Schroders

A world in transition: the outlook for 2025 and beyond

30 January 2025

Marketing material for professional intermediaries only, not for onward distribution.

Philip Chandler

Head of UK Multi-Asset & CIO of Schroder Investment Solutions

Learning objectives

By the end of this session, delegates should be able to:

1. Summarise the positive outlook for markets, with economic growth supporting corporate profitability

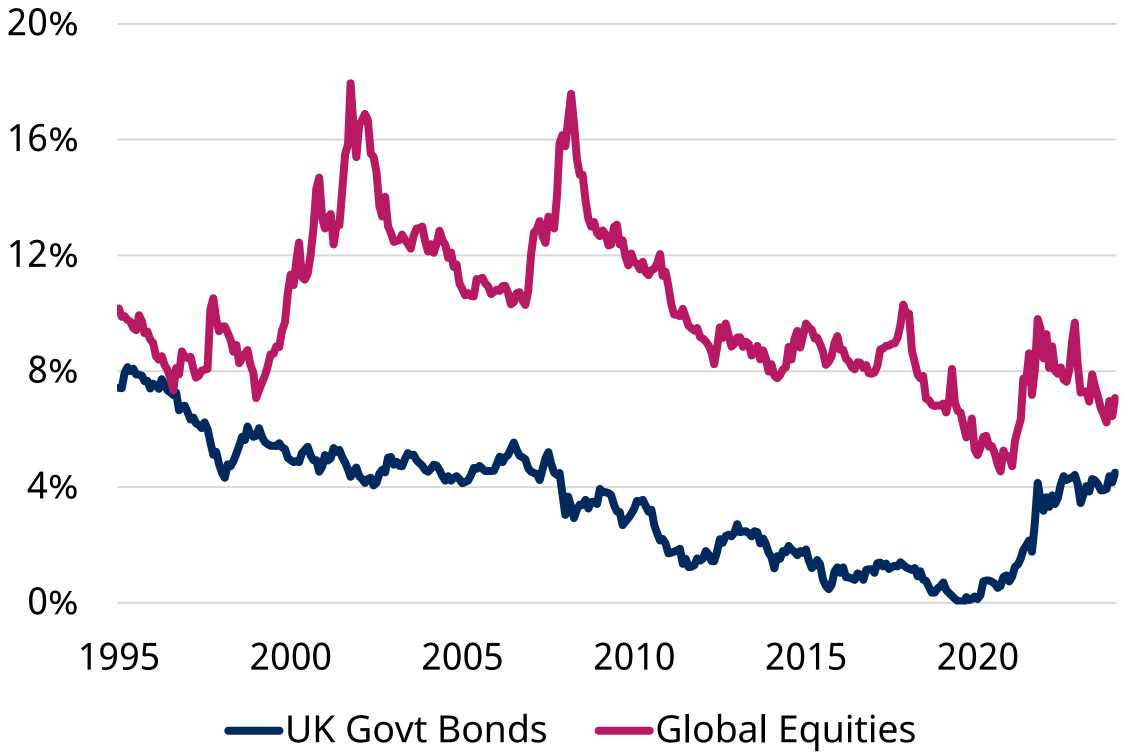
2. Explain the key risks to markets, namely higher bond yields and rising index concentration

3. Explain the importance of staying invested, but also understand the need for more thoughtful portfolio construction

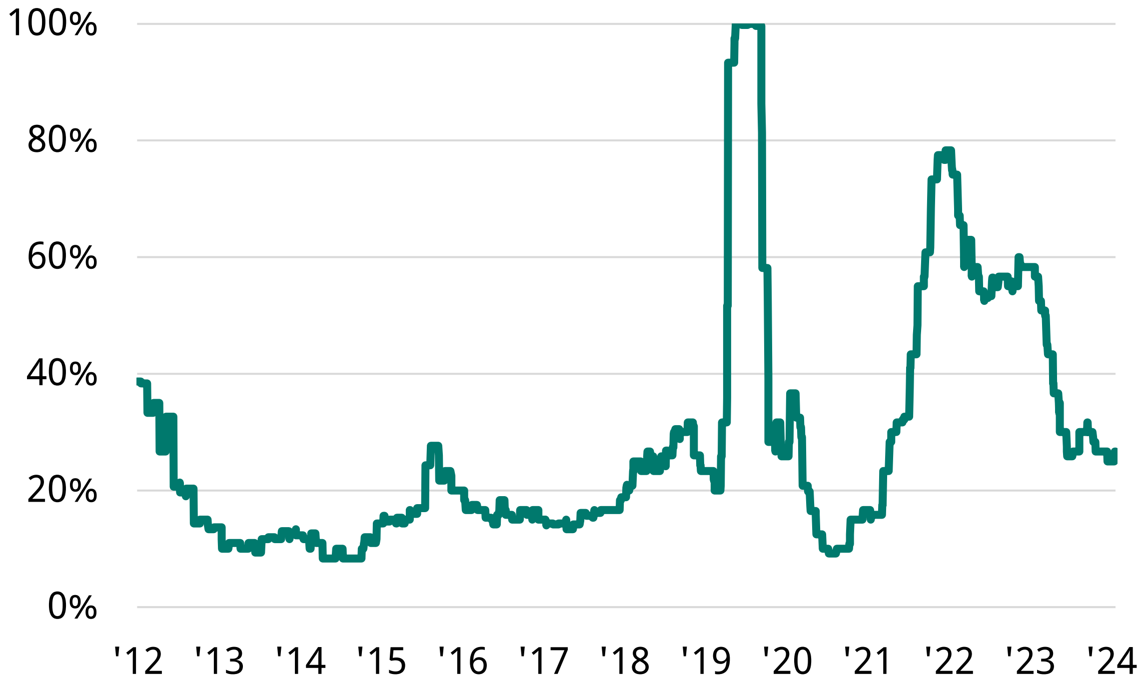
Market outlook: focus on valuations and the cycle

Return prospects ok-ish, soft landing achieved => buy risk?

Schroders return forecast (next 10 years, p.a.)



Probability of recession (US, UK & Eurozone average)



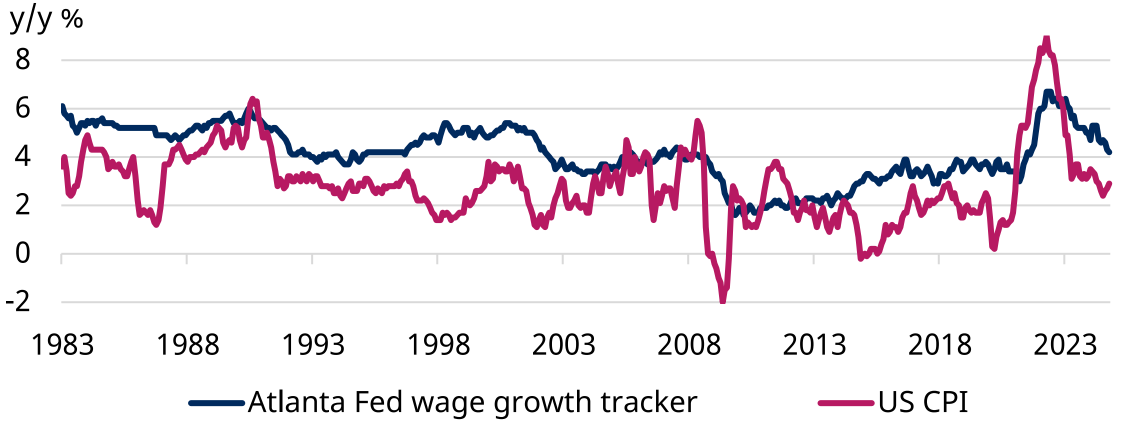
Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.

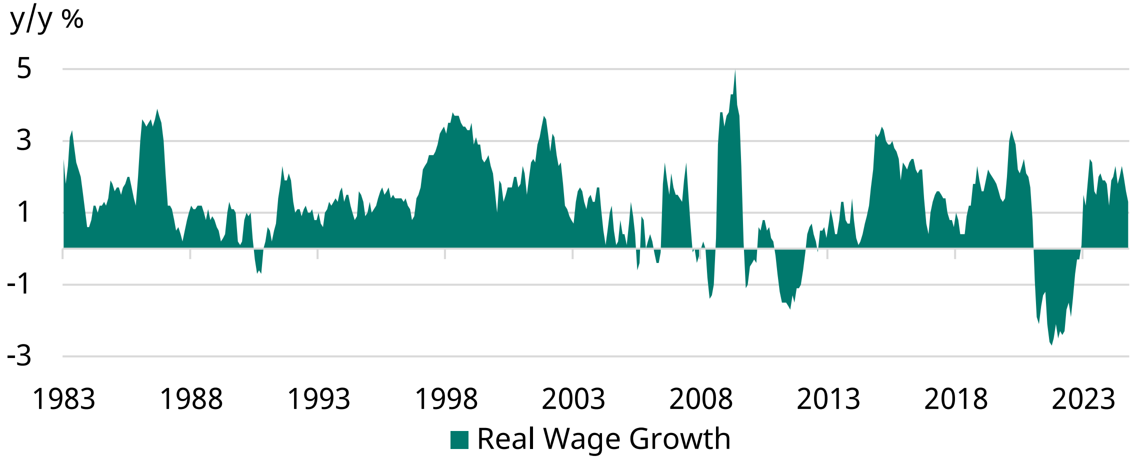
Source: LHS: Schroders, as of 31 December 2024. RHS: Bloomberg, Schroders, as of 22 January 2025; average of economic forecasters' recession probability over the next 12 months for US, UK and Eurozone. For illustrative purposes only and should not be viewed as a recommendation to buy or sell. The forecasts included should not be relied upon, are not guaranteed and are provided only as at the date of issue. Our forecasts are based on our own assumptions which may change. We accept no responsibility for any errors of fact or opinion and assume no obligation to provide you with any changes to our assumptions or forecasts. Forecasts and assumptions may be affected by external economic or other factors.

US consumers continue to spend

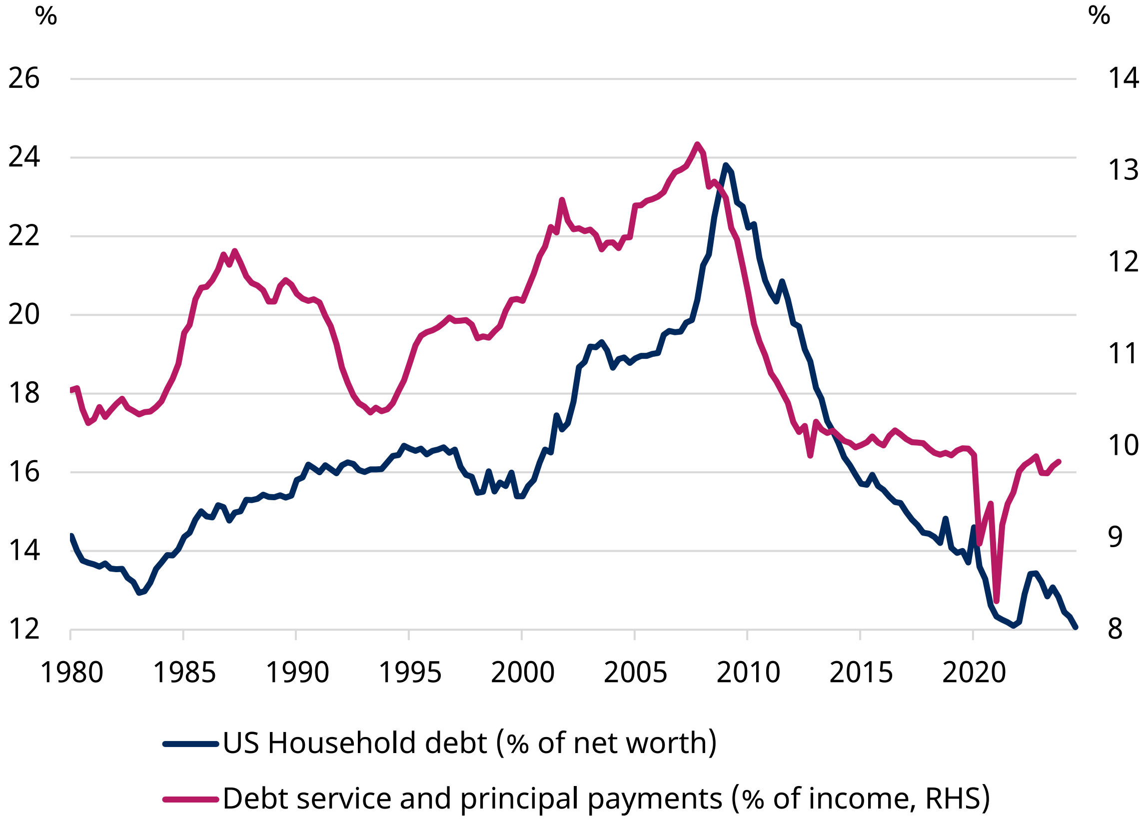
Positive real wage growth and healthy household finances

Real wage growth safeguarding US consumers' purchasing power





Substantial deleveraging since 2008 allows US households to withstand higher rates

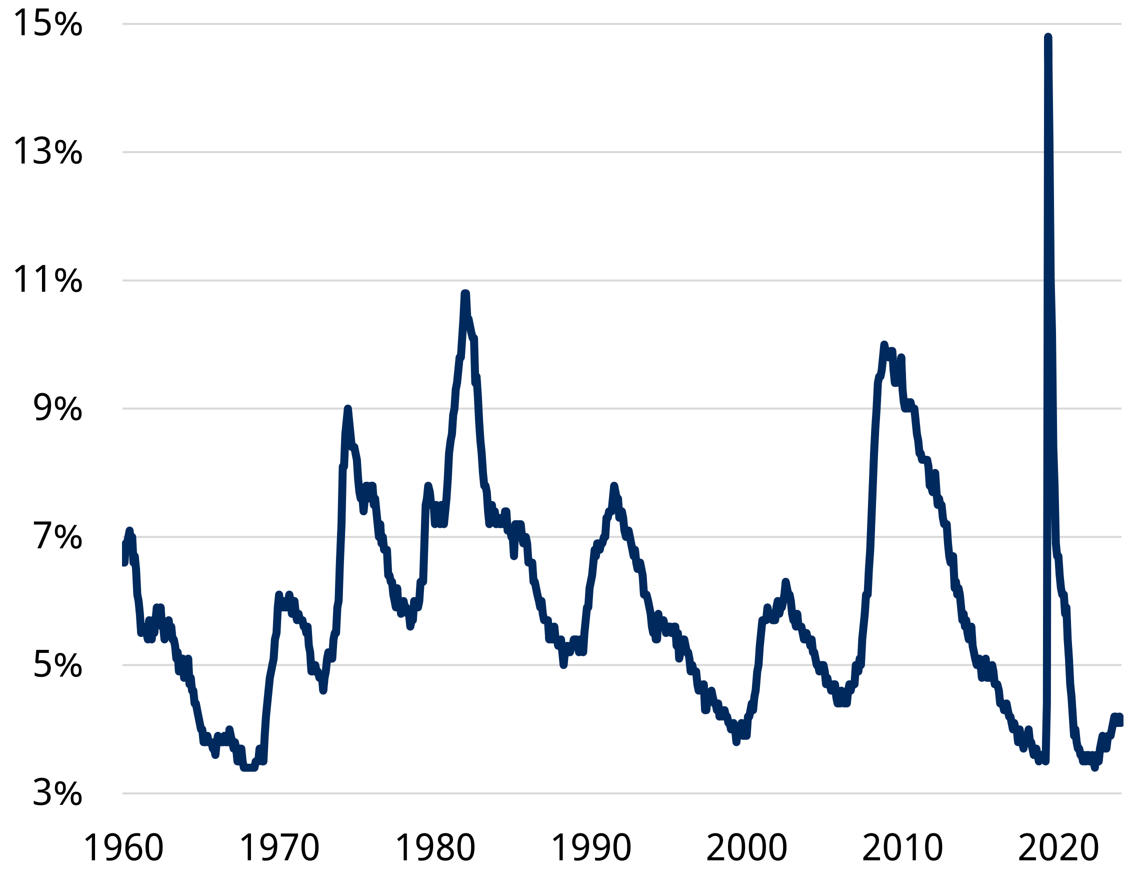


 Source: Schroders, Macrobond, 13 January 2025.

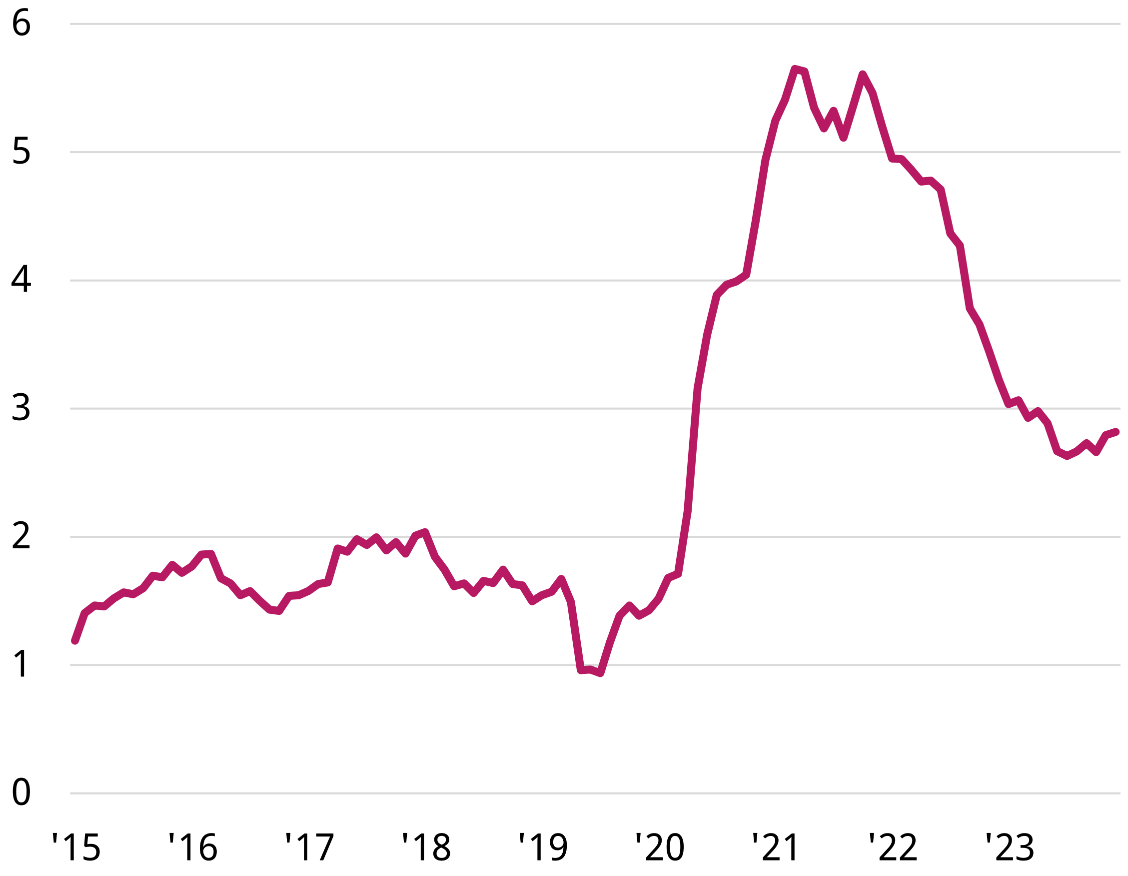
Caution: soft landings don't clear out old excesses

Labour market remains tight and inflation could be sticky

US unemployment still near cyclical lows



US core inflation stabilising above pre-covid levels?

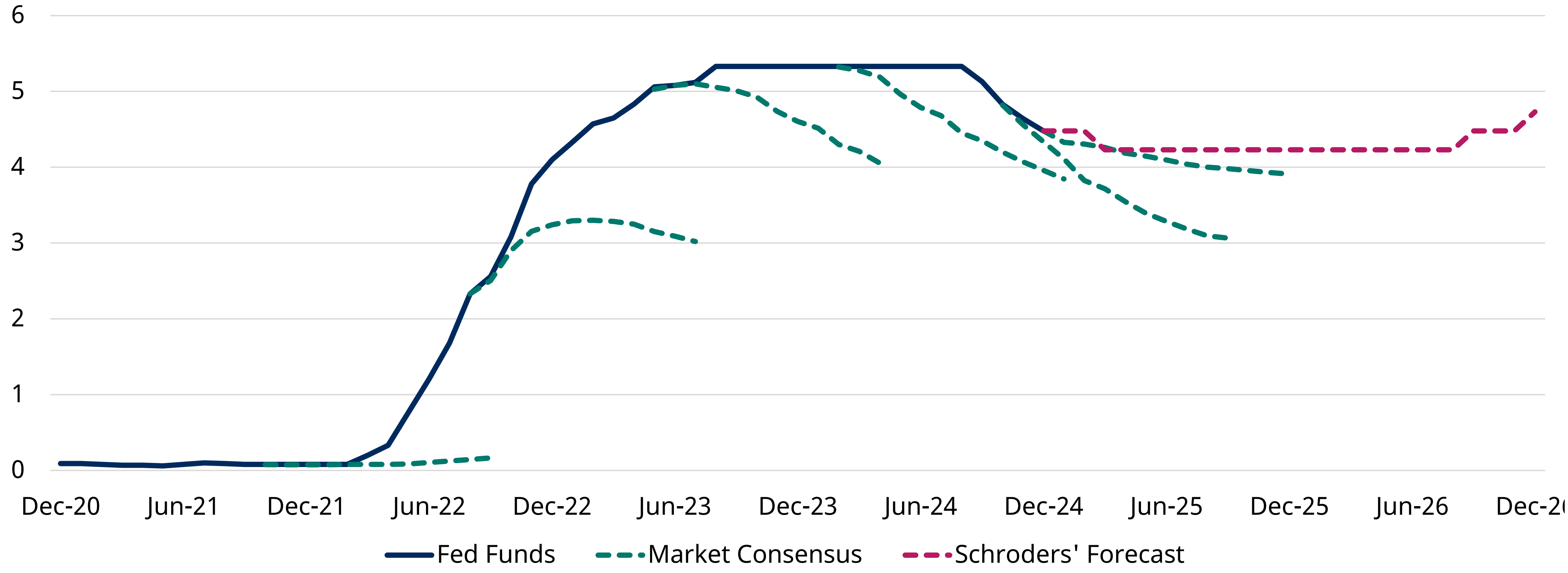


Source: Bloomberg, Schroders, as of 31 December 2024. RHS = Core PCE YoY to 30 November 2024. For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Fed to ease, but limited scope for substantial easing

Hard to justify significant easing if growth remains ok and inflation is sticky

The market has been consistently too dovish on Fed rate cut prospects

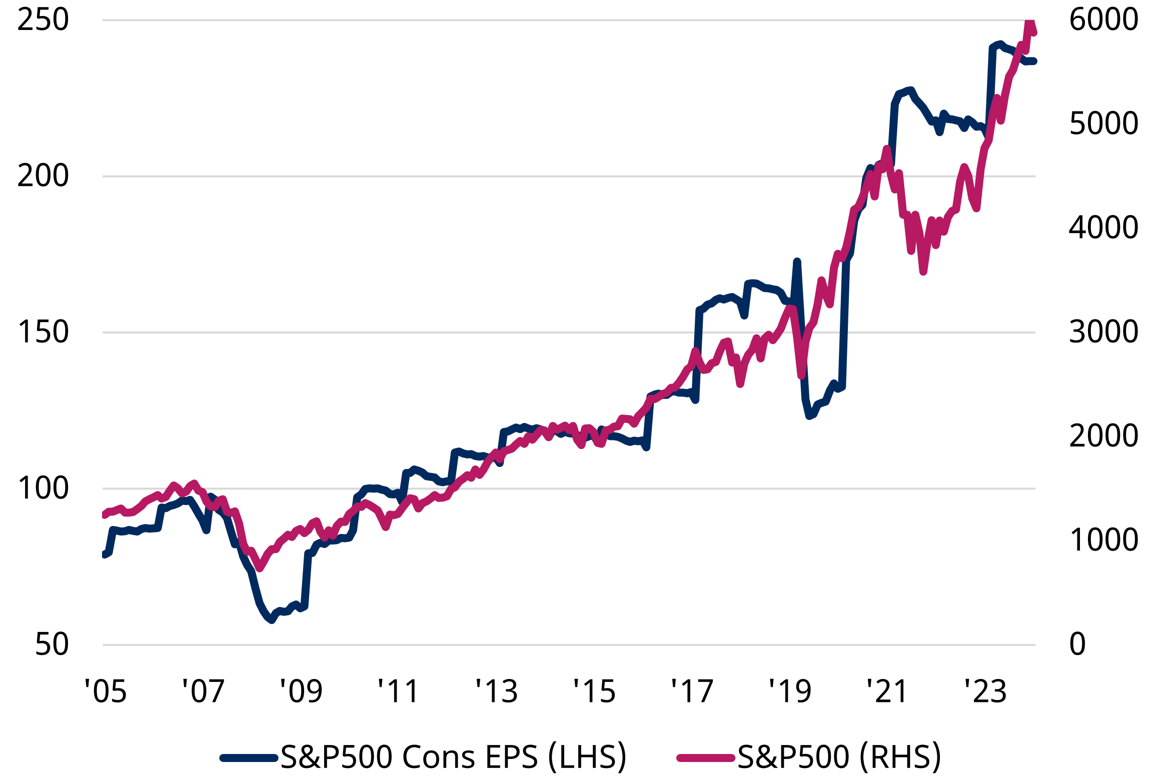


Source: Bloomberg, Schroders, as of 31 December 2024. For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Remaining overweight equities

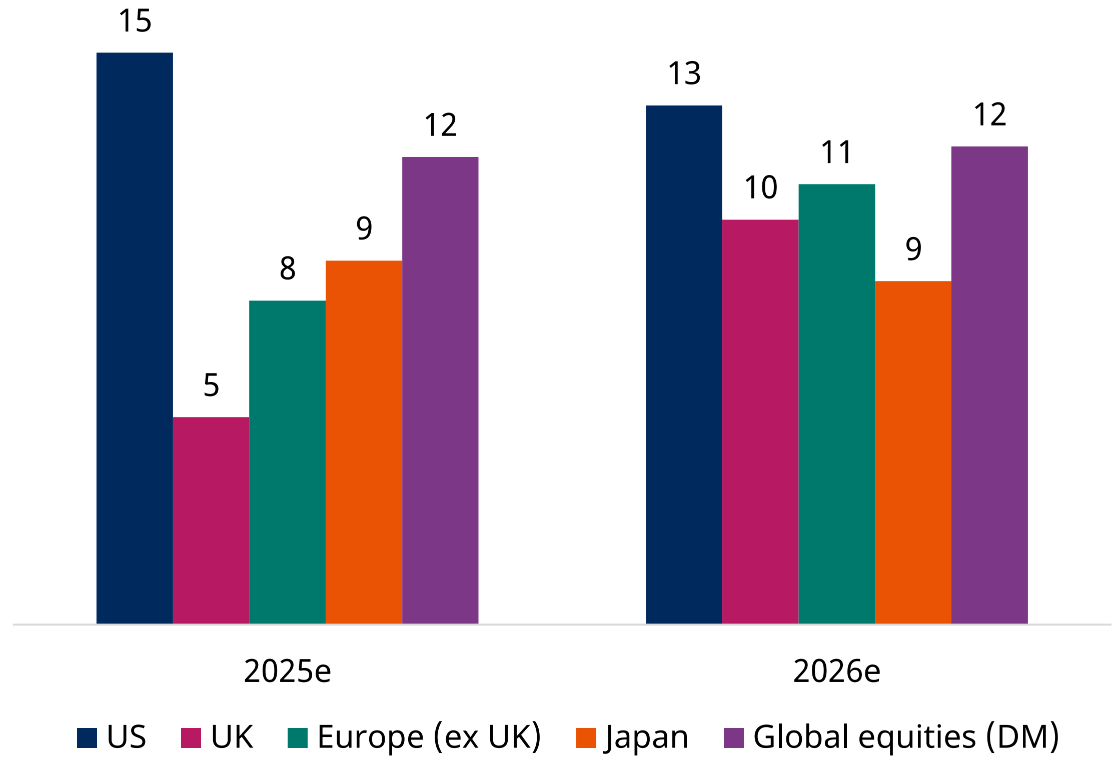
Growth and thus earnings look supportive

Over the long run earnings drive stock markets



Company profitability looks favourable

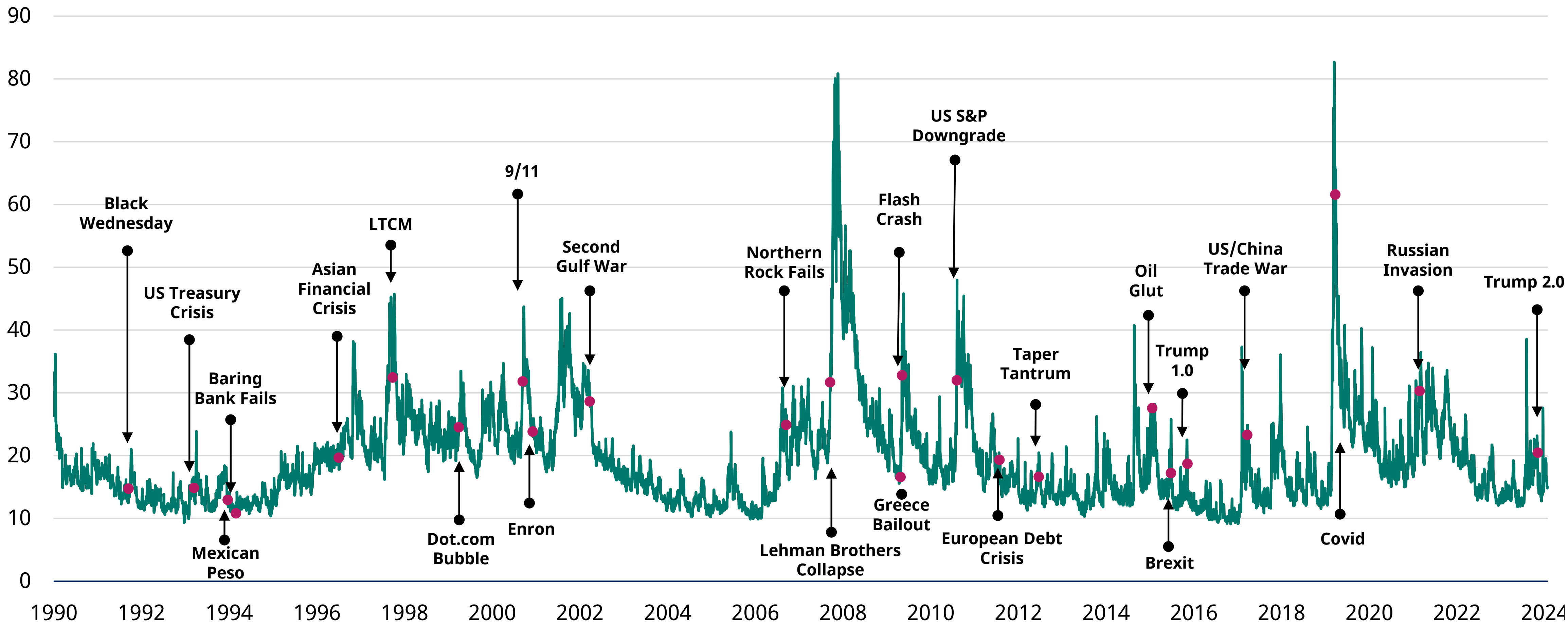
Consensus EPS growth forecasts y/y (%)



Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.
Source: LHS: Bloomberg, Schroders, as of 31 December 2024. RHS: LSEG Datastream, MSCI, Bloomberg and Schroders, 17 January 2025.
For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

There are always reasons not to invest…

VIX and selected market shocks



Source: Bloomberg, Schroders, as of 24 January 2025. For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

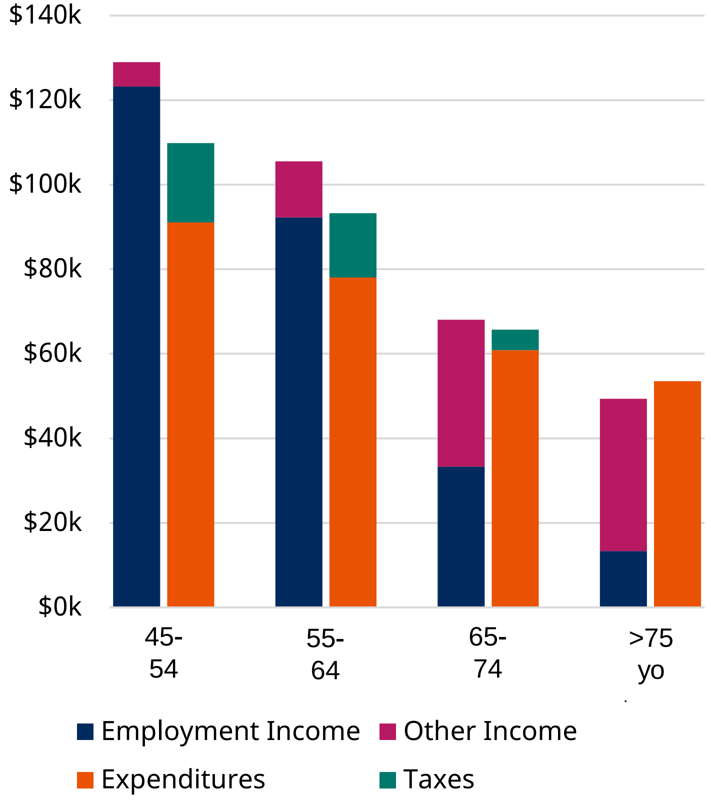
Schroders

Risk 1: higher bond yields

3D Reset: Demographics, Deglobalisation & Decarbonisation

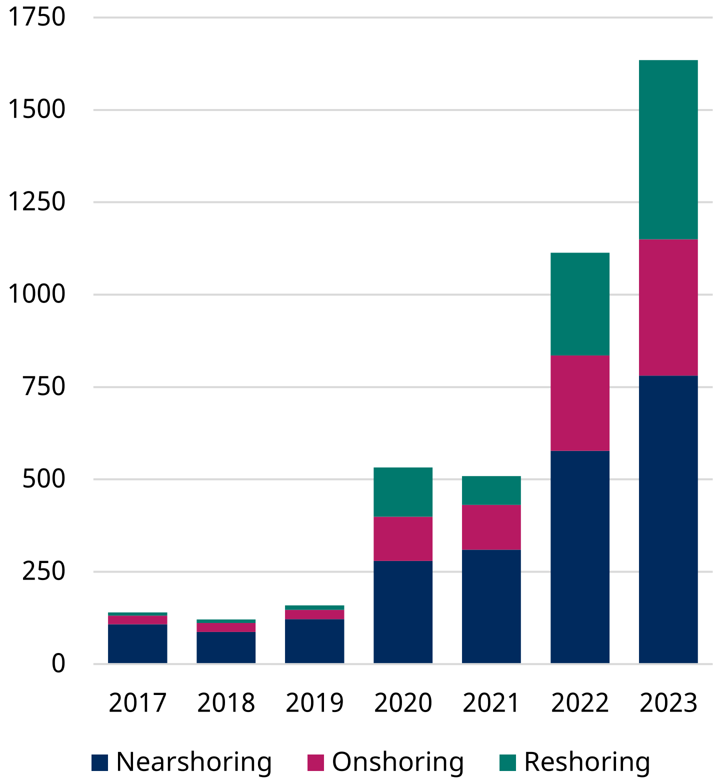
Retirees stop work but still spend

US income and expenditures by age group, 2022



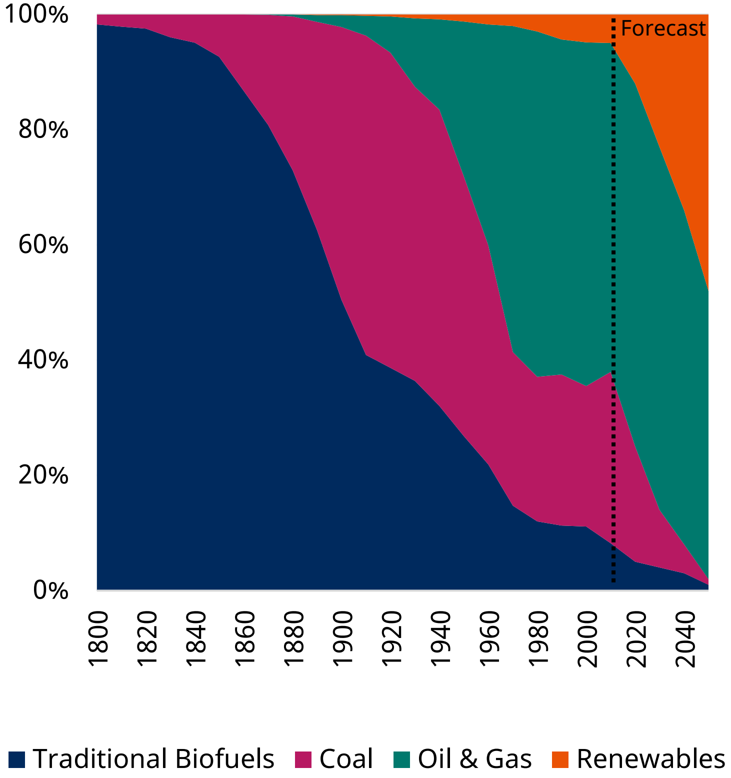
Globalisation stalling/reversing?

Mentions of near/on/reshoring in corporate reports



Investment in clean energy

Share of global energy consumed

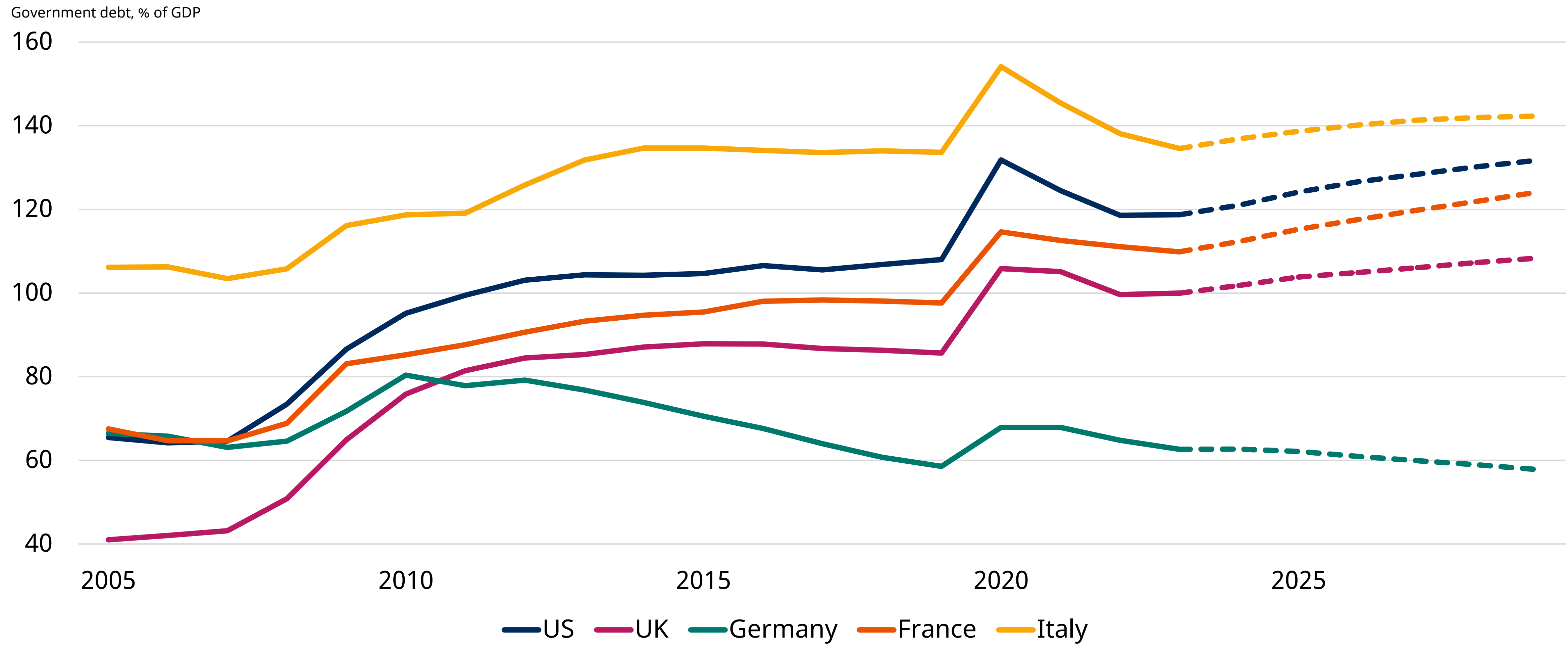


Source: LHS: Bureau of Labor Statistics' Consumer Expenditure Survey (2022), Schroders, as of 31 October 2023. Mean $ figure for each age group, except where data suppressed owing to small return within sample (<35yo investment income and >75yo taxes). Middle: Schroders Investments Insights Unit, as of 31 March 2024. RHS: IEA, Net Zero by 2050, World Bank, Schroders Economics Group, September 2022. For illustrative purposes only and should not be viewed as a recommendation to buy or sell. Forecast may not be realised.

Schroders

Risk 1: higher bond yields

Significant fiscal easing has increased government debt – what's the plan?

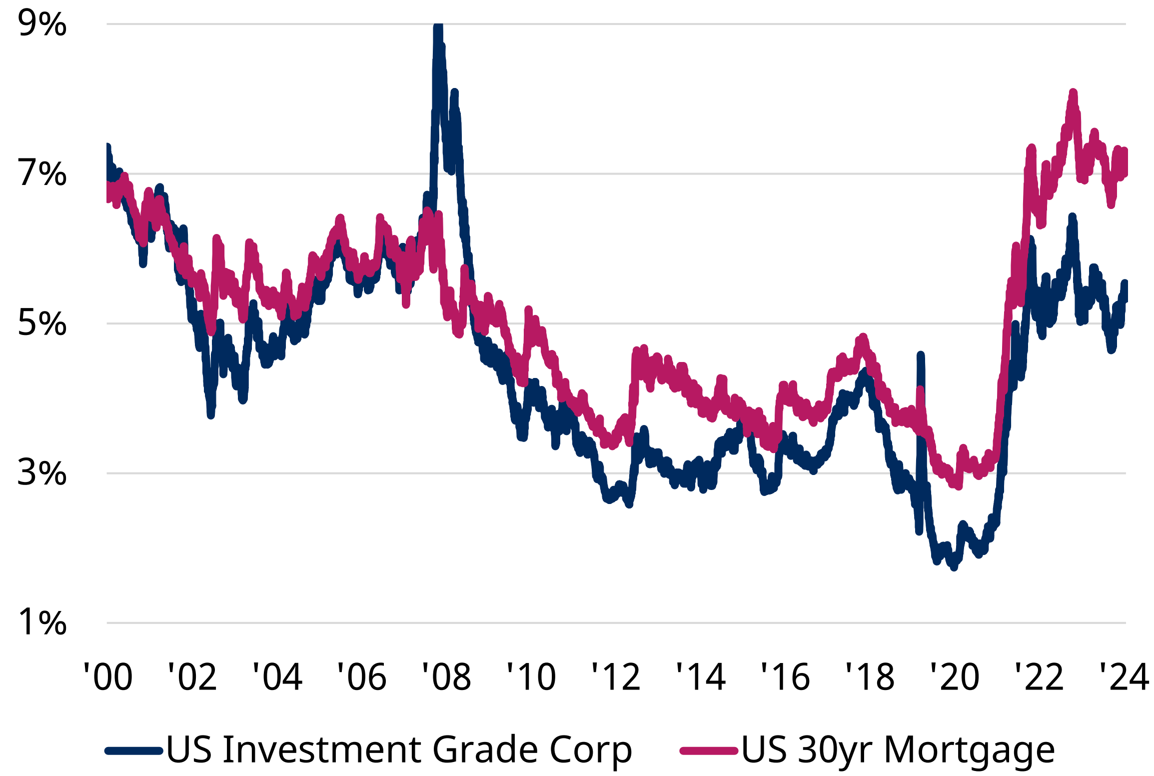


Source: Bloomberg, IMF, Schroders, as of 20 January 2025. Forecasts (dotted line) are the IMF's. For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

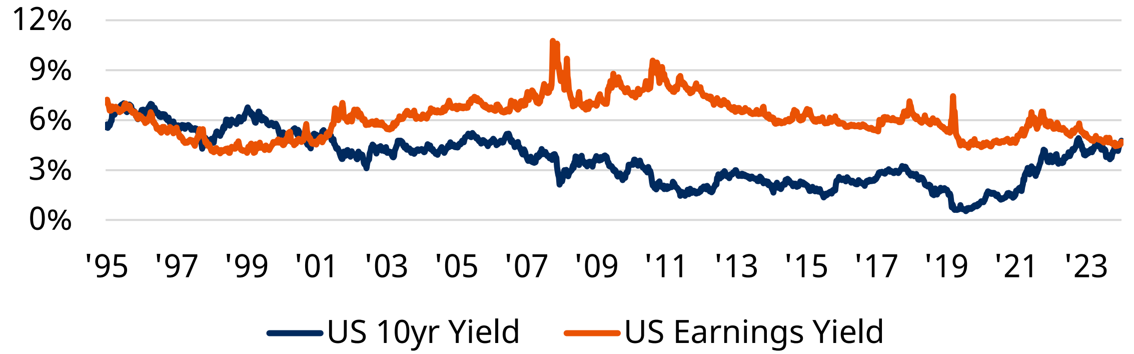
Risk 1: higher bond yields

Speed limit on the real economy and equity performance

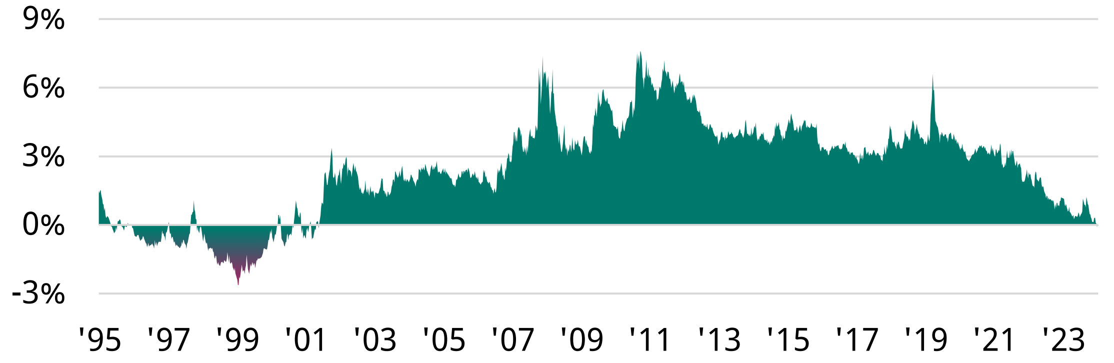
Transmission to real economy borrowing costs



Rising bond yields challenge equity valuations



US equity bond yield gap turning negative

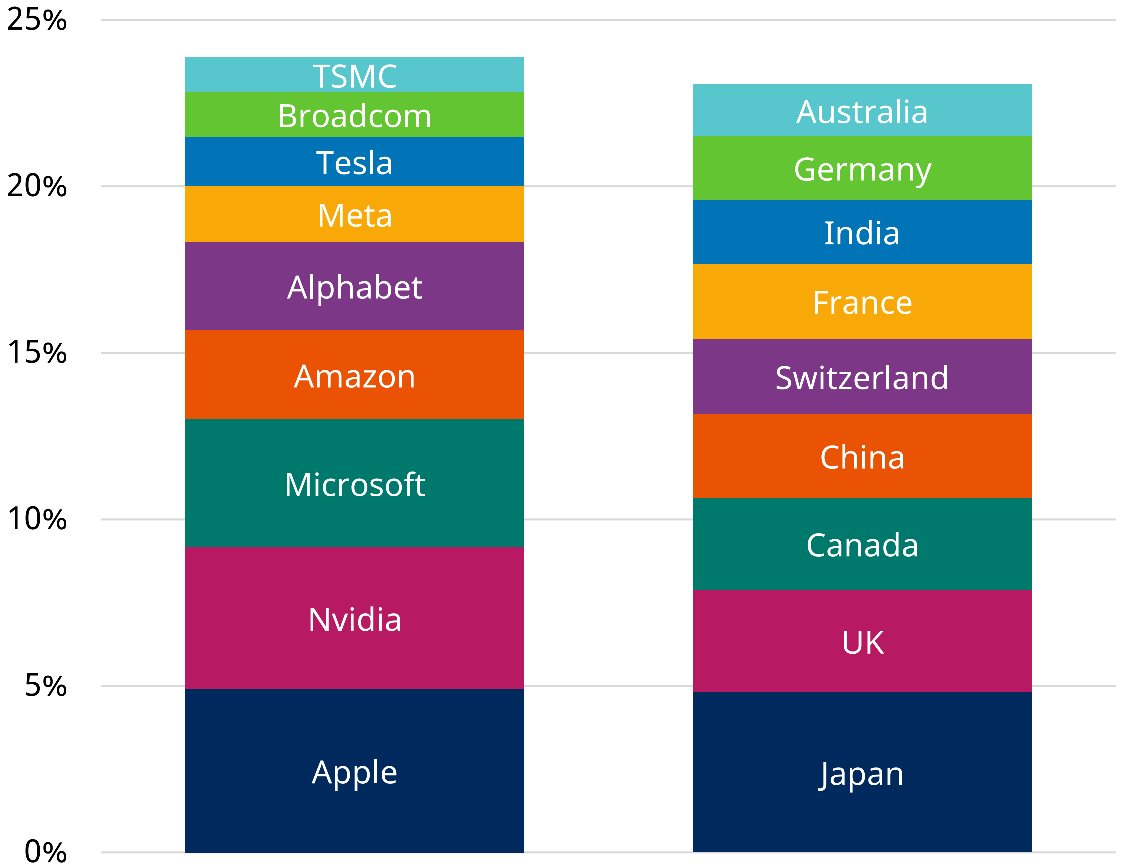


Source: LHS: Bloomberg, Schroders, as of 22 January 2025. RHS: LSEG Datastream, Bloomberg, Schroders, 12 January 2025.
For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Risk 2: market concentration

Significant idiosyncratic risk – who owns that risk for you?

Weight in MSCI ACWI, %



FINANCIAL TIMES

TUESDAY 28 JANUARY 2025

UK £3.70; Republic of Ireland €4.10

Doing business with the army in Pakistan
BIG READ, PAGE 21

Self-driving cars have a data problem
SARAH O'CONNOR, PAGE 23

Chinese AI leap triggers tech tumble by sowing doubt over chip spending

- DeepSeek uses less computer power
- Nvidia plunges on opening
- 'Sputnik moment' for US groups

FT REPORTERS

Tech stocks tumbled yesterday after Chinese artificial intelligence start-up DeepSeek stunned Silicon Valley with advances apparently achieved with far less computing power than US rivals.

Shares in the US's Nvidia, one of the biggest beneficiaries of spending on AI chips, plunged 17 per cent, wiping more than $600bn from its market value, a record loss for any company.

DeepSeek last week released a large language AI model that achieved a comparable performance to that of US rival OpenAI, even though it has previously claimed to use far fewer Nvidia chips.

Venture capital investor Marc Andreessen referred to "AI's Sputnik moment", drawing a comparison with the Soviet Union's stunning the US by putting the first satellite into orbit.

The US tech sector was hit as investors reassessed future investment in AI hardware. The tech-heavy Nasdaq index lost 3.2 per cent by the afternoon, while the S&P 500 fell 1.9 per cent. Microsoft dropped 3.6 per cent. In Europe, chip equipment maker ASML fell 6.3 per cent, while Dutch semiconductor company ASM International dropped 12 per cent.

The rout extended well beyond traditional tech names. Siemens Energy, which supplies electrical hardware for AI infrastructure, plunged 20 per cent. Schneider Electric, a French maker of electrical power products that has invested heavily in services for data centres, fell 9.5 per cent.

The sell-off in the companies making the "picks and shovels" of the AI revolution evoked memories of the share price crash of IT hardware company Cisco when the dotcom bubble burst.

Nvidia, Broadcom and other chipmakers have benefited from Silicon Valley's race to build ever-larger clusters of chips, which the likes of xAI boss Elon Musk and OpenAI's Sam Altman argue are needed to advance AI's capabilities.

Nvidia chief executive Jensen Huang and Broadcom's Hock Tan have said in recent weeks that they expect the data centre building frenzy to continue until the end of the decade. "It shows how vulnerable the AI trade still is, like every trade that is consensus and based on the assumption of an unassailable lead," said Luca Paolini, chief strategist at Pictet Asset Management.

But some Wall Street analysts and AI researchers have questioned the hype surrounding DeepSeek, which was founded by hedge fund manager Liang Wenfeng. "It seems categorically false that 'China duplicated OpenAI for $5M' and we don't think it really bears further discussion," wrote analysts at Bernstein.

Some researchers speculate that DeepSeek was able to take shortcuts in its training costs by leveraging the latest OpenAI models, suggesting that while it has replicated US advances quickly, it will be harder for it to pull ahead.

AI investment by large-cap US tech groups hit $224bn last year, according to UBS, which expects the total to hit $280bn in 2025. OpenAI and SoftBank announced last week a plan to invest $500bn over the next four years.

Even after DeepSeek's latest release, Meta chief Mark Zuckerberg said on Friday that he planned to spend up to $65bn on AI infrastructure this year.

"There is a bit of reality dawning that China has not been sitting idle, even as these tariffs and investment restrictions on tech companies have been put in place," said Mitul Kotecha at Barclays.

The US imposed stringent curbs on chip exports to China under Joe Biden's presidency, banning the sale of Nvidia's most advanced models.

Arjun Neil Alim in Hong Kong, Leo Lewis in Tokyo, Eleanor Olcott in Beijing and Tim Bradshaw and Ian Smith in London

Markets Insight page 14
FT View page 22

Tech stocks were hit hard yesterday but the rout extended well beyond traditional names and into the technology supply chain

Lex.

At the very least, DeepSeek may take some of the US giants' customers. At worst, it has challenged the core belief that more hardware is the key to better AI

Changing rules
Page 24

Briefing

▸ Buyout group backers sell stakes at record rate
Investors offloaded a record $162bn of private equity stakes on the second-hand markets last year as the long drought in dealmaking spurred pension funds and buyout groups to seek other ways to cash in their investments.– PAGE 9

▸ Insurers pick up pensions
Businesses are set to offload a record £70bn of pension risk to insurers as healthy funding levels support a flurry of dealmaking, a new forecast has shown.– PAGE 12; STARMER GROWTH PLEDGE, PAGE 2

▸ Alarm at migrant policy
Latin American presidents are to hold an emergency summit to respond to Donald Trump's mass deportations as they reel from his tactics with Colombia and Mexico. – PAGE 4; GIDEON RACHMAN, PAGE 23

▸ City in conflict with BoE
Lenders have urged the Bank of England to dilute its plans for handling failing banks, arguing they go beyond equivalent US or EU rules and will impose heavy costs on the sector.– PAGE 12

▸ Rents fall outside London
Rental prices beyond the capital fell quarter-on-quarter late last year for the first time since before the pandemic, a "key milestone" in Britain's housing market after years of soaring costs.– PAGE 3

▸ DR Congo rails at Rwanda
Kigali-backed rebels have moved to tighten their grip on the city of Goma in the Democratic Republic of Congo's east, in what Kinshasa described as "a declaration of war" by its neighbour.– PAGE 8

▸ Khan 'free ride' warning
Lina Khan, former chair of the US Federal Trade Commission, fears "catastrophic consequences" if antitrust officials fail to scrutinise private equity groups buying up chunks of the economy.– PAGE 10

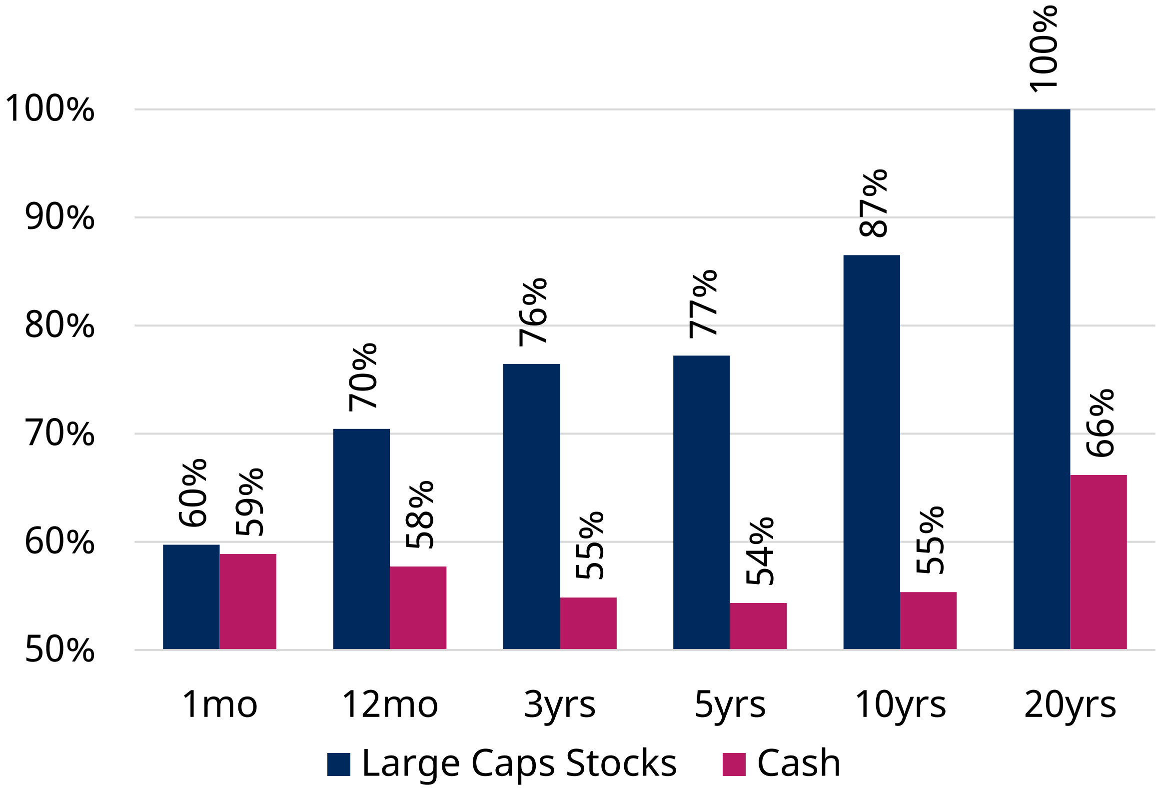
▸ Test specialists ditch talks
Swiss group SGS and Bureau Veritas of France have ended talks that were at an advanced stage on a merger that would have created a €30bn specialist in testing and certification services.– PAGE 9

Source: Bloomberg, Schroders, as of 31 December 2024. Note: 1,276 stocks in the nine listed countries. For illustrative purposes only and not a recommendation to buy/sell.

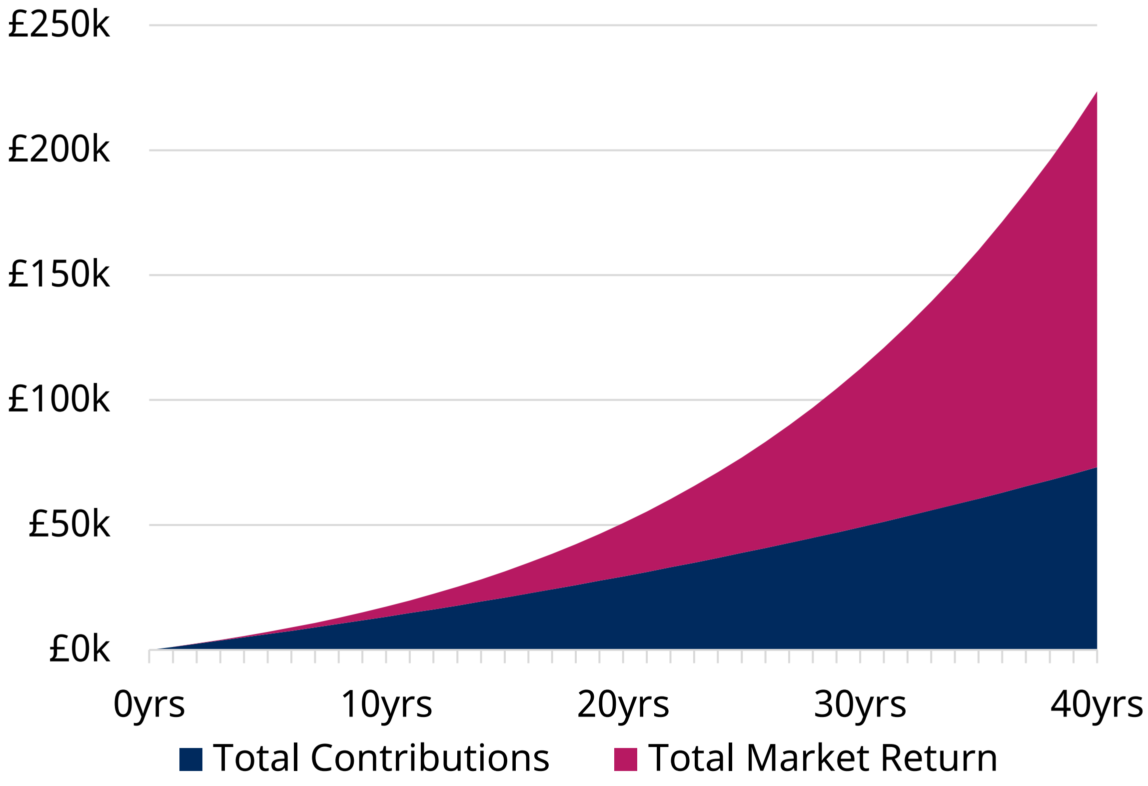
Stay invested!

Market returns plus compounding have historically delivered better outcomes

% time stocks/bonds beat inflation



Saving £100/mo at 5.5% return



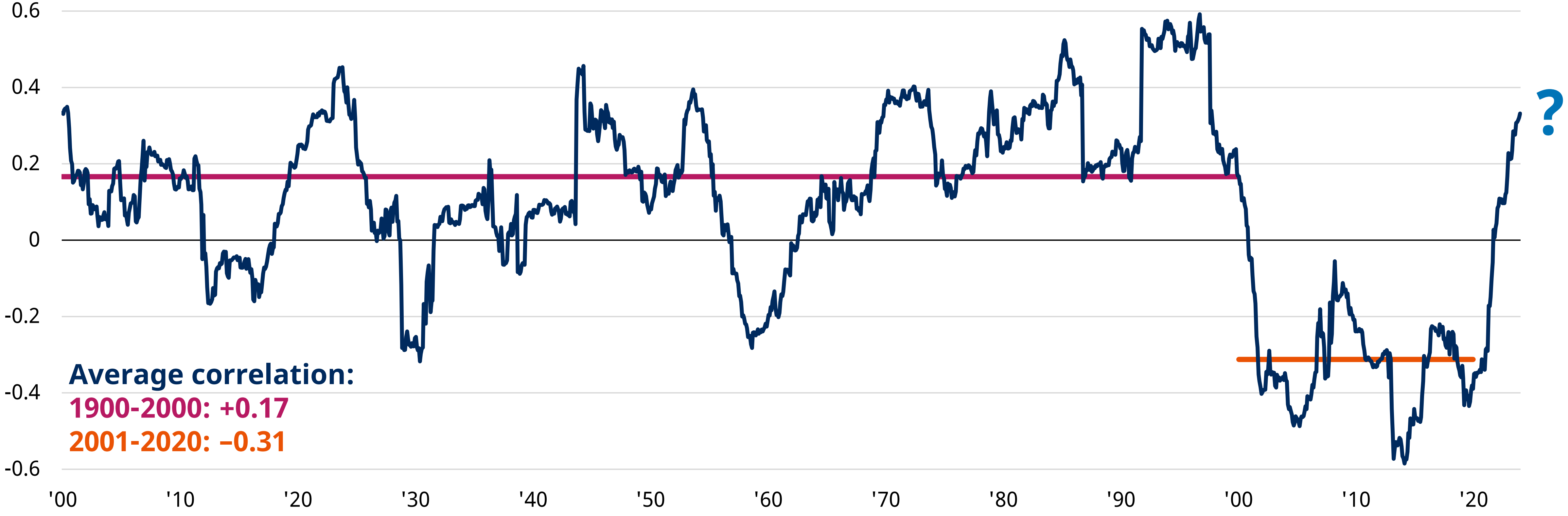
Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.

Source: LHS: Morningstar Direct, accessed via CFA Institute and Schroders. Ibbotson® SBBI® US Large-Cap Stocks and Ibbotson® SBBI® US (30-Day) Treasury Bills; January 1926–December 2022. Schroders Talking Point August 2023: 'Cash real returns after inflation remain negative even though rates have risen and the jump in inflation since early 2022 means that the value of cash is eroding at a faster pace than for most of the previous decade.' RHS: assumes £100 saved per month, increasing at 2% p.a., returning 5.5% p.a. For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Risk 3: portfolio construction

How do we cushion clients against market volatility?

Correlation of US equities & Treasuries

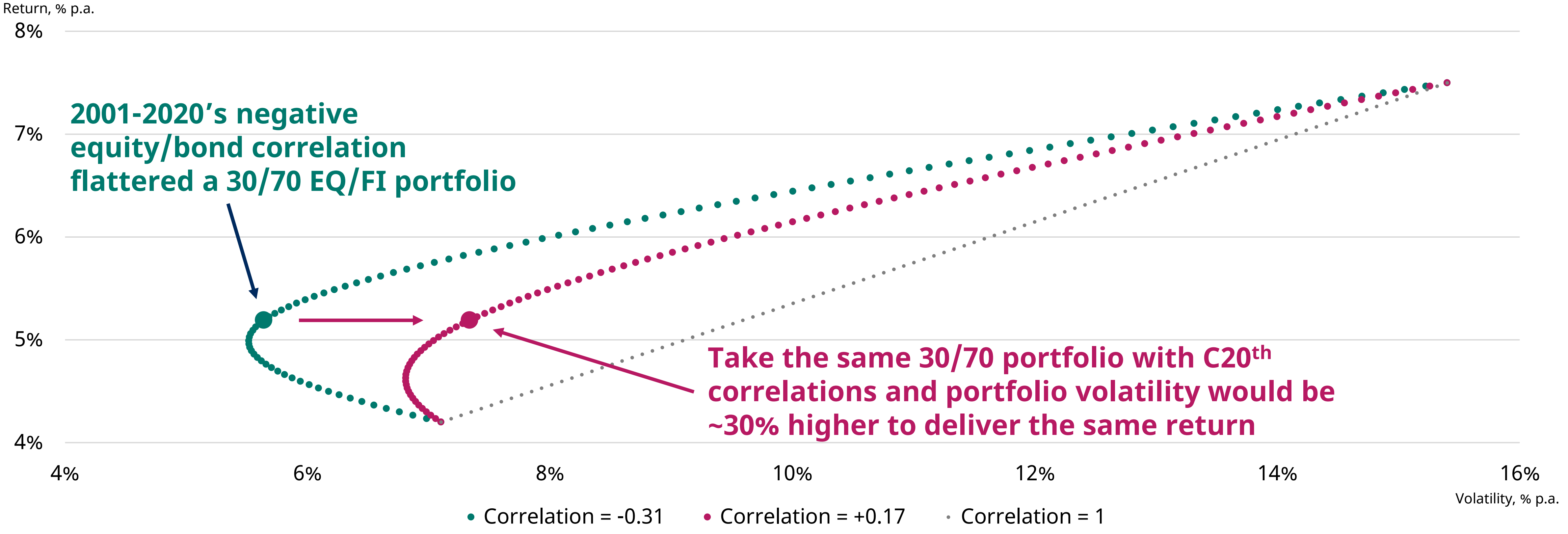


Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.
Source: Bloomberg, Robert Shiller, Schroders, as of 31 December 2024. Chart shows rolling 5 year correlation of S&P500 and US 10yr Treasury, monthly data.
For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Risk 3: portfolio construction

Higher correlations lead to same end point, but a bumpier path

US equity/bond efficient frontier – adverse shift as correlations rise



Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.

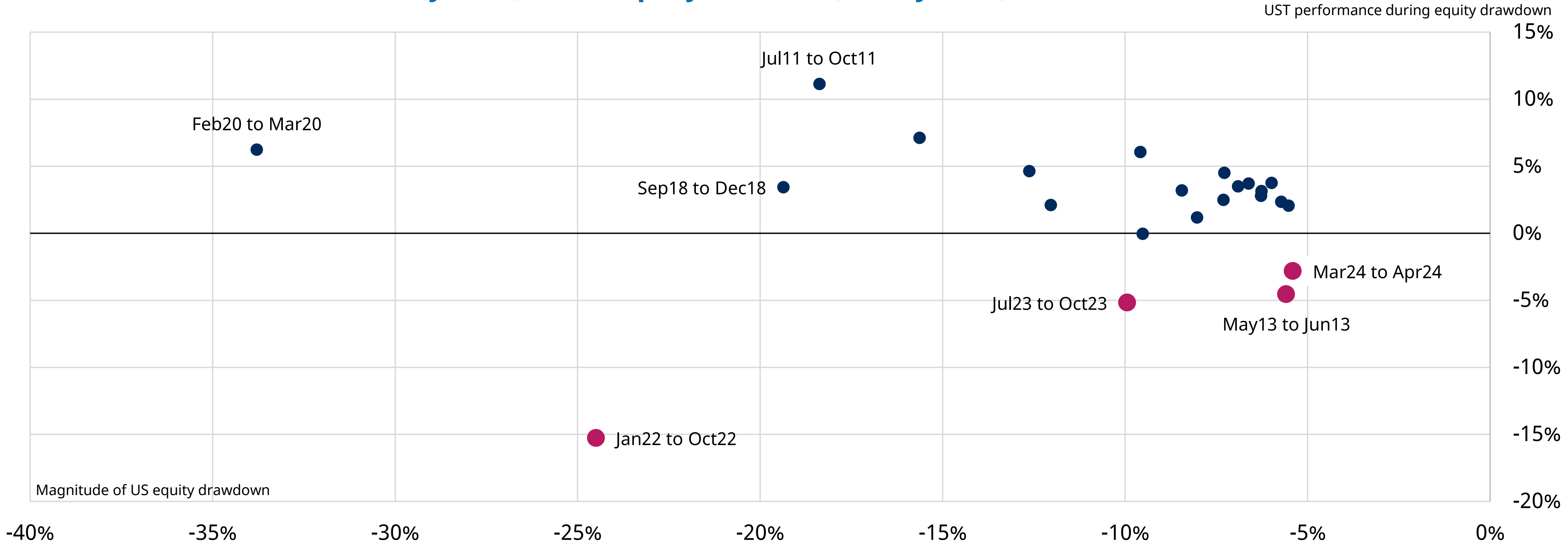
Source: Schroders, as of 31 May 2023. Hypothetical efficient frontier of US equities and Treasuries, assuming different correlations; return and risk forecasts = Schroders.

For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Risk 3: portfolio construction

Bonds lose their safe haven status when inflation / rate hikes / debt is the problem

Performance of US Treasuries (y-axis) in US equity sell-offs (>5%, y-axis)



Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.

Source: Bloomberg, Robert Shiller, Schroders, as of 31 December 2024. Performance of Bloomberg US Treasury 7-10yr during S&P500 drawdowns over 5%; daily total returns.

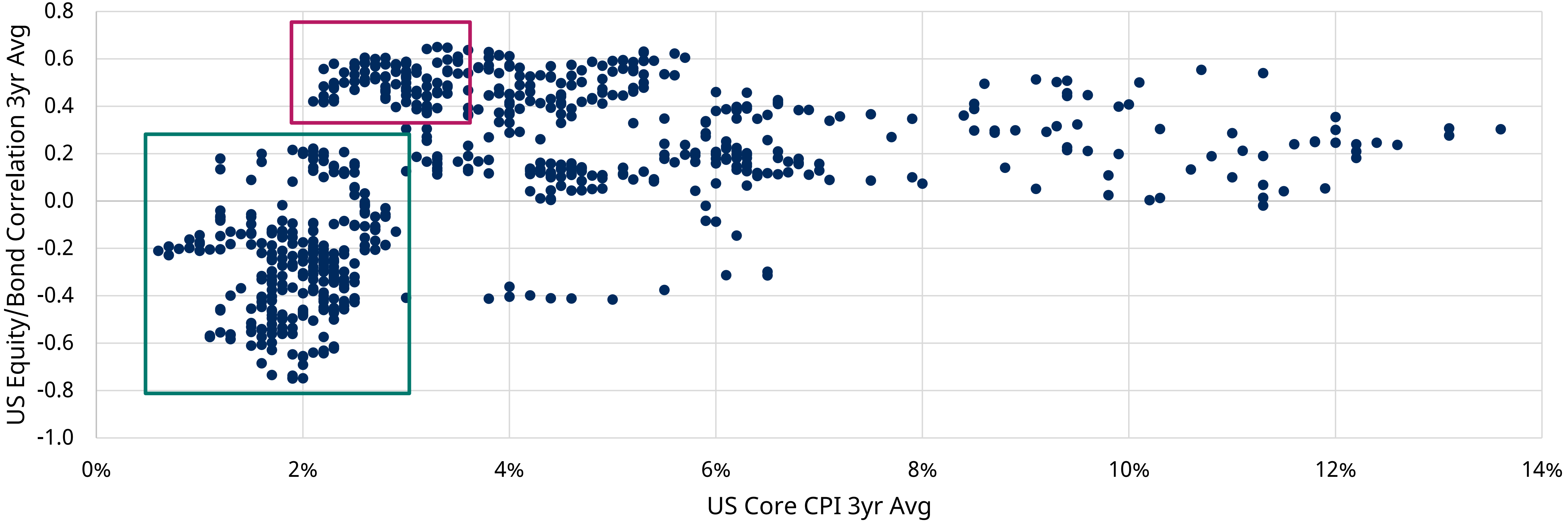
For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Schroders

Risk 3: portfolio construction

The good news: cyclical moderation of inflation…

Historically equity/bond correlations have been more favourable when inflation is low



Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.
Source: Macrobond, Schroders, as of 19 August 2024. Correlations are 3-year monthly correlations between S&P 500 and US 10-year treasury bonds. Data from January 1962 – July 2024.
For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

Learning outcomes

Delegates should now be able to:

1. Summarise the positive outlook for markets, with economic growth supporting corporate profitability

2. Explain the key risks to markets, namely higher bond yields and rising index concentration

3. Explain the importance of staying invested, but also understand the need for more thoughtful portfolio construction

Important information

Marketing material for professional intermediaries only, not for onward distribution. This information is a marketing communication. Any reference to sectors/countries/stocks/securities are for illustrative purposes only and not a recommendation to buy or sell any financial instrument/securities or adopt any investment strategy. The material is not intended to provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations. Reliance should not be placed on any views or information in the material when taking individual investment and/or strategic decisions. **Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.** Schroders has expressed its own views and opinions in this document and these may change. Information herein is believed to be reliable but Schroders does not warrant its completeness or accuracy. Insofar as liability under relevant laws cannot be excluded, no Schroders entity accepts any liability for any error or omission in this material or for any resulting loss or damage (whether direct, indirect, consequential or otherwise). Schroders will be a data controller in respect of your personal data. For information on how Schroders might process your personal data, please view our Privacy Policy available at www.schroders.com/en/privacy-policy/ or on request should you not have access to this webpage. For your security, communications may be recorded or monitored. This document is issued in January 2025 by Schroder Unit Trusts Limited, 1 London Wall Place, London EC2Y 5AU. Registration No 4191730 England. Authorised and regulated by the Financial Conduct Authority. 02203.

Schroders

Thank you