Allianz Global Investors

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Capital Markets Monthly

Geopolitics strikes back

The inauguration may still be more than a month away, but President-elect Donald Trump has already dropped a bombshell. Immediately after being sworn in, he wants to slap hefty tariffs on imports from Canada and Mexico. That is probably just the opening salvo of "**America First**", an all-out protectionist agenda steeped in the doctrine of trade barriers. **China** and **Europe** will not be spared. On the contrary: Since Deng Xiaoping's reforms ushered in its gradual transition to capitalism, the People's Republic has emerged as a powerful economic and strategic rival. Now, the incoming US administration wants to impose all manner of tariffs and trade restrictions in an effort to shift the balance of power and promote domestic job creation and investment. Far from being a new trend, this approach to **deglobalisation** is an escalation of one that has been underway for some time. Given that trade tariffs will drive up prices, the result looks set to be higher inflation and less competitive pressure. This is bad for economies of scale and specialisation, bad for innovation and productivity and, consequently, bad for the country's growth trajectory. Slower growth coupled with higher inflation rates: It is going to be interesting to see how central banks respond to this environment, particularly the US **Federal Reserve** (Fed). Although this conversation has been very muted on capital markets until now, it should gather pace in 2025.

This situation is compounded by geopolitical risks from other corners of the world. Any further escalation of conflicts in the Middle East or Ukraine, particularly if it leads to a sharp rise in energy prices, could sour the outlook for global growth and inflation. So, it is reassuring that the economy appears headed for a "soft landing". The **US economy** has defied expectations of a looming recession, and we project that growth will continue to outpace other major economies in 2025, albeit at a somewhat slower pace than this year. In 2025, the US economy should expand by around 2%, roughly in line with trend growth. In the **euro area**, economic growth is expected to be more modest, remaining under 1%. **Japan's** economy has lost momentum. This macroeconomic scenario should not be an obstacle to any further softening in inflation rates.

Given a mix of geopolitical risks and sound if not exactly euphoric growth expectations, riskier forms of investment retain their appeal – despite an ostensibly overvalued US equity market and corporate bond

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Publications

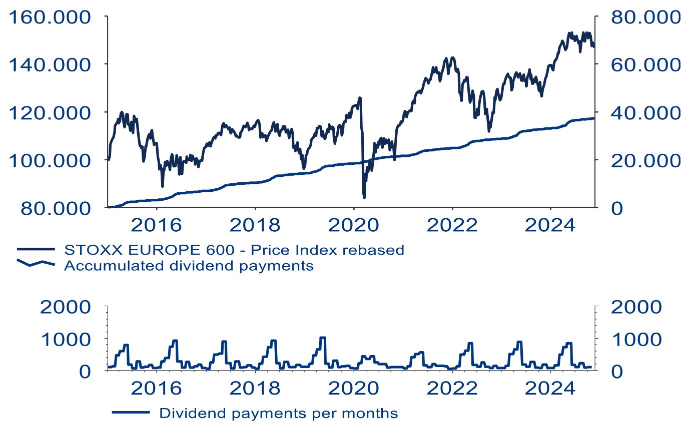
→ Outlook 2025: New ways to diversify
Following a decisive result in the US election, the outlook for risky assets seems positive with a soft landing in sight for the US and world economies despite the potential for volatility ahead.

→ Dimensions of disruption: Deglobalisation
The world is being transformed at an unprecedented pace. The first part of this study on the dimensions of disruption sheds light on the process of deglobalisation.

→ Dimensions of disruption: Digitalisation
The sweeping tide of digitalization is a result of rapid improvements in computing power and a simultaneous and dramatic fall in the prices of storage hardware.

What happened to an investment of 100,000 euros over a period of 10 years.

STOXX Europe – 600 price index and dividends
Share price performance and dividends, cumulative & monthly for an 100.000 Euro investment



Source: LSEG Datastream, AllianzGI Global Capital Markets & Thematic Research, 28.11.2024

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Market overview as of 02.12.2024

Equity Indices		
DAX		19,934
Euro Stoxx 50		4,883
S&P 500		6,047
Nasdaq		19,404
Nikkei 225		39,249
Interest Rates %		
USA	3 Months	NA
	2 Years	4.21
	10 Years	4.20
Euroland	3 Months	2.93
	2 Years	1.99
	10 Years	2.09
Japan	3 Months	0.59
	2 Years	0.61
	10 Years	1.01
FX		
USD/EUR		1.051
Raw Materials		
Oil (Brent, USD/Barrel)		71.9

spreads narrowing to precariously tight levels. At the same time, volatility is very low and is expected to rise. In contrast, following a bout of weakness in the autumn, yields on sovereign bonds from industrialised countries look attractive again.

Wishing you a prosperous 2025,

Dr Hans-Jörg Naumer

This would suggest the following **tactical allocation for equities and bonds:**

- Should the "soft landing" scenario continue to play out, this should have a positive impact on both equities and bonds.
- While **equity markets** globally, and especially in the US, are bullish about the prospects of a second Trump administration, investors are advised to remain vigilant and mindful of the additional uncertainties associated with the potential impact of sweeping changes in trade and immigration policy.
- Some of the optimism in the market is being fuelled by expectations that the new administration will unleash a wave of deregulation across a range of industries, notably in the tech, finance and energy sectors.
- Market concentration is at its highest in the United States since the 1930s and it seems likely that deregulation could help stimulate a much-needed boost to market breadth that would benefit companies beyond the mega-caps, most of all in the tech space.
- In **China**, the government recently unveiled a new stimulus package worth USD 1.4 trillion designed to aid the restructuring of local government debt and support the economy's transition away from dependence on the real estate sector.
- The scale of the package has disappointed some observers. However, it is a step in the right direction and the central government is expected to take further action as soon as the dust settles on Washington's policy direction under the new administration.
- The latest indicators from China point to a stabilisation in the macroeconomic environment and even a rebound in the financial sector. While investors remain sceptical on China, recent initiatives show that regulators are actively relaxing fiscal and monetary policy and attempting to lift asset prices – a dramatic shift from just a few months ago.
- While China is starting to feel the strain of its demographic structure, it is a different story in **India**, whose economy is beginning to capitalise on its demographic dividend of a young and increasingly skilled population. Currently, India enjoys several tailwinds that will boost productivity across all sectors in the years ahead.
- **Bond markets** are likely to see continued volatility into 2025. As such, portfolio durations should be tactically managed depending on market conditions.

- In terms of spreads (yield premiums over government bonds in industrialised countries), **emerging market bonds** have proven resilient, having held up well in the face of heightened geopolitical risks, market volatility, elections and shifting expectations of interest rate cuts by the Fed. In 2025, emerging market fundamentals should be robust and investment inflows look set to return to this asset class. In this environment, we see opportunities in local currency bonds and selected hard-currency, high-yield bonds.
- In the **corporate bond** universe, spreads on high-yield debt have become significantly tighter, while those on investment grade bonds are slightly less so. In the high-yield segment, investors' focus should be skewed towards shorter maturities.

UPCOMING POLITICAL EVENTS 2024

11 Dec	CA	Bank of Canada meeting
12 Dec	EZ	ECB Governing Council meeting
17–18 Dec	US	Meeting of the US Federal Open Market Committee (FOMC)
19 Dec	JN	Bank of Japan meeting
19 Dec	GB	BoE announcement and minutes

→ Overview political events 2024 (click here)

Investment theme: Investment income in times of disruption

- **Demographics**: The world's population is growing but at an increasingly slower rate, while life expectancy is steadily rising. The overall global population is aging, and the potential working-age population is shrinking – most dramatically in industrialised economies.
- **Digitalisation**: "Smart machines" are leading to radical changes in employment structures.
- The question as to what kinds of tasks will remain available for humans to perform and how many jobs will be available inevitably leads to the issue of their remuneration. In this respect, the labour economist Richard Freeman envisages a paradigm shift in the relationship between human and mechanised labour. With a hint of irony, he gets to the heart of the matter when he asks, "Are you going to work for the robot or is the robot going to work for you?"[1]
- Consequently, factors such as robots and demographics suggest that the time has come for a conversation on investment income to supplement income from work.
- We need more investment income, especially in an age of smart machines and a state pension scheme creaking under the pressure of demographic change. However, it does not end there. Indeed, investment income can be put to a great many more welcome uses: more money for a holiday, for everyday purchases or as a "grandparents' grant" to support grandchildren during their apprenticeships and university studies, ...
- Investment income can originate from two sources: interest from bank deposits, coupons paid on bonds or dividends paid on equities.
- In conclusion, the time has come not just to focus on the total return of an investment but also on its expected future cash flows. *Why should our money (or the "robots") not work for us?*

[1] Freeman, R. B. (2018). **Employee and citizen ownership of business capital in the age of AI Robots**, 101-108. SpringerGabler. Wiesbaden.

If not mentioned otherwise data and information sources are from LSEG Datastream.

Diversification does not guarantee a profit or protect against losses.

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