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Multi-Asset Solutions Strategy Report

Global markets and multi-asset portfolios

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In brief

- The "America first" agenda the new U.S. administration is following has not translated into U.S. equity outperformance: The S&P 500 has trailed China's and European indices so far in 2025, although in bond markets, U.S. Treasuries are rallying while government bonds in China and Europe have declined.
- Equity outperformance in Europe and China is primarily valuation driven and, in our view, overestimates the economic outlook and underestimates the risks from tariffs. Fiscal and monetary policy interventions could be an upside risk in the second half of the year. We maintain a preference for U.S. and Japanese equities in portfolios today.
- Bond market underperformance in Europe and China could reverse, given disinflationary trends in both regions and the scope for further rate cuts. Even allowing for optically low yields today, we see scope for attractive real returns from these bond markets.
- Geopolitical risks remain elevated amid U.S. tariff threats – tariffs would negatively affect growth in Europe and China – but the scope for a lasting resolution in Ukraine presents a potentially offsetting boost to European growth, particularly should European investment in security accelerate.

"America First": Coming soon to a stock market near you

The "America first" agenda is apparent in virtually every policy announcement from the new U.S. administration. It is, however, notably absent in the year-to-date performance of U.S. stocks. Two months into 2025, the S&P 500 is up 1.3%, but those countries on the sharp end of tariff threats are doing rather better: Canada's stock index is up 2.4% so far in 2025, Mexico's 8.8%, China's is up 17.6% and Europe's 12.1%.

Bond markets paint a different picture. U.S. 10-year Treasury yields are down 32 basis points (bps) year-to-date, while Chinese and German 10-year government bond yields 7 bps and 11 bps higher, respectively. That has led the U.S. 10-year Treasury index to outperform its Chinese and European equivalents by about 250 bps in 2025.

The early outperformance of non-U.S. equity markets has been attributed to narrowing valuation discounts vs. U.S. equities. However, the outperformance of U.S. bonds appears at odds with both the relative growth outlook between the U.S., China and Europe, and the policy backdrop. As the year plays out, we expect the early outperformance of global stocks vs. U.S. to fade.

Meanwhile in bond markets the gradual cooling of U.S. growth back towards a trend-like 2%, together with fiscal event risks both in the U.S. and internationally, create some intriguing relative value opportunities.

What may lie ahead for Chinese asset markets?

It seems incongruous that China, the country most squarely in the crosshairs of tariff threats, would lead equity returns in 2025. It may be that a lot of bad news is already in the price of an unloved market. China's 2025 equity rally is mostly a tech story. January's Deepseek news, when the Chinese AI startup launched an apparently breakthrough model, was a key catalyst; in Hong Kong's Hang Seng Index (HSI), in which the tech complex comprises 40%, the sector has gained almost 30% in 2025. The move is valuation driven and the HSI price-earnings (P/E) ratio is now close to its 10-year average of 10.6x.

Hopes that the valuation-led rally morphs into a sustainable, earnings-driven move may be forlorn. Consensus 2025 EPS growth expectations for the HSI, at 5%, are modest but reflect a lackluster economy. We see Chinese GDP slipping from 5.7% in 2024 to 4.1% in 2025, and expect strong policy easing to offset the forecasted hit from tariffs.

We anticipate some fiscal support as China's budget deficit is set to grow by 100bps, to 4%, this year; and while we expect People's Bank of China (PBoC) rates to remain accommodative, China faces disinflation. Even with the 7-day repo rate at just 1.5%, we see Chinese CPI of just 0.3% by 4Q25, translating to a real interest rate of over 100bps in 2025 – hardly stimulative, given the external factors China faces.

Our instinct is to book some profits in Chinese stocks. Should the PBoC ease more aggressively – and, particularly, should China unleash further fiscal stimulus – there may be upside to Chinese equity. But for now, the prospect of tariff threats pivoting from Brussels to Beijing presents a headwind.

By contrast, the recent backup in Chinese yields might offer an entry point. Economically, China has an unappealing mix of an aging workforce, a high personal savings rate, excess capacity and positive real rates. True, 10-year yields of 1.8% are optically low, but we've seen this movie before.

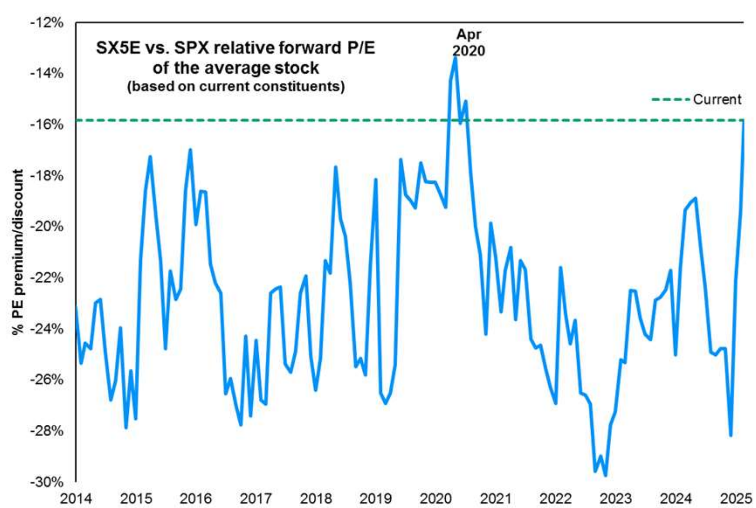
Go back 25 years and look at Japan from February 2000 to the dawn of Abenomics[1] in late 2012: During that 12-year period, Japanese CPI averaged -0.3%, so even with policy rates close to zero, the real rate averaged almost +50bps even as economic growth contracted by around 50bps per year. in February 2000, 10-year Japanese government bond (JGB) yields were close to where Chinese 10-year yields are today; over the subsequent 12 years up to the beginning of Abenomics, the 10-year JGB index rose 44% and saw annualized real returns of 3.5%.

Europe: An intriguing balance of risks

European stocks have also been strong in early 2025, driven entirely by multiple expansion, but we disagree that this was a "cheap" index playing catchup. Compared to the S&P 500, Europe was cheap – but then, so was everything. The Eurostoxx 50 Index P/E started 2025 at 14.1x, half a turn above its five-year average, and had expanded to 15.7x by late February. More tellingly, the valuation differential between the median stock in the S&P 500 and the median stock in Europe is at its narrowest level, post-pandemic (**Exhibit 1**). For European stocks to rally further, earnings growth would be needed and the outlook for that is rather murky.

European stocks' discount to U.S. stocks has narrowed

Exhibit 1: The relative valuation differential of median U.S. stock vs. median European stock



Source: Factset, J.P. Morgan Asset Management Multi-Asset Solutions; data as of February 2025

[1] The actions under Prime Minister Shinzo Abe (2006–to 2007 and 2012–2020), characterized by aggressive monetary policy, flexible fiscal policy and structural reform of the economy.

Tariff threats complicate the European outlook, as they do China's, and there are also the tectonic changes in Europe's strategic military partnership with the U.S. to consider. From a Chinese standpoint, tariff negotiations are ultimately transactional but from a European perspective, the combination of tariff threats and a reset of the U.S. relationship is fundamental.

We expect European GDP to expand 0.8% in 2025 but with risks in both directions. Should tariffs of 4%–5% be implemented, they could knock 50bps off annual growth, while a ceasefire in Ukraine could add 50bps–100bps over three years. But what may yet present an upside risk to growth is Europe's response to Washington's talks with Moscow, and the wider conversation about Europe's investment in its own security – especially given the German election outcome.

Improved investor sentiment toward Europe has been driven by optimism over fiscal expansion and a resolution of the Ukraine war. Near term, we believe that European equities currently underprice the risks surrounding both of these issues, and that investors are unduly sanguine about Europe's growth outlook. Nevertheless, in the longer term, the proposal from Germany's presumptive next chancellor, Friedrich Merz, to ease the "debt brake,"[2] to free up fiscal spending rules before the next parliament on March 25, is a material upside risk.

While the outcome of Germany's election implies a simpler two-partner coalition between center-right and center-left, fringe parties on the left and right are set to enter the Bundestag (parliament) in sufficient size to have an effective blocking minority for constitutional changes – including the debt brake. But the current mix in the Bundestag has no such blocking minority; thus, an easing of the debt brake leading to greater military spending and higher domestic investment could be, at least theoretically, more plausible.

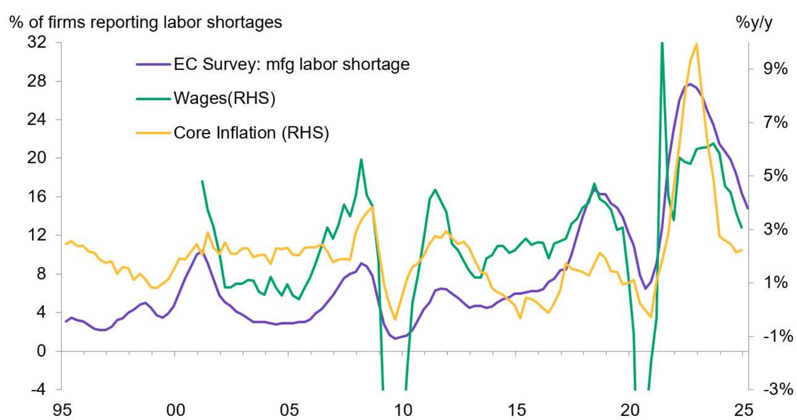
Higher European military spending would level the playing field in ongoing security negotiations and could tilt the shape of a ceasefire more in favor of Europe and Ukraine. Greater investment may also kickstart growth in Germany, the European industrial heartland, after two years of declines. With global equities facing seasonal headwinds, from looming U.S. tax return deadlines and signs of exhaustion in retail and systematic flows, the prospect of such a political gamble coming good may not boost European stocks much yet. But it presents an upside risk to European growth as the year unfolds.

Investment implications

In the near-term, we think there is more prospect for European core bonds to rebound. We see European policy rates dipping below 2% by summer, as the disinflation process becomes entrenched, but the market does not agree. The prospect of increased fiscal spending has added further upward pressure on European yields, but we see wage moderation driving disinflation and accelerating the easing cycle (**Exhibit 2**). These factors lead us to favor owning duration in the eurozone.

Slower wage growth and better labor market balance imply further downward pressure on core services inflation

Exhibit 2: Eurozone core inflation has moved back to the ECB's target



Source: Bloomberg, Eurostat, European Central Bank; data as of December 2024 (core CPI, wages) and January 2025 (European Commission survey).

In sum, the outperformance of non-U.S. stocks over the S&P 500, and the underperformance of non-U.S. bonds vs. U.S. Treasuries may be running out of steam. We expect some consolidation in risk assets in the near term as U.S. growth moderates towards trend, which may point to the early 2025 winners giving back a portion of their gains.

[2] Germany's debt brake (Schuldenbremse), established in 2009, limits the federal structural deficit to 0.35% of GDP and mandates balanced budgets for states, with exceptions for emergencies, to ensure fiscal discipline.

Near term, non-U.S. bond markets overestimate regional growth and underestimate local disinflation. Meanwhile, non-U.S. equities have closed their valuation gaps with the U.S., yet their earnings outlook remains mixed. As such, we choose not to chase these markets, and believe the earnings outlook for U.S. stocks remains superior, unless or until we see tangible fiscal expansion in Europe or meaningfully easier monetary policy in China.

Exhibit 3: MAS Asset Class Views

Asset Class	Opportunity Set	UW	N	OW	Change	Conviction
Main asset classes	Equities	○	○	●		Low
	Duration	○	●	○		
	Credit	○	○	●		Low
Preference by asset class – Equities	U.S.	○	○	●		Low
	Europe	●	○	○		Moderate
	Japan	○	○	●		Low
	UK	○	○	●	▲	Low
	Australia	●	○	○		Moderate
	Canada	○	●	○		
	Hong Kong	○	○	●		Low
	EM	○	●	○	▲	
Preference by asset class – Fixed Income	U.S. treasuries	○	●	○	▲	
	German Bunds	○	○	●	▲	Low
	JGB	●	○	○		Low
	UK Gilts	○	●	○		
	Australia bonds	○	●	○	▼	
	Canada bonds	●	○	○	▼	Low
	BTPs	○	○	●		Low
	Corporate Inv. Grade	○	●	○	▼	
	Corporate High Yield	○	○	●		Low
	EMD Sovereign	○	●	○		
Preference by asset class – Currency	USD	○	○	●		Moderate
	EUR	●	○	○		Low
	JPY	○	●	○	▼	
	CHF	●	○	○		Moderate

The tick chart and views expressed in this note reflect the information and data available up to February 2025.

Multi-asset solutions

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As of December 31, 2024.

Next steps

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