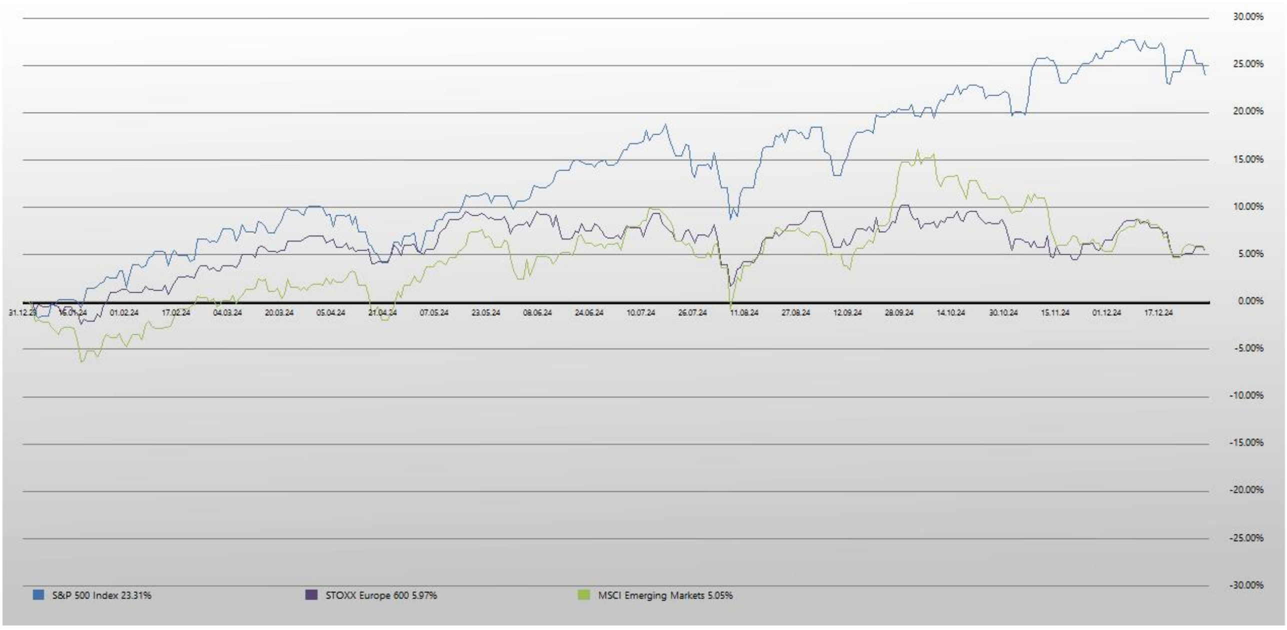
Quarterly Financial Market Update, December 2024

In early November, Mr. Donald Trump was elected to become the 47th president of the United States of America on 20th January 2025 and if investors had forgotten how it was under his first presidency, the last two months of the year were a reminder. Indeed, November and December gave a glimpse of how the equity market could behave under the future President Trump's administration, i.e. an increased level of uncertainty and risks, translating into an elevated level of volatility, but nonetheless ending up with some gains at Uncle Sam.

Over this two-month period global equities posted a return of 1.4%, compensating somehow for the weak month of October. This roller-coaster ride resulted in a slight decline of 0.9% in global equity prices for the entire fourth quarter overall. US stocks were the only region to register some gains during the quarter, up 2.4% for the S&P 500 index. European and Chinese shares were down 2.5% and 1.7% respectively (the latter weighing on emerging market equities, in addition to a strong US dollar).

Equity Index Performance, rolling 12 months (%)



Source: Kestrel Wealth Management

Unpredictable and provocative, President-elect Trump wants to "make America great again" and as he is essentially a business man, the overall environment for US companies should be supportive. This has led us to keep our positive stance on stocks generally speaking. Furthermore, US stocks trade at an estimated forward P/E ratio of 22.5x for an expected earnings growth of above 10%. Whilst not particularly cheap, this is reasonable given the overall environment. Moreover, if the environment does indeed improve for US companies, earnings expectations should be revised upwards, leading stock prices higher.

That said, investors should bear in mind that volatility should increase in the future, in our opinion. We have already witnessed this since the US presidential election. Mr. Trump's future intentions have fueled investor nervousness, particularly if (and provided they come into effect) this leads to a much higher inflation rate than today.

Amongst those were his intention to apply tariffs on all imported goods in the US. The tariffs could reach 10%-20% in general, though 25% on goods from Canada and Mexico and 60% for goods imported from China. Nevertheless, the implementation of these tariffs will lead to retaliatory measures by the rest of the world, to

the detriment of the United States. Consequently, it is very likely that a large chunk of this project will be part of a wider, far-reaching negotiation process.
Mr. Trump would also like to send illegal immigrants back home. However, should these low-wage workers need to be replaced, this would support inflation. According to our readings, we doubt that he will be very successful in this plan, as the "costs-to-benefit" ratio would be in the disfavour of the USA.
Still regarding the risks of seeing a higher inflation is the future of the US debt ceiling. President-elect Trump would like to remove it, allowing him to stimulate the economy further. However, with an already record-high deficit, he will face major obstacles in convincing Senators even in his own camp.

Separately, Mr. Trump would also lower the taxes on individuals and on US corporates. This will be a positive for the US economy, though again it will take time for any decisions to reach the real economy (if they come into laws once he is in office).

Geopolitics will also be under the spotlight with Donald Trump. On the one hand, he claims that he could end the war in Ukraine, which will be positive, though no one knows how, when and/or under which terms this could be done. On the other hand, tensions with China could increase, especially regarding the situation with Taiwan.
As far as the Middle East is concerned, Iran could face a much harsher position from the US, if the conflict with Israel escalates further.
Finally, NATO is in his line of sight. President-elect Trump has repeatedly said the other members are not paying their share. Thus, he urges that NATO members to increase their defense budget to 5% of GDP from 2% currently (which could also be an element of negotiation behind the threat of higher tariffs).

We will not develop other comments from Mr. Trump, which are sometimes a bit far-fetched and always unpredictable. Typically, his remark on renaming the Gulf of Mexico the "Gulf of America", or his insistence on the United States annexing Greenland by buying it (or even invading it) for security reasons, or taking over the control of the Panama Canal, claiming that prices paid by US ships transiting by the canal are too high, are examples that generate short-term nervousness in the financial markets and increase the level of volatility in stock prices.

Although Mr. Trump took the center stage during the fourth quarter, the economic fundamentals should not be overlooked. The US Federal Reserve (the Fed) cut its benchmark interest rate for a third time this year, amid an inflation rate hovering between 2.4% and 2.7% during the quarter. The consensus foresees inflation to remain stable over the next twelve months.
Looking forward and given the latest data regarding inflation, the labour market and the economic activity, economists are expecting fewer cuts in the benchmark interest rate than previously (three instead of four) by the Fed, supporting bond yields overall. The comments and future intentions of Mr. Trump mentioned earlier also pushed up interest rates. Thus, global bond prices lost 5.1% during the quarter.

As a consequence of the above, the yield curves have steepened in general and we believe the current interest rates are attractive for investors who still lack exposure to the bond market in the long-run. Over the next twelve months, the consensus believes the Fed will reduce its benchmark interest rate to 3.75% from 4.5% for the upper bound. Additionally, the yield on the US 10-year government bond is expected to be at 4.2% at the end of 2025, down from 4.7% currently. Although these expectations might be revised upward depending on the impacts of President's Trump policy on the inflation rate, we see an attractive risk/reward ratio overall on the Investment Grade segment, i.e. high-quality bonds.