of travel currently is very clear". Hence, the market has priced in more easing for the ECB than the Fed in 2025, with a further 100bps of cuts expected this year.

Politics was in focus in Q4. The governing coalition in Germany collapsed, and a federal election will take place in February 2025. France's minority government was also defeated in a no-confidence vote in December, less than three months after forming, with Prime Minister (PM) Michel Barnier resigning the next day. This came after disagreements over the 2025 budget, which aimed to reduce France's fiscal deficit to 5% of GDP this year from an estimated 6% in 2024. President Emmanual Macron subsequently appointed François Bayrou as PM, but passing a budget to reduce the deficit may remain challenging.

MARKET ROUND-UP

Equities

Over Q4, global equities, as represented by the MSCI All Country World Index (ACWI), rose by 1.4% (6.8% in euro terms), supported by a 2.8% (10.8% in euros) rally in the MSCI USA.

Global activity data indicated ongoing divergence, with US data showing economic strength while there were some mixed signals in the Eurozone. Inflation remained controlled, and expectations for further falls allowed the Fed to continue its easing cycle, while the European Central Bank (ECB) also loosened policy further. Meanwhile, Q4 political developments included the re-election of Donald Trump in the US and the collapse of both the German and French governments. The potential for growth-boosting policies from the incoming Trump administration helped equities rally to new all-time highs during the quarter. However, a hawkish rate cut in December, when the Fed guided to fewer rate cuts in 2025 on the back of strong growth and potential sticky inflation, weighed on equities.

Small cap equities rose by 0.4% (5.1% in euros) amid expectations that policies like tax cuts and deregulation from the incoming Trump administration would be supportive for US small caps.

EM equities declined by 4.2% (-0.7% in euros) as the asset class was weighed down by a potential growth drag from US tariffs, which hurt sentiment towards Chinese stocks – the MSCI China fell by 7.0% (-0.5% in euros) over the quarter.

Bonds

The ICE BofA 5+ Year Euro Government bond index returned -0.6% as German Bund 10-year yields rose from 2.12% at end-Q3 to 2.35%, pulled higher by US yields and the possibility of looser fiscal policy post the German election in February. In the US, the 10-year US Treasury yield rose substantially, by 78bps to 4.57% over the period, as fewer rate cuts from the Fed were projected after the central bank revised its 2025 forecasts at its December meeting.

European investment grade (IG) corporate bonds returned 0.8%, with yields down by 3bps to 3.26%, despite the rise in government bond yields as spreads narrowed by 16bps to 100bps over the period. Global high yield bonds returned 0.4% in Q4, supported by income yield that more than compensated for capital losses from increased yields – there was a 35bps increase in yields in Q4 to 6.58% while spreads narrowed by 11bps to 235bps.

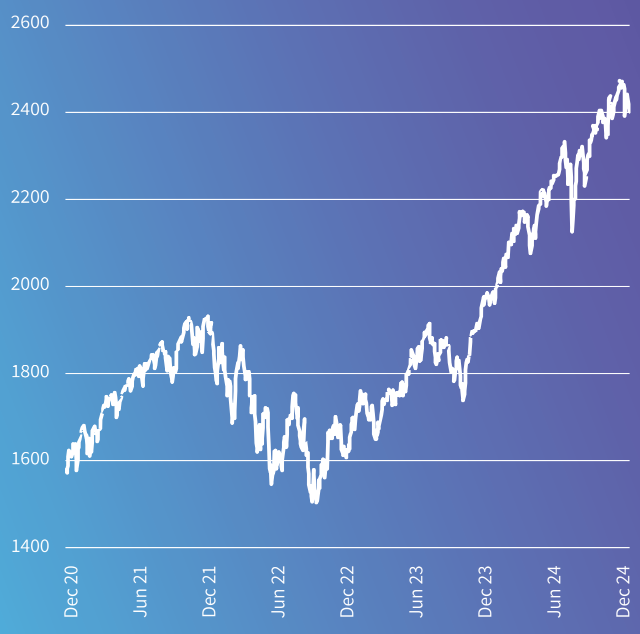
EM local debt returned -0.2%, with yields up by 33bps to 6.45%. EM hard debt returned -2.9% as the asset class was weighed down by a stronger US dollar, which increases debt repayments in local currency terms, as well as a 38bps increase in yields over the period to 6.99%.

Meanwhile, peripheral Eurozone bond spreads narrowed as more easing from the ECB was expected while Spain's economy showed robust activity. Italian 10-year spreads over equivalent German Bunds fell by 17bps to 116bps, while spreads for Spanish government bonds were down by 12bps to 69bps.

Moody's downgraded its rating on French government debt by one notch to Aa3 in December, which the rating agency said "reflects our view that the country's public finances will be substantially weakened over the coming years". French 10-year spreads against Germany were up by 4bps in Q4 to 83bps.

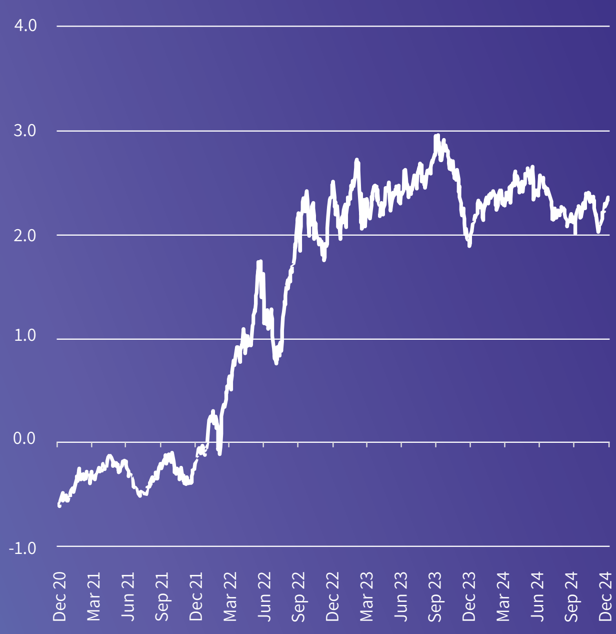
CHARTS OF THE QUARTER

Global equities



Source: ILIM, FactSet. Data is accurate as at 31 December 2024.

Bonds – German 10-year yield



Source: ILIM, FactSet. Data is accurate as at 31 December 2024.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	QTD Return (%)	YTD Return (%)	2023 Return (%)
MSCI Ireland	-5.6	22.8	20.6
MSCI United Kingdom	0.4	14.7	10.3
MSCI Europe ex UK	-3.5	7.7	18.5
MSCI North America	10.6	32.9	22.3
MSCI Japan	3.9	15.9	16.7
MSCI EM (Emerging Markets)	-0.7	15.3	6.5
MSCI AC World	6.8	25.9	18.6
10-Year Yields	**Yield last month (%)**	**2023 Yield (%)**	**2022 Yield (%)**
US	4.57	3.88	3.87
Germany	2.35	2.02	2.57
UK	4.37	3.54	3.67
Japan	1.09	0.61	0.42
Ireland	2.63	2.38	3.13
Italy	3.51	3.69	4.70
Greece	3.23	3.06	4.62
Portugal	2.84	2.66	3.59
Spain	3.04	2.99	3.66
FX Rates	**End last month**	**2023 Rates**	**2022 Rates**
U.S. Dollar per Euro	1.04	1.10	1.07
British Pounds per Euro	0.83	0.87	0.89
U.S. Dollar per British Pounds	1.25	1.27	1.21
Commodities (USD)	**QTD Return (%)**	**YTD Return (%)**	**2023 Return (%)**
Oil (Brent)	4.0	-3.1	-10.3
Gold (Oz)	-0.4	27.1	13.1
S&P Goldman Sachs Commodity Index	3.8	9.2	4.3

Source: ILIM, Bloomberg. Data is accurate as at 1 January 2025.

THE ILIM VIEW – LOOKING AHEAD

With inflation having fallen significantly and central banks suggesting policy is still above neutral levels, rates are likely to be cut further through 2025, enabling bond yields to decline over the next 12 months. On a 12-month view, our base case is that German and US 10-year government bond yields fall from current levels of 2.35% and 4.57% to 1.75% and 4.00%, respectively. We believe fixed income offers a strong risk-reward profile at this stage in the cycle, with the potential to offer protection if the economy slows. The asset class is attractive from an income perspective while also providing potential for capital gains via falling yields. We believe that the risks of materially higher bond yields have reduced and, if the economy falters, major central banks will be able to cut rates to support growth. In that scenario we would expect bonds to outperform to a greater extent.

Despite uncertainties relating to the implications of US policy going forward, the fundamental backdrop for global equities, and particularly US equities, remains positive. Steady growth, strong consumer balance sheets, ongoing disinflation, rate cuts and corporate-friendly policies continue to provide a positive equity backdrop. Divergence within regional equity performance, however, is likely to remain a feature as US exceptionalism continues with tax cuts and deregulation adding to its existing structural competitive advantages. Global equities valuations are above long-term averages, trading on a 12-month forward price-to-earnings (P/E) multiple of 17.9x against a long-term average of 16.1x. However, with a positive fundamental backdrop, multiples can remain close to current levels. Despite equities appearing fully valued, the outlook on a 12-month view is positive. With growth expected to remain firm and US corporates set to benefit from growth-friendly policies from the incoming administration in 2025, earnings are forecast to rise strongly in the next one to two years, which should be supportive. Additional rate cuts in a positive fundamental backdrop can also contribute to further gains. Over the medium term, the rollout of AI should boost efficiencies and earnings across the whole market and allow equities to trade at higher valuation levels. The ongoing green-related capex cycle could also boost earnings over the medium term. Any short-term volatility in markets is likely to be offset by the above factors, resulting in positive returns on a 12-month time frame.

THE MONTH AHEAD

JANUARY

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
	07 EA Inflation rate YoY Flash (Dec) EA Unemployment Rate (Nov) US ISM Services PMI (Dec) US JOLTs Job Openings (Nov)	08 US FOMC Minutes		10 US Non Farm Payrolls (Dec) US Unemployment Rate (Dec) US Michigan Consumer Sentiment Prel (Jan)
	14 US PPI MoM (Dec)	15 GB Inflation Rate YoY (Dec) US Inflation Rate YoY (Dec)	16 GB GDP YoY (Nov) US Retail Sales MoM (Dec)	17 GB Retail Sales MoM (Dec)
	21 GB Unemployment Rate		23 JP Inflation Rate YoY (Dec)	24 GB Gfk Consumer Confidence JP BoJ Interest Rate Decision GB S&P Global Manufacturing PMI Flash (Jan)
27 DE Ifo Business Climate (Jan)	28 US Durable Goods Orders MoM (Dec)	29 US Fed Interest Rate Decision	30 EA GDP Growth Rate QoQ Flash (Q4) EA Unemployment Rate (Dec) EA ECB Interest Rate Decision	31 US Core PCE Price Index MoM (Dec) US Personal Spending MoM (Dec)

Source: tradingeconomics.com

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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