Investment Outlook 2025

Pushing the Boundaries

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In brief

- Our central expectation is that President Trump's policy agenda will be growth supportive. But there are risks, particularly if the balance of fiscal stimulus, tariffs and immigration curbs prompt more inflation than real growth.
- A renewed focus on 'America first' policies will require responses from other regions, notably Europe and China, where large scale monetary and/or fiscal stimulus is expected.
- For equity market leadership, how the technology boom evolves is more important than who is in the White House. We think the best of the tech gains have been had, and as these technologies proliferate around the broader economy the next stage of the technology evolution will lift asset prices elsewhere in the global stock index.
- It's tempting to believe that Trump's re-election will reinforce US outperformance. But it's worth remembering that expectations embedded in European stocks are already low and it's not just what you buy, it's how much you pay for it. We like the UK market in particular.
- For multi-asset investors, today's investment landscape demands that we re-think diversification, incorporating bonds for income and recession protection, but also assets that will perform well during inflation shocks.

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Many moving parts

The re-election of Donald Trump is likely to have far-reaching consequences beyond the US. Domestically, the incoming President will almost certainly introduce more fiscal stimulus, meaning governments elsewhere, notably in Europe and China, will have little choice but to follow suit to offset any negative economic effects stemming from aggressive trade policy.

At face value, risk markets may continue to cheer the prospect of such 'pump-priming', so we think a pro-risk stance remains sensible. However, it is imperative investors consider the downside risk that geopolitical hostilities lead to a fall in corporate confidence and recession, as well as the risk that inflation re-emerges and pushes bond yields higher.

The cross currents of taxes and tariffs

Prior to the election, the US economy appeared to be moderating as pandemic-related household savings were run down. The labour market in particular was showing signs of cooling, but in a reassuringly orderly fashion. The fact that the majority of households and corporates were dealing so well with higher interest rates was an encouraging sign of the underlying health of the US economy. With cooling activity came a reduction in inflationary pressures and the prospect of potentially significant monetary easing.

The re-election of Donald Trump brings with it the potential for new fiscal stimulus. The tax package that President Trump enacted in his first term will now likely be fully extended, rather than expire at the end of 2025 as previously legislated. President Trump has also discussed the potential for reducing the corporate tax rate further from 21% to 15%, additional tax cuts for households such as removing taxes on tips and overtime, as well as deregulation in a number of areas.

There are two risks that could temper such a positive outcome that will require monitoring as 2025 progresses. The first is the risk that ongoing large budget deficits and talk of more stimulus unsettles the bond market and what is put in pockets via lower taxes is taken out in the form of higher mortgage and corporate borrowing rates, as long-term Treasury rates move higher. The second is that tariffs damage consumer and business confidence.

President Trump is certainly asking bond investors for a lot (**Exhibit 1**). On current policy, the fiscal deficit already looks set to stay in the region of 7-8% for the coming decade, and debt as a percent of GDP to rise to over 120% (**Exhibit 2**).

Exhibit 1: Additional stimulus will push the US fiscal deficit to extraordinary levels

Composition of the US federal deficit

% of GDP

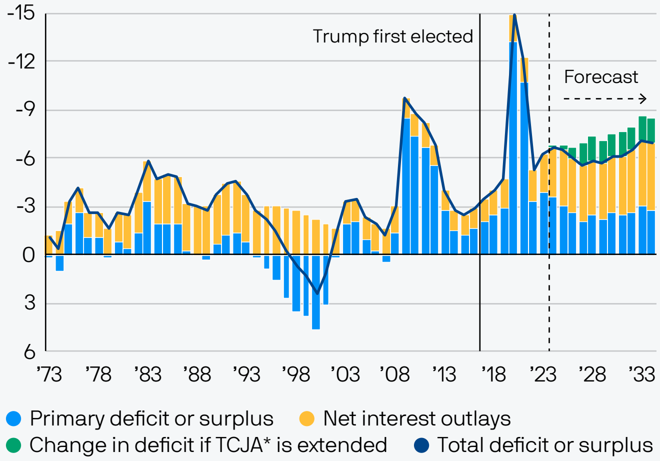
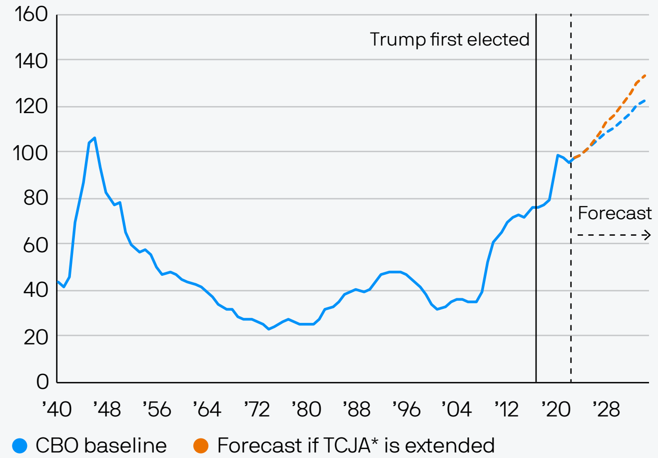


Exhibit 2: Ever-rising government debt could unsettle the bond market

US federal debt

% of GDP



Source: (All charts) BEA, CBO, US Treasury, J.P. Morgan Asset Management. Forecasts are based on the Congressional Budget Office's (CBO's) latest budget and economic outlooks and internal J.P. Morgan Asset Management estimates. *TCJA refers to the Tax Cuts and Jobs Act of 2017, parts of which will expire on 31 December 2025 unless extended. Years shown are fiscal years. Data as of 12 November 2024.

The bond market has digested the news of a Republican sweep relatively well so far. Where yields go from here depends on how the potential for further fiscal stimulus interacts with the potential delivery of some other campaign promises.

Tackling migration was one of the issues at the heart of Trump's campaign, and he has promised draconian immigration curbs and large-scale deportations. The last successful deportation effort was in 1956 under President Eisenhower, when roughly 1.3 million immigrants were expelled. Whether deportations prove to be practically realistic, much more stringent controls at the border, more challenging conditions for gaining asylum, and the prospect of workplace raids are likely to significantly deter both prospective migrants and US employers.

This will impact the labour market. It's worth remembering that the massive increase in immigration in recent years, while clearly upsetting the electorate, has played a major role in the US's ability to maintain a strong rate of growth and at the same time bring down inflation. A significant reduction in migrant workers could reignite wage pressures and inflation concerns.

Firms' cost pressures could also rise if the self-titled 'tariff man' enacts large and widespread tariffs on imports. He has stated that he will impose a 60% tariff on all goods entering the US from China and a 10%-20% tariff on goods arriving from all other regions.

Is this a day one priority or a starting point for negotiation?

We expect the tariffs on China to be delivered. China being an 'unfair trader' is a view with bipartisan political backing in the US. While the 60% rate is an eye-catching number, it's worth noting that the volume of trade that the US conducts with China has already fallen significantly since President Trump's first term (**Exhibit 3**). Friend-shoring and near-shoring has occurred remarkably quickly, in part thanks to Chinese companies themselves moving their production to other locations like Mexico.

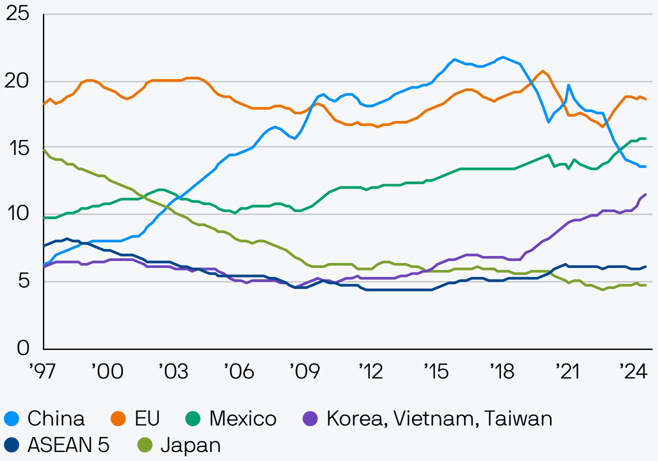
A blanket tariff on all other regions would have more profound effects, but how far will President Trump push this agenda? On the one hand he, and key members of his team such as his former trade negotiator Robert Lighthizer, are clearly ideologically predisposed to tariffs. They do not believe in the advantages of free trade, and see tariffs as an easy revenue raiser to fund tax cuts at home.

However, it is not clear that the President can impose a universal tariff by executive order. He has authority to do unilateral targeted tariffs, but broad-based tariffs seem likely to require congressional action and that will take time. Broad-based tariffs are also economically more risky. Recent years have demonstrated how much the electorate does not like inflation and a 10%-20% tariff on imports from all destinations is likely to have a greater impact on US price pressures. Also, the uncertainty that arose from Trump's first trade war did coincide with a dramatic decline in US business investment (**Exhibit 4**).

Exhibit 3: China's share of US imports has already fallen meaningfully

Share of US imports

% of total goods and services imports, 4-quarter moving average

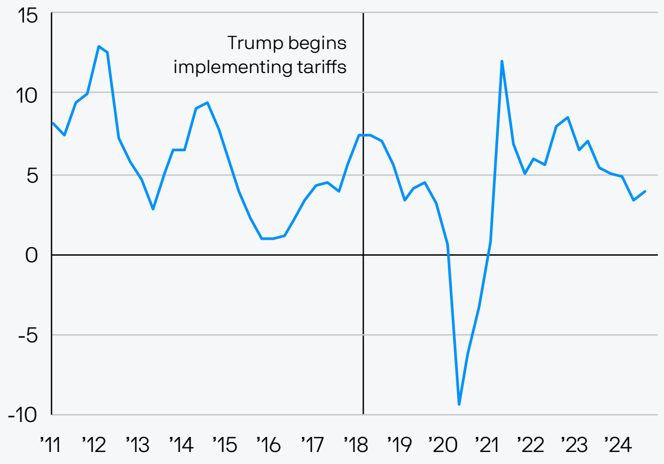


Source: LSEG Datastream, US Census Bureau, J.P. Morgan Asset Management. Data as of 12 November 2024.

Exhibit 4: The last trade war coincided with a sharp fall in US business investment

US real business investment

% change year on year



Source: BEA, LSEG Datastream, J.P. Morgan Asset Management. Data as of 12 November 2024.

Therefore, we suspect there will be scope for other regions to negotiate with respect to tariffs. Those with the largest trade surpluses – including China, Mexico, Vietnam and Germany – are likely those where negotiations will prove most challenging (**Exhibit 5**).

One doesn't envy the Federal Reserve (Fed) amid all this. US policymakers will have to disentangle how tax cuts will boost demand, at the same time as understanding how migration and trade tensions may curtail supply. All being equal, these considerations are likely to push up inflation and therefore reduce the likelihood that the Fed cuts rates meaningfully through 2025. It's also worth noting the difficult relationship between President Trump and Fed Chair Jerome Powell. In his first term, President Trump frequently criticised Chair Powell for not being a 'national champion', going as far as to say in a social media post: "Who is our bigger enemy, Jay Powell or Chairman Xi?". He has even threatened to appoint a Shadow Chair so that the President has greater oversight on decision-making at the Fed.

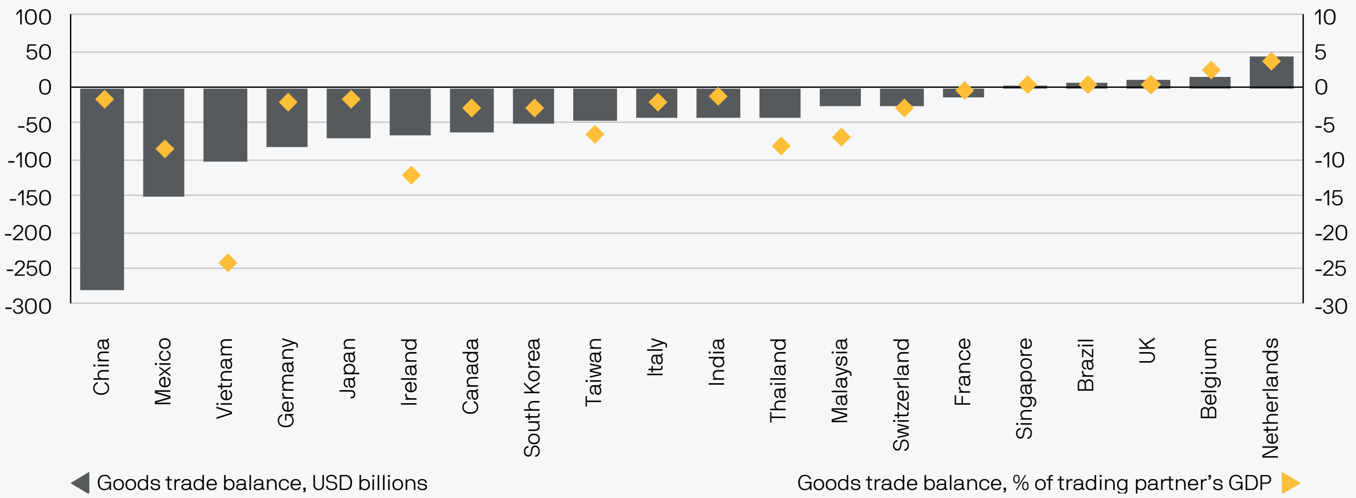
Our central assumption is that the Fed will be very reluctant to increase interest rates during Trump's presidency, and will be quick to act in the event of any weakening in the data. Provided that Powell succeeds in keeping bond investors onside, a central bank reaction function that prioritises growth should be supportive for risk assets.

> Outside of those imposed on China, we suspect that there is scope for negotiations on tariffs.

Exhibit 5: Those with the biggest trade surpluses may be most at risk of higher tariffs

US goods trade balance by country

USD billions (LHS); % of trading partner's GDP (RHS)



Source: FactSet, J.P. Morgan Asset Management. Data as of 12 November 2024.

Europe and China will have to react

What does an 'America first' approach mean for the rest of the world?

Europe and China were already struggling before the election. In contrast to the US's demonstration of confident exuberance, European households and consumers have remained cautious and reticent (see our recent On the Minds of Investors). While US households have been happy to run down the savings they accumulated during the pandemic, European households have continued to build up theirs (**Exhibit 6**).

The allure of higher interest rates is part of the story (**Exhibit 7**), but fear has almost certainly played a role as energy costs remain high, the conflict in Ukraine continues, and discussions about higher taxes to tackle government deficits have resurfaced.

Within Europe, the UK has seen the most verdant green shoots emerge and appears to be on a modest upswing as falling headline inflation and strong real wage growth have reinvigorated consumer spending. The recent budget from the new Labour government contained significant tax rises, but even more government spending which was front-loaded and therefore has the potential to provide a net positive boost to growth in 2025.

With a very small manufacturing sector, the UK is also less vulnerable than the eurozone to the ongoing global weakness in trade, as much of the global recovery in recent years has been driven by services demand.

The weakness in global goods demand may merely be a hangover from the pandemic. During lockdowns, households focused their spending on goods and when lockdowns eased, they shifted their attention to services and making up for lost experiences. At some point, we would expect spending patterns to normalise; there is plenty of evidence for a very high average age of durable goods at present, such as cars.

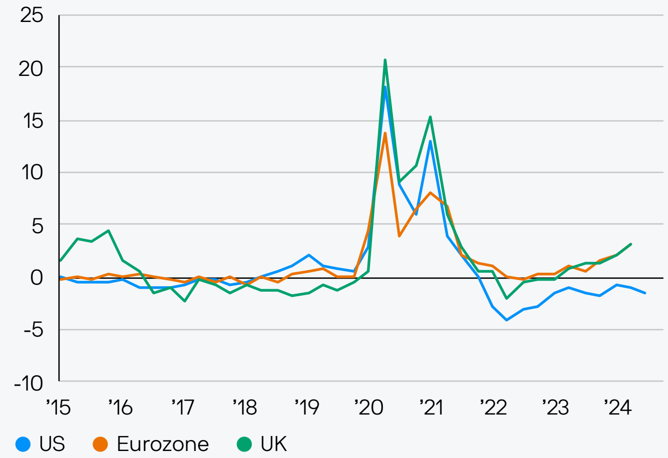
Persistent weakness in demand from China is also part of the story, since China's post-pandemic recovery has been even more disappointing than that of Europe. The property overhang – after a decade-long building boom – has continually weighed on house prices. Given two-thirds of Chinese household wealth sits in property, the sector's woes have unsurprisingly been a continual drag on consumer confidence. With a sputtering domestic engine, firms have focused on exports but this intense competition has further challenged European manufacturers.

At face value, the US election result looks like it will compound Europe and China's problems, but we expect both China and Europe to meet this hostility with more support for their own economies.

Exhibit 6: US consumers have spent pandemic-era savings but Europeans have not

Excess savings rates

% points, savings rates relative to 2015-2019 average

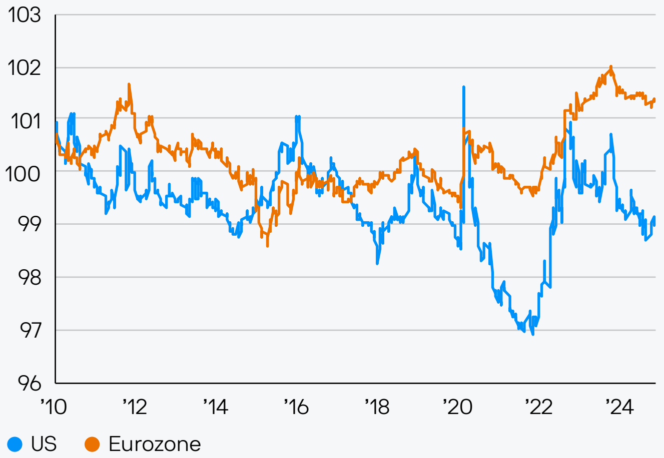


Source: BEA, Eurostat, LSEG Datastream, ONS, J.P. Morgan Asset Management. Data as of 12 November 2024.

Exhibit 7: The ECB still has its foot firmly on the monetary brake

US and eurozone financial conditions

Index level



Source: Bloomberg, Goldman Sachs, J.P. Morgan Asset Management. The financial conditions index is a measure of how easily money and credit flow through the economy. Data as of 12 November 2024.

China's stimulus has so far focused on making credit both more readily available and cheaper but when the underlying problem is too much debt, making credit more attractive rarely provides a lasting solution. We anticipate that foreign hostility will lead Beijing to tackle the property and local government debt overhang more directly and provide more direct fiscal stimulus to households and corporates.

Europe's ability to react quickly may be hindered by its own political problems.

In Germany, Chancellor Olaf Scholz's designation of Trump's re-election – paired with the war in Ukraine – as an 'emergency situation' that should allow for a temporary suspension of the debt brake[1] was met with resistance from the fiscally conservative FDP party.

The government coalition has since collapsed and we are likely to see a general election in February. The fall in popularity of the FDP, according to current polls, suggests that the party's fiscal responsibility is not being rewarded. Indeed, the FDP currently looks unlikely to reach the crucial 5% level needed in the popular vote to enter the German parliament. It is uncertain whether Germany can quickly form a government with a credible plan for its domestic economy and policy towards Ukraine. In our view, while the deficits projected in the US for the next 10 years seem unwise, Germany's extreme obsession with fiscal conservatism appears like an extraordinary act of self-harm.

France's political situation is similarly precarious. After President Macron called surprise legislative elections in June, his coalition lost its majority. It then took several months for a new centre-right coalition government to be formed, to the fury of the left-wing alliance which had won the most seats. Michel Barnier – the new prime minister – inherited a fragile fiscal situation. The deficit is projected to reach 6.1% over 2024, and France is now subject to the European Commission's 'excessive deficit procedure', forcing it to spell out consolidation measures.

France's new budget plan thus includes €40bn of spending cuts and €20bn of tax rises. This plan is likely to be rejected by parliament. If attempts are made to force it through via a controversial constitutional article, this could trigger a no confidence vote and new legislative elections, although these cannot be held before June 2025.

Europe also needs to reflect on its approach to climate policy. While it is undoubtedly admirable to prioritise the future of the planet, other regions do not have the same sense of urgency. Under President Trump, the regulation gap between Europe and other regions looks set to widen, becoming an increasing headwind for European industry. Europe either needs to adapt its current plans, or subsidise those companies affected and erect its own borders to protect against competition from goods produced in regions with less stringent environmental policies.

It's tempting to be pessimistic and assume that Europe's politicians will not have the urgency or ability to provide a solution to these problems. However, it's often in times of global crisis that the eurozone's policymakers are galvanised to step up. Consider the continent's response to the war in Ukraine or the post-pandemic cooperation that led to the EU Recovery Fund, which was an extraordinary move towards a much needed fiscal union.

> **It's often in times of crisis that the eurozone's policymakers are galvanised to step up.**

[1] Germany's debt brake restricts the fiscal deficit to a maximum 0.35% of GDP.

Today's crises may again prove to be the vehicle for further stimulus. Many European countries now meet their NATO commitment to spend 2% of GDP on defence (**Exhibit 8**). But President Trump has recently said that this number should be 3% of GDP.

Government support may take time, so the European Central Bank (ECB) will be pressured in the first instance. Unlike the Fed, the ECB is unlikely to be hindered by concerns about a resurgence in inflation, so we still expect multiple interest rate cuts from the ECB over the course of 2025. Moreover, given how tight financial conditions are in Europe, this loosening of interest rates could have a material impact on the rate-sensitive business sector and perhaps even encourage households to spend some of their ample savings.

The Bank of England is unlikely to provide as much stimulus, given more robust demand in the UK and ongoing concerns about a tight labour market due to low and falling domestic participation.

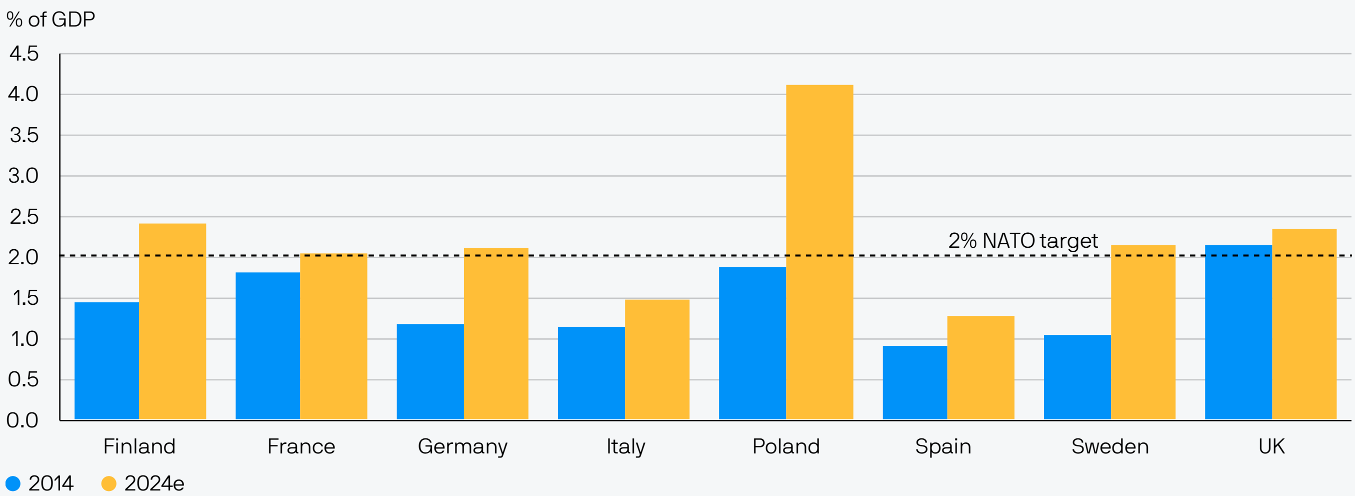
Known unknowns

Overall, we have to remember that there is a high degree of uncertainty about US domestic and foreign policy and the policy responses that will be enacted by other regions. While an 'America first' policy stance might lead to ongoing 'US exceptionalism' across asset classes, we'd argue that at a multiple of 22x forward earnings, vs 14x in Europe, a lot of that relative optimism is already priced into the equity market (see **Challenging the discount on European stocks** and **China's stimulus and prospects for emerging market stocks**). Investors also need to be very mindful about how to manage their equity allocations as the AI boom needs to progress from hype to reality (see **AI investing: More broadening than bubble**).

We should also recognise that beyond the cyclical implications, today's picture reinforces some of the structural views that we have been communicating for some time. These include the fact that, with a regime shift in the interaction of fiscal and monetary policy compared to the pre-pandemic era, the risk of higher and more volatile inflation forces us to re-think the basics of portfolio diversification (see **Re-thinking portfolio diversification**).

Exhibit 8: European countries are already spending more on defence but further increases are likely to maintain relations with the US

Defence expenditure



Source: NATO, J.P. Morgan Asset Management. NATO estimates are used for 2024. Data as of 12 November 2024.

AI investing: More broadening than bubble

"By 2005 or so, it will become clear that the Internet's impact on the economy has been no greater than the fax machine's," declared a former winner of the Nobel Prize in Economics in 1998. This famous quote clearly demonstrates how even the sharpest analytical minds can struggle to forecast the pace of technological progress.

It is now increasingly consensus that a booming artificial intelligence (AI) industry is driving the next technology revolution. For investors, however, the most important question to address is whether the expectations embedded in financial markets today project a realistic path ahead.

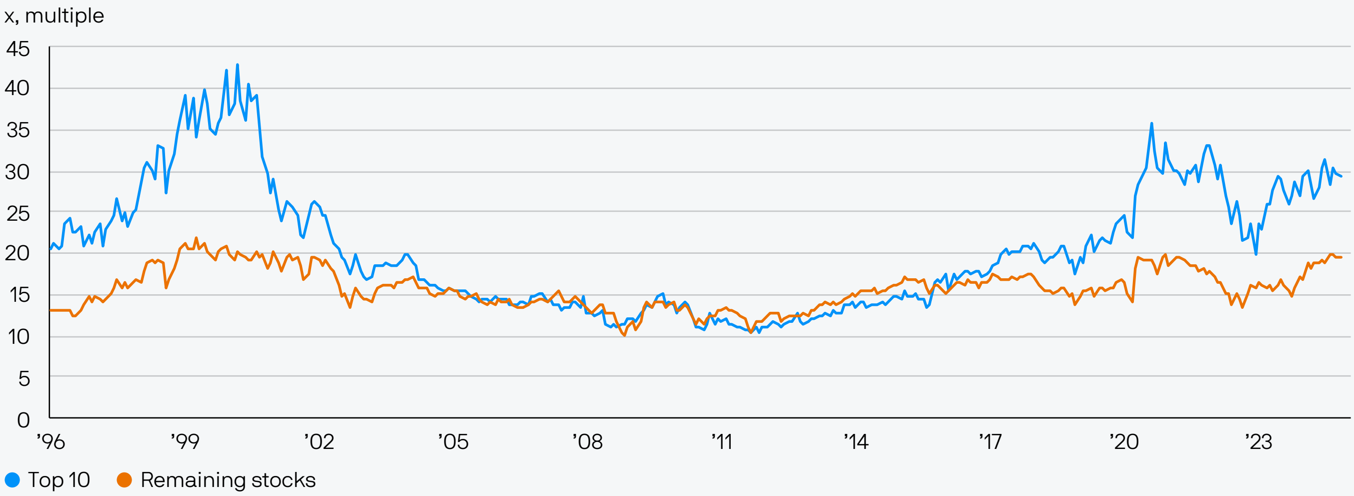
AI stocks and index concentration

The current composition of the S&P 500 highlights just how important a small number of companies linked to AI have become. While each of the companies in the Magnificent Seven are geared differently to the AI theme, this group of stocks now make up nearly 35% of the S&P 500 market cap and have driven over 70% of returns since the beginning of 2023. This outperformance has also seen valuations expand. While the rest of the S&P 500 trades on a 12-month forward earnings multiple of 19x, the largest 10 stocks in the index now trade on 29x (**Exhibit 9**).

The valuation gap between the biggest stocks (the megacaps) and the rest is unlikely to persist indefinitely. If the broad AI ecosystem generates sufficient revenues to justify the earnings expectations already assumed for a handful of companies, the "rest" should catch up over time. If instead, the broader corporate universe does not see the clear use case of these technologies and are unwilling to pay for them, then a "catch down" scenario is more likely.

Exhibit 9: The valuation discrepancy between 'tech and the rest' is unsustainable

Forward P/E ratio of the S&P 500 top 10 vs. the rest



Source: FactSet, S&P Global, J.P. Morgan Asset Management. The top 10 stocks are based on the 10 largest index constituents at the start of each month. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Exhibit 10: Delivered earnings growth has supported share price gains

Magnificent Seven valuation, earnings and share price performance

	Alphabet	Amazon	Apple	Meta	Microsoft	Nvidia	Tesla
12m fwd P/E ratio 1 year ago	20x	48x	28x	20x	32x	31x	56x
12m fwd P/E ratio today	21x	35x	30x	24x	31x	39x	106x
1-year change in 12m fwd earnings	35%	100%	13%	54%	18%	145%	-19%
1-year price change	37%	46%	20%	78%	14%	207%	53%

Source: IBES, LSEG Datastream, J.P. Morgan Asset Management. Forward P/E ratio is price to 12-month forward earnings, calculated using IBES earnings estimates. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

The strong fundamentals of the megacaps, both relative to other parts of the S&P 500 today, as well as relative to the 2000s tech bubble, provide some comfort that a major "catch down" is unlikely. Collectively, the Magnificent Seven have cash on their balance sheets to the tune of around $460 billion, according to their most recent set of earnings reports. The current spread of just over 10 basis points on Apple's corporate bonds maturing in 2032 is one example of how the market perceives these companies' quality.

Another key difference relative to 2000 is how delivered earnings growth has supported much of the move in stock prices (**Exhibit 10**). Take Amazon, whose P/E ratio has declined from 48x to 35x over the past 12 months, but where huge earnings growth has resulted in a 46% one-year return. Or Nvidia, the poster child of AI, whose multiples have risen over the past 12 months, but where a 145% change in 12-month forward earnings has played a major part in the stock's 207% return.

In other words, what we are seeing today is reality over hope, rather than the hope over reality that prevailed during the dotcom bubble (**Exhibits 11** and **12**).

Understanding the AI value chain

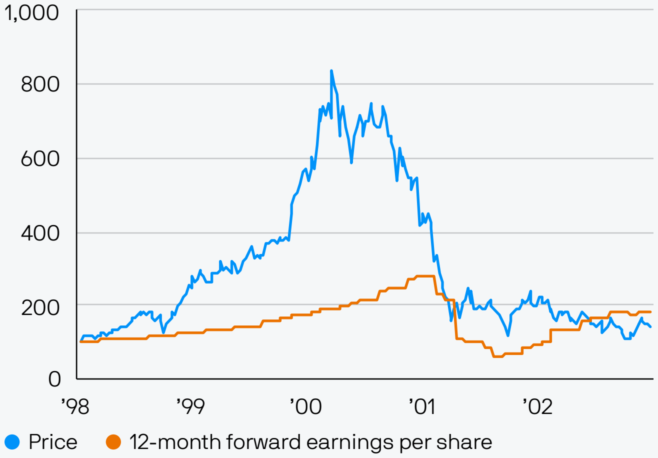
To understand how a "catch up" scenario could play out, it's necessary to look much further out along the AI value chain (**Exhibit 13**). In very simple terms, AI companies can be bucketed into five key groups:

- **AI hardware** (for example, Nvidia in the US, ASML in Europe and TSMC in Taiwan), which are the companies that drive the design and manufacture of the semiconductors that are key to generating computing power;
- **AI hyperscalers** (for example, Amazon's Web Services business or Google Cloud), which are the companies that provide physical AI infrastructure such as cloud services and data centres, create custom silicon chips, and build large language models that can be used by other companies;
- **AI developers**, which can range from small app builders to existing enterprise software companies (for example, Adobe or Microsoft) that leverage hyperscaler technologies to provide solutions for end users;
- **AI integrators**, which are the larger organisations that have sufficient technology functionality to build their own AI solutions, as well as the IT services companies that support them;
- **AI essentials**, which include companies that are less directly impacted by the technology itself, but provide the resources that enable the whole AI value chain to work, whether that is energy, air conditioning, raw materials or even the data to train models.

Exhibit 11: The 2000s saw a decoupling of prices from earnings

Cisco share price and earnings expectations

Index level, rebased to 100 in January 1998

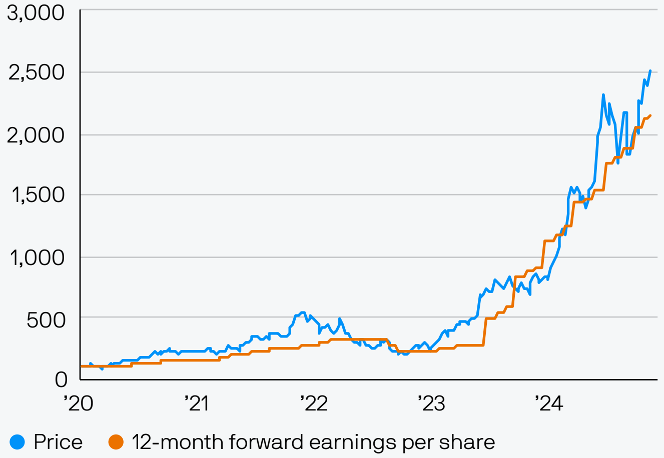


Source: IBES, LSEG Datastream, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Exhibit 12: Today, rapidly rising earnings have supported tech valuations

Nvidia share price and earnings expectations

Index level, rebased to 100 in January 2020



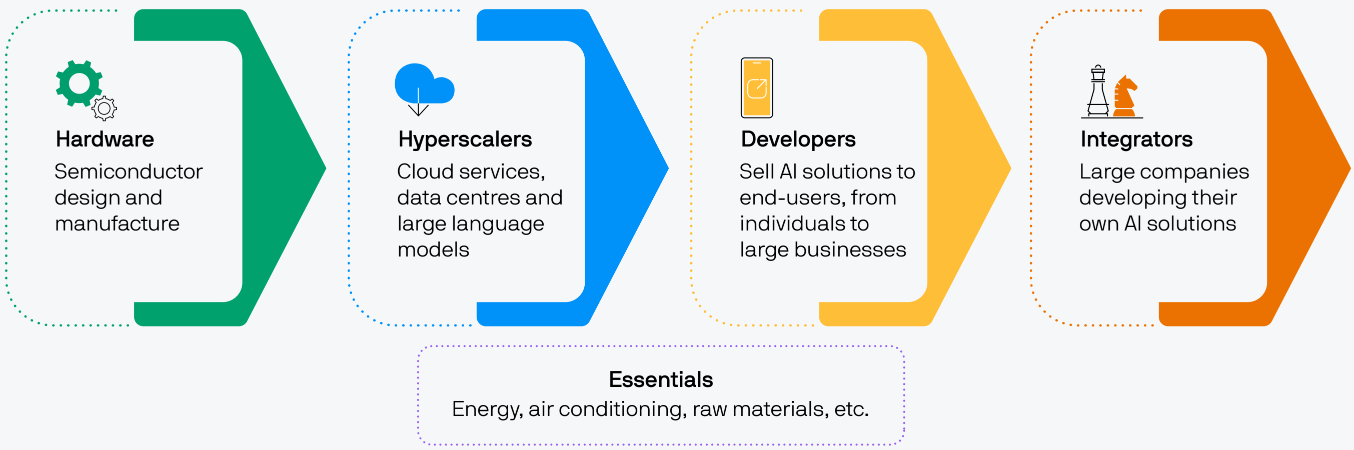
Source: IBES, LSEG Datastream, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

A megacap monopoly, so far...

Despite the huge array of companies that will at some point find themselves in one (or more) of these AI buckets, only a handful of megacap companies are viewed as winners today based on current earnings expectations, with the flow of capital expenditure (capex) across this small number of megacaps creating a virtuous earnings cycle over the past two years.

According to data from S&P Global, just five AI hyperscalers are currently projected to spend more than $1 trillion in capex collectively from 2024 to 2027, which in turn is driving massive revenue expectations for AI hardware names. Nvidia is the prime beneficiary, where annual revenues have increased from $4bn in 2014 to an expected $61bn in 2024. At the same time, the top 10 stocks in the S&P 500 are now responsible for over 40% of research and development (R&D) expense, despite only representing 13% of the S&P's revenues (**Exhibit 14**).

Exhibit 13: Understanding the AI value chain

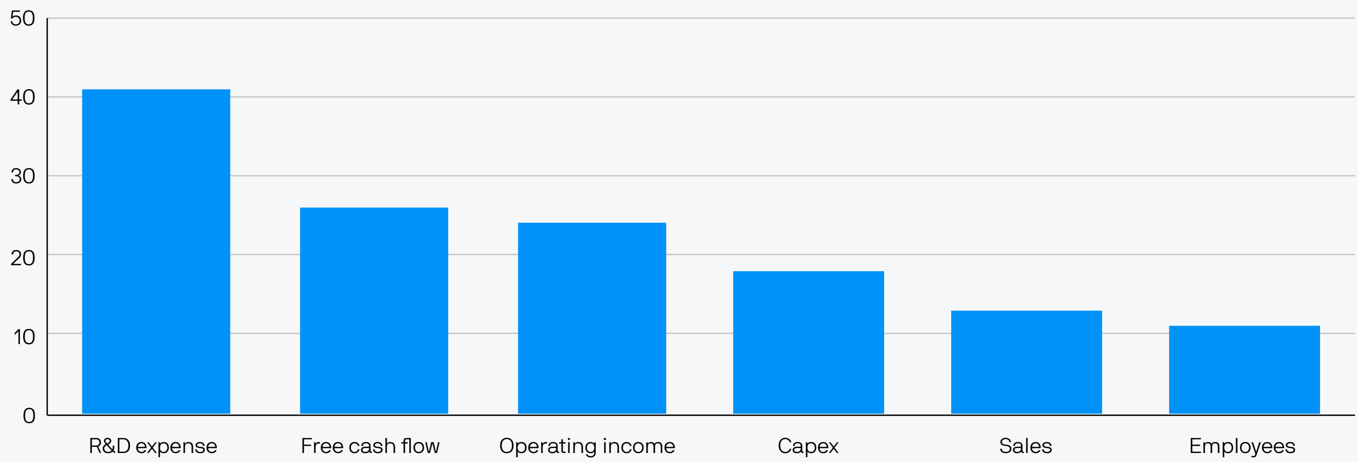


Source: J.P. Morgan Asset Management, as of November 2024.

Exhibit 14: Tech domination is in R&D, cash flow and income

Economic concentration in the S&P 500

Top ten stocks' share of given S&P 500 metric



Source: FactSet, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Return on investment is now under the spotlight

The substantial gap between the revenue expectations of hardware companies and the revenue growth that can be generated by the AI ecosystem is an issue that has already attracted significant attention.[2] If the developers and the integrators can't generate sufficient profit, this weakness will eventually spread up the value chain. As the initial hype around AI starts to cool, the question investors are posing is a simple one: "show me the money?"

The good news for technology bulls is that AI adoption appears to be increasing. McKinsey's Global Survey on AI from earlier this year, for example, showed that the proportion of companies that have adopted AI in at least one business function had jumped from 55% in 2023 to 72% in 2024, with an even greater jump in the proportion of businesses using generative AI.

Quantifying the revenue benefit, however, is much more challenging. For the hardware providers, while forecasts are still uncertain, a large proportion of AI-related revenues are coming from a small number of hyperscalers. But for the developers, whether they're selling software to a law firm in a bid to reduce headcount, or new technology to a pharmaceutical company to enable accelerated drug testing, these increased revenues are going to be scattered right across the economy. Crucially, this makes it far harder for analysts to gauge the outlook for earnings.

Assessing AI investment opportunities

As AI hype turns to AI reality, where along the value chain should investors be positioning for further upside?

So far, investor excitement has primarily been anchored in the first two of our categories, hardware and hyperscalers, where companies are often located in the technology and communication services sectors. High levels of valuation dispersion in these categories suggest that opportunities for skilled stock pickers persist, but investors must recognise that any earnings disappointment could lead to substantial volatility. These categories are also likely to be the most exposed to escalating trade tensions between the US and China, although the nature of any new policy is yet to be known. Today's wide margins make tariffs somewhat of a secondary issue, but new trade restrictions that look to restrict the availability of sophisticated technology would pose greater risks.

We find ample opportunities in the AI essentials bucket, where companies often trade on less demanding valuations and many are now seeing a significant acceleration in revenues. Take the utilities sector as one example, where data centre demand for electricity is set to more than double by 2026 relative to 2022 levels.

The biggest AI-driven winners may well be found in the developers bucket over time. The category already has many incumbents in the form of enterprise software companies, who are now integrating AI to enhance their product line-ups. Yet the growth of the internet in the early 2000s highlights just how long it can take to fully understand how transformative new technology can be. Few investors anticipated the success that lay ahead for companies such as Amazon and Uber, which later leveraged the huge amount of capex first invested by others, and the same could yet be true for AI. A diversified approach will be critical given the high degree of variability in the future prospects of the less established developers.

Finally, practically every S&P 500 company will be hoping to achieve "integrator status" over the coming years. The key challenge for equity analysts will be to differentiate between those companies "talking the talk", and those whose earnings reports demonstrate that they really are "walking the walk".

Conclusion: Look beyond megacap tech stocks for AI opportunities

In our view the gap between the valuation of mega-cap tech and the broader S&P 500 is unsustainable. However, unlike 2000, we see a 'catch up' scenario as more likely than a 'catch down' scenario. From here, investors should focus on opportunities that will prevail right along the AI value chain. Investors need to weigh future potential earnings against what is already embedded in the price. Cheaper valuations and less demanding earnings expectations outside of megacap tech stocks suggest that even AI bulls should be positioned for further broadening across sectors in 2025.

[2] See, e.g., https://www.sequoiacap.com/article/ais-600b-question/

Challenging the discount on European stocks

The S&P 500 has continued to strongly outperform the UK's FTSE All-Share or the MSCI Europe ex-UK index over the course of 2024. As a result, the UK equity market now trades at a discount of nearly 50% to the US benchmark, and the MSCI Europe ex-UK index at a discount of over 35%.

Is such a discount on European stocks justified? Should investors contemplate rebalancing towards the stocks that Europe has on sale?

One might be tempted to disregard this notion in the face of a new US president with a very clear 'America first' mandate, and given that Europe's recovery was lacklustre even before the prospect of renewed trade tensions. However, we see several reasons why investors should consider regional diversity in their equity allocations.

Europe has a much lower hurdle to beat expectations

There is a large gulf between expectations for US companies and those for their European peers (**Exhibits 15** and **16**). S&P 500 earnings are expected to grow by 14% over the next 12 months, and the index trades on a multiple of 22x those earnings. In contrast, earnings for the MSCI Europe ex-UK are forecast to grow 8% over the next 12 months, and the index trades on 14x those earnings. Earnings for the companies in the FTSE All-Share are expected to grow at 8% and the multiple on those earnings is just 11x. Thus, a significant degree of European underperformance is already priced in.

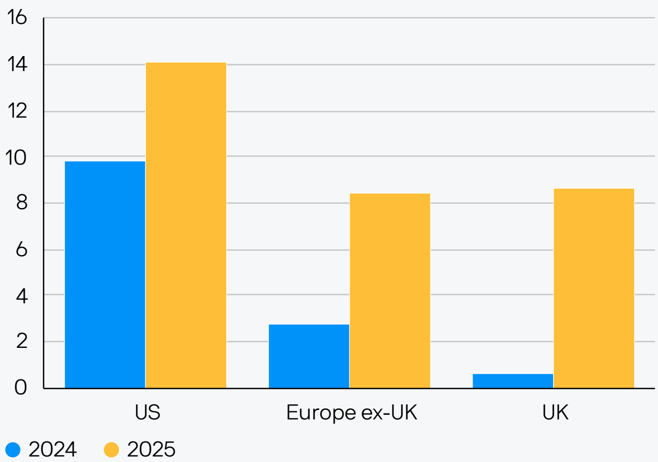
Part of Europe's valuation discount at the benchmark level is due to sector composition. The region has far fewer tech stocks than the US market, and so has not benefitted from AI-related investor optimism. Instead, European indices contain more industrials, financials and commodity companies, which have faced challenges stemming from muted global goods demand, fear of non-performing loans, and a weaker Chinese economy.

However, every European sector currently trades at a discount well above the normal versus its US counterpart (**Exhibits 17** and **18**). This reflects general investor pessimism about European revenue and margin prospects.

Exhibit 15: Expectations for Europe are low, whether one looks at expected earnings growth...

Consensus estimates for earnings per share growth

% change year on year

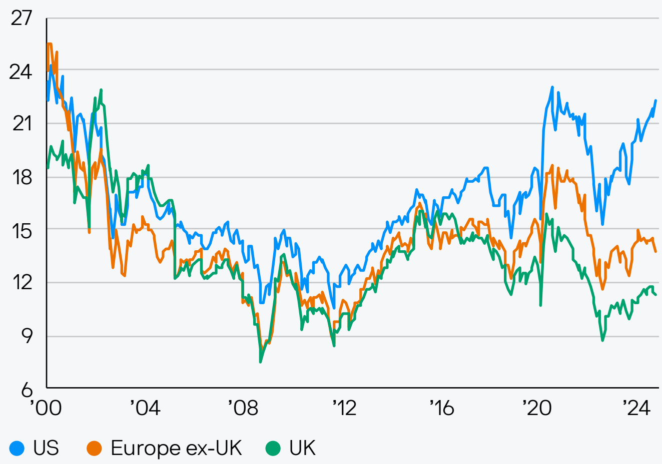


Source: FTSE, IBES, LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. US: S&P 500; Europe ex-UK: MSCI Europe ex-UK; UK: FTSE All-Share. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Exhibit 16: ...or valuations

Forward P/E ratios

x, multiple



Source: FTSE, IBES, LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. US: S&P 500; Europe ex-UK: MSCI Europe ex-UK; UK: FTSE All-Share. Earnings data is based on 12-month forward estimates. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Policy stimulus is likely to be greater than the market currently expects

We suspect it will become clear that while the new US administration will quickly levy tariffs on China, relations will be less hostile with Europe. This alone could support sentiment towards European assets.

However, Europe's trade-heavy economies will nonetheless be affected by restrictions on global trade, particularly if the European Union (EU) is forced to follow the US and impose restrictions on Chinese imports to protect its industries from excess Chinese supply.

A mitigating factor that investors may be underestimating is the response of European policymakers. We are confident that the European Central Bank will continue on an easing path, since Trump's policies could reignite inflation in the US but dampen inflationary pressures within continental Europe as the European growth outlook faces tariff-related risks. Lower interest rates could incentivise consumers to spend some of the savings accumulated during the pandemic.

Some European leaders also have fiscal levers that they could pull to counter the effects of more aggressive trade policy and, as the decline in voting intentions for the fiscally conservative FDP party in Germany suggests, this is something the electorate appears to be hoping for. At the very least, efforts to reduce deficits are likely to be very gradual, with domestic industrial, energy and military security taking precedence.

In addition, we might finally see European countries make more urgent efforts to deploy the more than 50% of the EU Recovery Fund that remains to be disbursed.

In the UK, the economy's underlying structural dynamics suggest inflation may persist for a little longer than in its European neighbours. That said, there is still room for the Bank of England to cautiously ease its foot off the brake further. And while the recent budget was already expansionary, we suspect the new government will come under further pressure to meet its prior commitments on defence, as well as bolstering its as yet unspecified plans to boost investment.

It's also possible that these policy surprises in Europe come at a time of policy disappointment in the US, if it becomes clear that Trump does not have the backing of the more traditionally conservative Republicans in the Senate for additional corporation tax cuts.

Exhibit 17: Every sector trades at an abnormally large discount on the continent...

MSCI Europe ex-UK relative valuation vs. the US

%, relative discount/premium based on 12-month forward P/E ratios

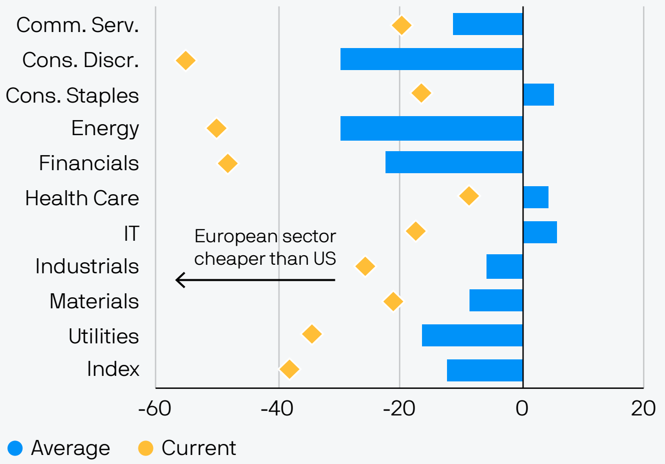
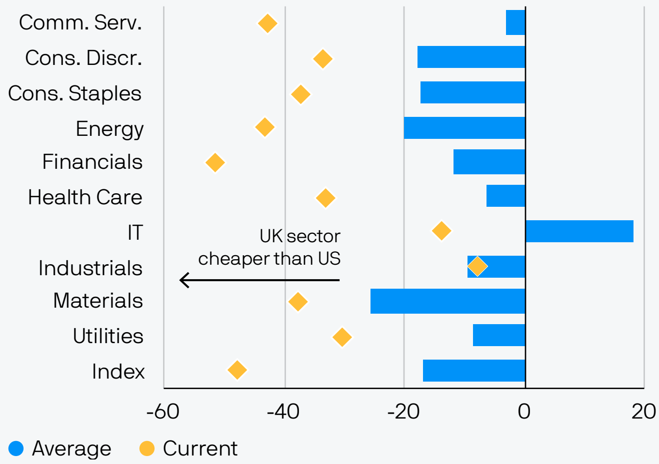


Exhibit 18: ...and in the UK

MSCI UK relative valuation vs. the US

%, relative discount/premium based on 12-month forward P/E ratios



Source: LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. The chart shows the current percentage discount of the index or sector 12-month forward P/E ratio vs. the equivalent for the S&P 500, and the average since 1995. Communication Services average is calculated using data from 1995 to 2000 inclusive and from 2005 to date, due to sector composition changes. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

How tech stocks perform is more important than Trump

In times like these, it's easy to become absorbed by politics but often much bigger market forces are the primary driver of relative equity market performance. We would argue that the outlook for US technology stocks over the coming four years may well end up playing a greater role in the relative performance of US versus European benchmarks than Trump's policies, since 32% of the US benchmark is tech, versus 9% in MSCI Europe ex-UK and just 1% in the FTSE All-Share.

Our core belief is that US tech is not a bubble and these companies will grow into their valuations as earnings expand through widespread technology adoption (**Exhibit 19**). However, if these companies disappoint on earnings, this will act as a major drag on the relative performance of the US, as we saw after the 2000 bubble burst (**Exhibit 20**).

The UK's cash yield is getting ever more enticing

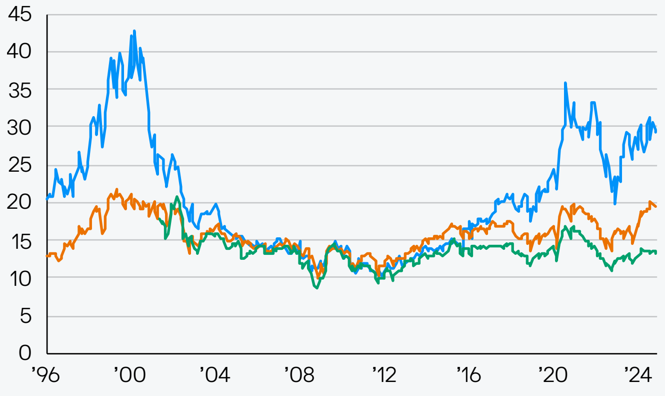
It is well-known that UK companies pay a healthy dividend: 4% on the FTSE All-Share, relative to the 1% available from the S&P 500. As we outlined in our recent On The Minds of Investors, however, buybacks have also picked up, suggesting that the chief financial officers of UK-listed companies view their shares as too cheap. UK buyback yields now exceed those on offer in the US market, with the FTSE All-Share offering a current cash yield of close to 6%. What's more, merger and acquisition activity is picking up, which should be another supportive factor for valuations.

Overall, while the re-election of President Trump does appear to reinforce a narrative of American outperformance, investors might wish to consider the above factors when determining the magnitude of any US overweight. Within the basket of European stocks, we have a preference for UK equities. As the old investment adage goes, 'it's not just what you buy, it's also what you pay for it'.

Exhibit 19: How the US megacaps perform is critical

12-month forward P/E ratios

x, multiple

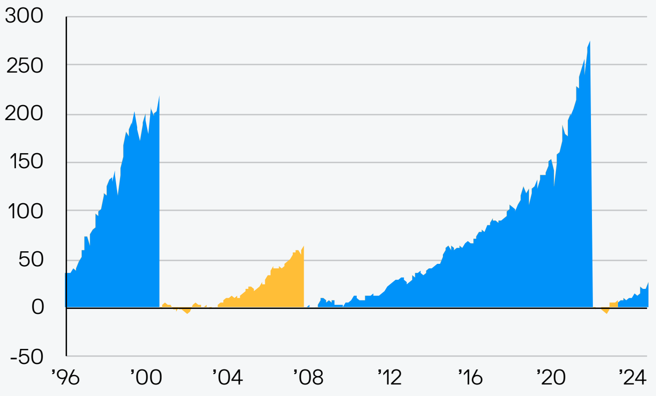


Source: FactSet, IBES, LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. The top 10 S&P 500 stocks are based on the 10 largest S&P 500 index constituents at the start of each month. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Exhibit 20: Sectoral performance is closely tied to regional performance

US vs. DM ex-US relative performance

% total return in USD, cumulative outperformance



Source: LSEG Datastream, MSCI, J.P. Morgan Asset Management. US: MSCI USA; developed markets ex-US: MSCI EAFE. A regime change is determined when cumulative outperformance peaks and is not reached again in the subsequent 12-month period. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

China's stimulus and prospects for emerging market stocks

The People's Bank of China's (PBoC's) substantial monetary easing and the Chinese government's fiscal support have lifted Chinese stock market valuations from the extreme lows they reached earlier this year.

This signal of intent from policymakers is encouraging. However, we will need to see further interventions – both via stimulus and regulatory – to be confident that Chinese corporate earnings are on a sustainable upswing, particularly in the face of likely further trade hostility. Investors should manage their emerging market (EM) allocations actively to take advantage of shifting trade patterns and nuance in domestic policy.

Addressing the Chinese real estate crisis

The property market has been a high-profile thorn in the side of the Chinese economy. Residential property prices have on average lost 12% from their high in the second quarter of 2021. In contrast to Europe and the US, China currently suffers from a short-term excess of residential property supply, as demand estimates made during the boom years have proven too optimistic. Indeed, the pandemic coincided with a sharp drop in China's birth rate from 10.4 births per 1,000 inhabitants in 2019 to 6.4 births in 2023, as well as a significant decline in marriages. This has contributed to China's property sector woes. It now takes on average almost 28 months to shift a new property in the 80 largest cities.

For Chinese households, the weak real estate market is particularly painful as nearly two-thirds of their assets sit in property (**Exhibit 21**). Thus, falling real estate prices are acting as a major drag on households' willingness to spend. Compounding this problem, many of these properties and their associated debt sit on local governments' balance sheets, reducing local governments' ability to fuel further activity. Without government support, there is a real risk that China enters a prolonged 'balance sheet recession', much as Japan experienced throughout the 1990s and 2000s.

In our view, the policy measures implemented by Chinese policymakers thus far have fallen short. The September 2024 announcements reduced financing costs, lowered the requirements for home purchases and provided financial support for households. While these policies are supportive for property demand and should slow price declines in the near term, we'd like to see Beijing tackle the root of the problem. This would include taking the excess housing and debt from the broader economic system onto the central government's own balance sheet.

Exhibit 21: Negative wealth effects have been a drag on consumer spending

China consumer income and wealth effect

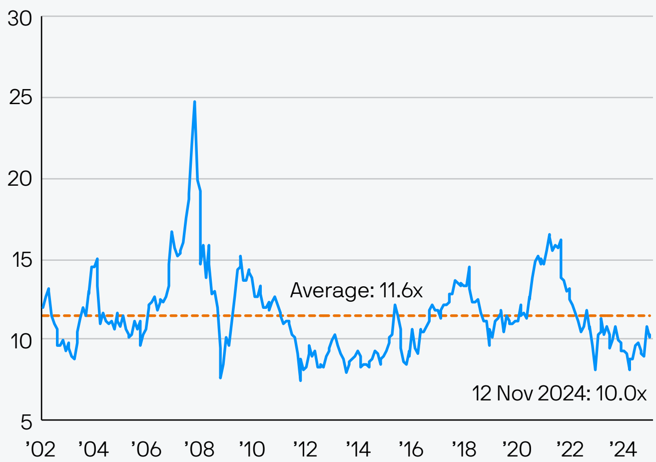
Index level, rebased to 100 in January 2021

Source: CEIC, China Securities Index Company, Goldman Sachs Investment Research, LSEG Datastream, National Bureau of Statistics of China, NIFD, Wind, J.P. Morgan Asset Management. Secondary residential property price index measures prices paid on existing home sales. Data as of 12 November 2024.

Exhibit 22: Boosting stock valuations is a Beijing priority

MSCI China forward P/E ratio

x, multiple



Source: IBES, LSEG Datastream, MSCI, J.P. Morgan Asset Management. Forward P/E ratio is price to 12-month forward earnings, calculated using IBES earnings estimates. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Although overall population growth in China turned negative in 2020, there is no structural excess housing supply just yet. A continuation of urbanisation has the potential to balance the housing market over the medium term, as the degree of urbanisation in China at 65% is still relatively low compared to other developed countries such as Korea (81%) and the US (83%). Reforming the 'Hukou system', which determines how rural individuals in new districts access health and education, would help with this process.

The central government should also consolidate some local government debt onto its own balance sheet. However, Beijing is still reluctant to take this step given total debt in the economy has risen from 224% of GDP to an estimated 289% in the last 10 years, and there is also a moral hazard issue in releasing local governments from any accountability.

Stocks as a source of consumer wealth effects

Negative wealth effects for Chinese households caused by falling property prices have been compounded by a simultaneous decline in equity markets and falling interest rates on deposits, leading to lower confidence (**Exhibit 21**). This is a fundamental difference between China's recent experience and the US's, where a booming stock market and more robust housing markets have contributed to positive consumer sentiment.

Recent interventions suggest that Beijing is focusing on measures to support the stock market (**Exhibit 22**) and in turn boost consumer sentiment. The implementation of a swap facility at the PBoC, which enables investment firms, insurance companies and funds to finance share acquisitions, and a re-lending facility, which enables listed companies to finance share repurchases at a rate of 2.25%, is another clear indication that decision makers are pursuing a strategy of reflation for asset markets.

> **Chinese policymakers want to support the economy. This show of intent is more important than the measures delivered so far.**

Investors should not underestimate the potential impact of such a positive liquidity effect in 2025. With 25% of Chinese household assets invested in deposits and cash, even a partial re-allocation into equities could give local markets a boost. The risk to this view is that foreign investors may instead use the recent bounce in prices to reduce their allocation to China.

While measures from the PBoC and the Chinese government have helped turn the tide on Chinese valuations, for the rally to continue we will need to see the earnings picture improve. At face value, the re-election of President Trump makes a revival in earnings more challenging.

We expect 60% tariffs on imports entering the US from China to be a near-term policy priority for the incoming US administration. However, it's worth remembering that since President Trump's implementation of duties in 2018, China's share of imports into the US has fallen from 21% to 12%. Yet, over the same period, China's global export share has risen from 13% to 14% as Chinese companies re-organised their supply chains to incorporate countries such as Mexico and Vietnam. President Trump could impose wider tariffs, and/or encourage other regions to place similar restrictions on Chinese imports, but such a strategy would risk damaging both consumer and corporate sentiment in the US.

We would also expect foreign hostility to be met with more Chinese domestic fiscal stimulus, for both households and corporates.

Additionally, we shouldn't underestimate the potential for regulatory and market interventions to become a tailwind in China, rather than the significant headwind that they have been since the Common Prosperity policy was established in 2021. The consequences of this policy for company valuations and earnings were significant, and the risk of further drastic regulation continues to be priced in, judging by the depressed valuations currently seen in the Chinese equity market. This regulatory risk appears particularly evident in growth sectors. At the beginning of 2021, major Chinese tech and online companies traded on similar valuations to their US rivals. Today, China's growth champions trade at a significant discount (**Exhibit 23**).

Harsh regulation also squeezed the profitability of Chinese companies. Earnings per share growth has not been able to keep up with economic growth over the last 10 years (**Exhibit 24**), while return on equity fell from 15% to 11%. To see a sustained improvement in Chinese stock performance, fewer and more predictable regulations would be helpful.

What about broader EM?

China's difficulties in recent years haven't transmitted uniformly to other emerging markets. Friend-shoring and the reshuffling of global trade have benefitted countries such as Mexico and Vietnam, while pro-growth domestic policies have fuelled investment into India.

Looking to 2025, stocks in broader EM may get a boost from China's recent stimulus announcements, although we are mindful that measures to stabilise the financial system and the real estate market differ significantly from previous stimulus packages which had more of a focus on investment and infrastructure. Therefore, the positive impact on the global economy and on the commodity market will be somewhat limited. We thus do not expect a significant tailwind for the classic raw material exporters in Latin America, the Middle East and Southeast Asia.

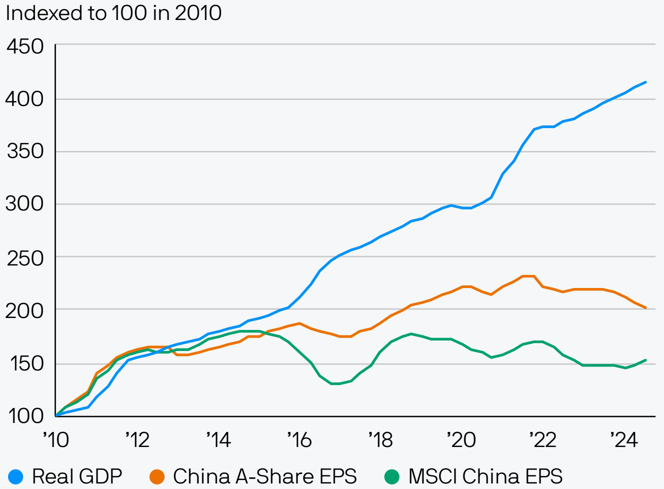
Exhibit 23: Unpredictable regulation has depressed valuations of Chinese growth stocks

MSCI Growth forward P/E ratio: China vs. US

Source: IBES, LSEG Datastream, MSCI, J.P. Morgan Asset Management. Forward P/E ratio is price to 12-month forward earnings, as published by MSCI. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Exhibit 24: Rapid economic growth has not translated into corporate earnings

China real GDP vs. earnings per share (EPS)



Source: Bloomberg, China Securities Index Company, MSCI, National Bureau of Statistics of China, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

A sharpening of the trade conflict between the new US government and China could further reinforce the friend-shoring trend. It seems practically more difficult for the US administration to craft a tariff policy that would counter the re-organisation of supply chains, and so economies like Mexico and Vietnam could be further supported. Northeast Asia is likely to continue to benefit from the ongoing global investment boom in technology.

The US dollar will also play a critical role in the relative performance of emerging markets in 2025. Tariffs and expansionary fiscal policy will likely have an inflationary effect on the US economy, meaning the Fed might be less inclined to continue steadily easing financial conditions. This would be dollar supportive and could prove a headwind for EM currencies, making it harder for EM central banks to support their domestic economies with further monetary easing.

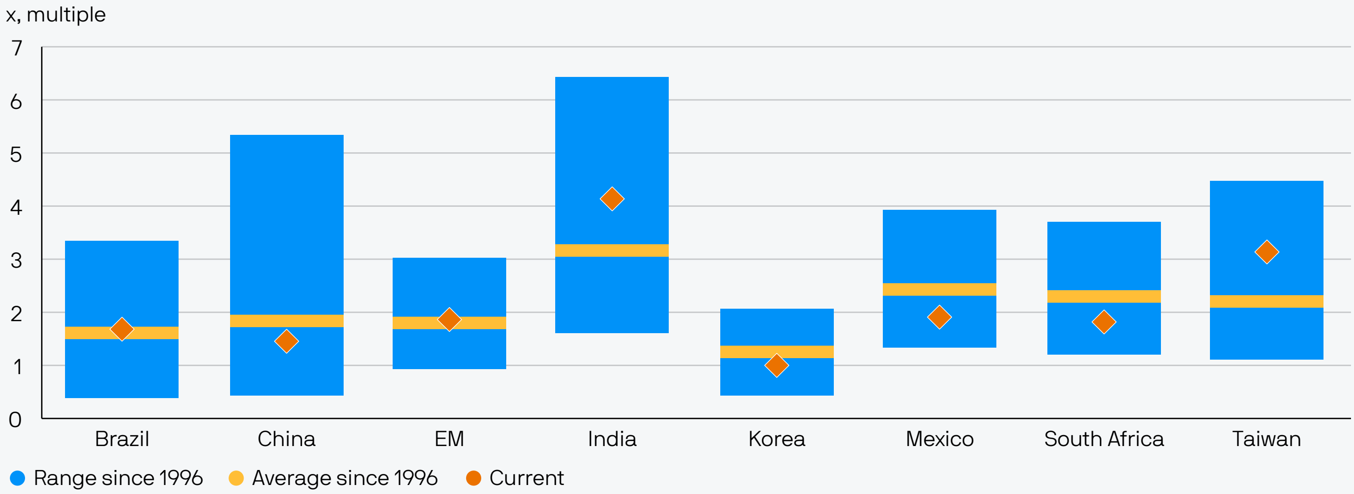
Conclusion

Chinese policymakers want to support the Chinese economy. Their demonstration of intent is more important than the exact measures delivered to date. We suspect they are saving their ammunition until it is clear exactly what trade hostility they are facing. Nonetheless, it remains uncertain whether policymakers' efforts will merely limit the downside to the Chinese economy and markets, or instead prove adequate to improve the medium-term trajectory of the economy and corporate earnings. The balance of risks, however, is now at least more two-sided, rather than skewed to the downside.

Current EM stock valuations look relatively cheap compared to developed market stocks. However, EM valuations look merely average compared to their own history (**Exhibit 25**). Investors need to be active in the EM space to take advantage of wide dispersion across the region, shifting global trade patterns, and the impact of idiosyncratic US foreign policy.

Exhibit 25: There is significant valuation dispersion across EM

EM price-to-book ratios by country



Source: IBES, LSEG Datastream, MSCI, J.P. Morgan Asset Management. All indices are MSCI. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Re-thinking portfolio diversification

With the return of inflation and spiralling levels of government debt, many investors are questioning whether bonds will still provide a life-raft in times of market turbulence. And if not, how should one construct a diversified, balanced portfolio?

There is no question that investors face a more challenging diversification problem than during the pre-pandemic period. Back then, a portfolio balanced between stocks and bonds fared well whatever the conditions. Equities provided capital growth in good times, while government bonds rose in value when recession hit and central banks cut rates.

The post-pandemic reality is more complex. Investors need protection from recession risk, but also from inflation shocks and fiscal largesse that have the potential to cause both bond and stock prices to fall. Bonds are no longer the one-size-fits-all solution they once were. Investors today need different life-rafts for different storms.

Government bonds for recessions, but be selective

Government bonds have undoubtedly had a difficult few years. Fears about inflation and excessive government spending have contributed to a level of rates volatility that, as we write, has even outstripped that seen in stock markets. No wonder investors are questioning the safe haven properties of their government bond holdings.

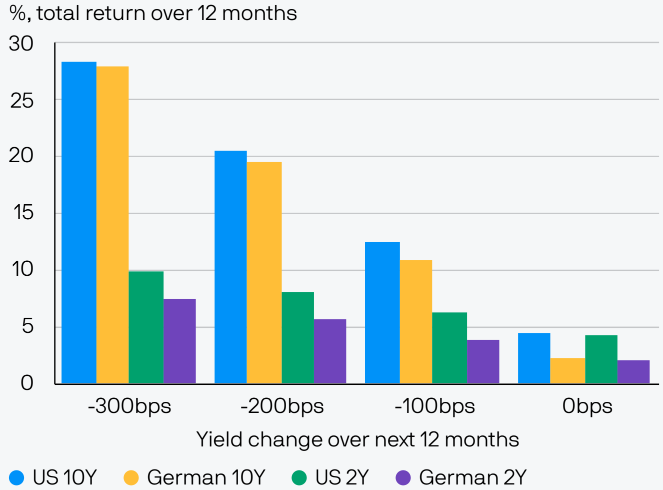
However, it's important to recognise that in recent years the predominant economic risk has been the risk of overheating, caused in part by generous fiscal payouts. As we look forward to 2025, risks are more evenly balanced.

As the US economy cools, it is possible that geopolitical tensions cause a loss of confidence and lead to recession. In this scenario, we would expect bonds to once again diversify against equity losses. Indeed, bonds have already demonstrated their worth when recessionary fears arise. During the equity market sell-off over the summer of 2024, bonds exhibited their more typical offsetting characteristics. US equities fell by 8.4% from 16 July to 5 August, while US 10-year Treasuries delivered positive returns of 3.2%.

Given the starting level of yields, the ability of bonds to protect against a deep recessionary shock is actually greater than it has been in a long time. If 10-year government bond yields were to fall by 100 basis points over the next 12 months, they would deliver a return of more than 10% (**Exhibit 26**).

Exhibit 26: Government bonds will provide protection in a recessionary shock

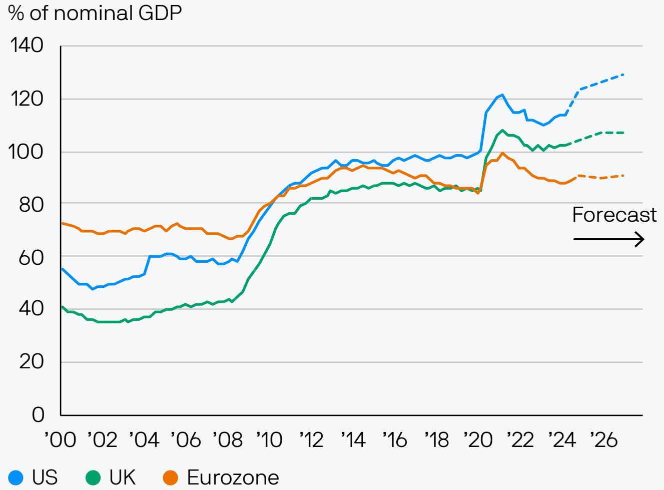
Government bond return scenarios



Source: LSEG Datastream, J.P. Morgan Asset Management. The chart indicates the calculated total return achieved by purchasing government bonds at current yields and selling in 12 months' time given various changes in yield. For illustrative purposes only. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Exhibit 27: US debt is on an unsustainable path

Government debt



Source: Bank for International Settlements, Eurostat, IMF, LSEG Datastream, J.P. Morgan Asset Management. Debt refers to gross debt at face value. The dotted lines represent IMF forecasts. Data as of 12 November 2024.

This performance would provide the kind of meaningful diversification against equity losses that multi-asset investors rely on when constructing balanced portfolios.

There are, however, nuances for investors to consider when deciding where to allocate their duration budget. Investors naturally tend to gravitate towards bonds with higher yields, given the more attractive income on offer. But for diversification purposes the size of the move in yields matters far more than the starting point (**Exhibit 26**). Investors should therefore focus on identifying markets where either inflation or fiscal risks are unlikely to hamper the ability of bond yields to fall.

We prefer German Bunds on both accounts. Cyclically, the inflation backdrop appears more benign, and we have more confidence that the European Central Bank will be cutting rates meaningfully in 2025. The European Commission's oversight of fiscal policy provides an institutional guardrail that is attractive for government bond investors. And on aggregate, eurozone debt to GDP is expected to remain lower on a relative basis (**Exhibit 27**). But reaching fiscal objectives looks politically challenging in more indebted eurozone countries such as France and Italy. We have more confidence in the ability of German Bunds to insulate a portfolio than Gilts or Treasuries.

Alternative assets for inflation and fiscal shocks

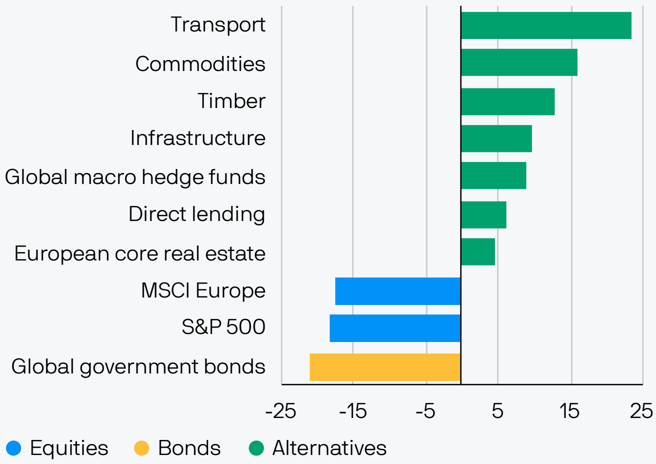
While pandemic-related inflationary pressures should continue to subside in the near term, we expect that over the medium term a more fragmented global economy – and the potential for fiscal misbehaviour – will give rise to more inflationary impulses similar to those experienced in 2022. In this case, fixed income assets might be expected to experience a sell-off at the same time as stock prices are falling (**Exhibit 28**).

This expectation underscores the importance of broadening diversification strategies beyond traditional bonds. In an environment characterised by two-sided risks, real assets emerge as a vital component of a well-rounded portfolio. These assets, which include real estate, infrastructure, transport and commodities, provide a hedge against inflation, offering protection when conventional safe havens are scarce. Their intrinsic value and tangible nature make them less susceptible to the erosive effects of rising prices, thereby maintaining purchasing power and protecting real returns during inflationary periods.

Exhibit 28: Alternatives offer protection from inflation

Selected asset class returns, 2022

%, total return in USD

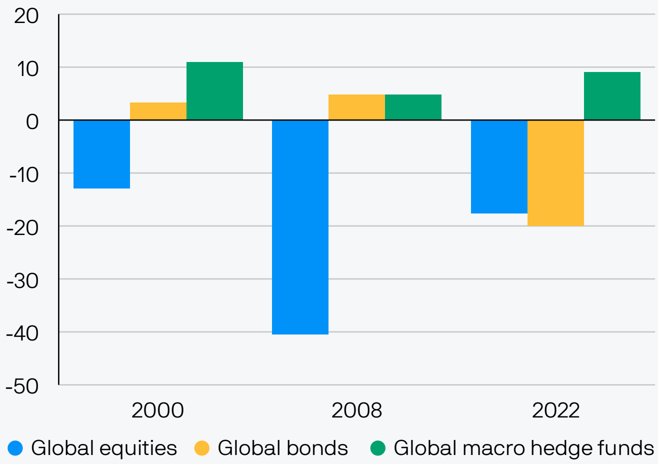


Source: Bloomberg, HRFI, MSCI, NCREIF, LSEG Datastream, S&P Global, J.P. Morgan Asset Management. Commodities: Bloomberg Commodities Index; Global government bonds: Bloomberg Global Aggregate – Sovereign; Hedge funds: HRFI global macro; US core real estate: NCREIF Property Index – Open End Diversified Core Equity component; Europe core real estate: MSCI Global Property Fund Index – Continental Europe; Global infrastructure: MSCI Global Quarterly Infrastructure Asset Index (equal-weighted blend); Timber: NCREIF Timberland Total Return Index. Transport returns are derived from a J.P. Morgan Asset Management Index. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Exhibit 29: Hedge funds can provide downside protection

Selected asset class returns in bear markets

%, total return in USD



Source: Bloomberg, HFRI, LSEG Datastream, MCSI, J.P. Morgan Asset Management. 2000 bear market is from 31 March 2000 to 31 October 2002; 2008 bear market is from 31 October 2007 to 28 February 2009; 2022 is calendar year. Global equities: MSCI World; Global bonds: Bloomberg Global Aggregate index; Global macro hedge funds are as defined in the HFRI hedge fund strategy classification system. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

Beyond real assets, other alternatives can also play a crucial role in diversification. By allocating a portion of a portfolio to strategies designed to generate returns irrespective of market conditions, investors can further enhance portfolio resilience. Hedge funds, with their diverse strategies such as long/short equity, event driven and global macro, can capture value in various environments. By actively managing exposures and being flexible in changing market conditions, hedge funds can mitigate losses and limit downside risks in portfolios (**Exhibit 29**).

Gold may also rise in value during inflationary episodes, as investors seek to store value in an asset that is limited in supply. Indeed, gold has performed well over the last two years, but in "normal times" gold is a zero-yielding asset – so we would argue that other real assets provide a better source of protection through the cycle. For example, since 1981 US real estate has outperformed gold 60% of the time on a rolling three-year basis, and has delivered three times the total return.

Ultimately, investors need to re-think diversification in today's investing landscape. A portfolio needs to incorporate core bonds for income and recession protection, but also inflation-sensitive real assets and hedge funds. While we maintain a constructive view on fixed income, a broader approach to diversification allows investors to build more resilient portfolios well-equipped to navigate the complexities and uncertainties of today's global economy.

> In an environment characterised by two-sided risks, real assets emerge as a vital component of a well-rounded portfolio.

Global market scenarios and risks

Our macro base case over the next 12 to 18 months sees the global expansion continuing, with inflation remaining somewhat sticky but at tolerable levels for policymakers. There is, however, a high degree of uncertainty about US domestic and foreign policy *and* the policies enacted by other regions in response.

Well-diversified portfolios are therefore essential to protect against both the downside risk that trade tensions lead to a fall in business confidence and recession, and the risk that inflation re-emerges and pushes bond yields higher.

> Well-diversified portfolios are essential to protect against both the downside risk that trade tensions lead to a fall in business confidence and recession, and the risk that inflation re-emerges and pushes bond yields higher.

Base case: The expansion continues

Macro: Global growth remains resilient, with moderate amounts of new fiscal stimulus announced in the US. Tariffs are levied against China but the new US administration stops short of a universal tariff. China continues to announce support for its economy. Europe cuts interest rates more rapidly than the US given lower inflation risk in the region. See **Exhibit 30** for details of our expectations for Trump's policies vs. those discussed on the campaign, and our expectations for the rest of the world's (RoW's) reaction.

Markets: The environment is pro-risk given the resilient economic backdrop. US equity performance broadens across sectors while there is scope for European and Asia stocks to follow if policy support is sufficient. Core fixed income delivers returns in line with coupons.

Downside risk: Stagflation

Macro: A global trade war leads to a re-acceleration in inflation while hurting growth across the world. Punitive tariffs on China stymie a recovery despite stimulus, while the implementation of a universal 10% tariff on US imports hits Europe particularly hard. Tax cuts and anti-immigration policies further fuel US inflationary pressures, while oil prices remain elevated with tensions in the Middle East offsetting increased US production. The Fed is unable to cut rates to support the growth outlook given elevated inflation.

Markets: A negative environment for stocks, with interest-rate sensitive sectors hit hardest. Rising yields on core fixed income lead to losses as stock-bond correlations remain positive. German Bunds outperform US Treasuries. Gold, real assets and commodity strategies outperform cash while hedge funds that can benefit from higher volatility also perform well.

Downside risk: Recession

Macro: Tough protectionist measures and geopolitical uncertainty hit business and consumer confidence, forcing companies to pull back on hiring. Tariffs are levied on China, but companies are forced to absorb higher prices through weaker margins given lower consumer confidence. Interest rates are cut by considerably more than currently priced to support the economy.

Markets: The negative stock-bond correlation returns. There is downside for stocks, but with higher quality and income strategies outperforming, while the environment is very positive for core fixed income, with significant capital upside.

Upside risk: Goldilocks

Macro: Growth accelerates driven by big fiscal stimulus and an artificial intelligence-induced productivity boom. Trade tensions ease as the threat of tariffs results in new trade deals, and geopolitical tensions calm. Rising productivity keeps inflation in check despite a tight labour market, allowing central banks to cut interest rates back towards neutral despite still solid growth.

Markets: A very positive environment for stocks globally, particularly in emerging markets. Fixed income also sees strong returns as interest rates move lower, and credit spreads tighten to new record levels.

Exhibit 30: Key policy proposals for the next Republican administration

	Campaign proposals	Assumed policy implementation	Implications for RoW
Taxes	• Extend Tax Cuts and Jobs Act (TCJA) provisions in full • Eliminate taxes on social security, tips and overtime • Cut corporate tax rate from 21% to 15%	• TCJA extended • Efforts to eliminate taxes on social security and tips and to reduce the corporate tax rate may face opposition from more fiscally conservative Republicans	Higher US growth and interest rates attract capital from other regions, putting downward pressure on RoW currencies vs. USD.
Tariffs	• 60% tariffs on Chinese goods • 10-20% universal tariff on all other imports	• 60% tariff on Chinese goods is an early priority • Universal tariffs less likely, with more bilateral bargaining	Negative growth shock in RoW likely to outweigh any inflation impulse, leading to greater incentives for both fiscal and monetary stimulus in Europe and China.
Defence	• US administration removes funding for Ukraine • Greater pressure on NATO members to increase defence spending to 2% of GDP	• Ukraine funding removed but US arms still available for purchase by Europe	RoW forced to ramp up defence spending, especially in Europe.
Energy	• Deregulation of traditional energy sector • Reduce clean energy subsidies in the IRA	• Increased US oil production thanks to deregulation • No major repeal of the IRA given flow on jobs and projects to Republican districts	Wider gap in the approach to climate policy between the US and Europe, forcing Europe to decide between climate goals and protecting domestic industry.
Immigration	• Much stricter immigration measures • Attempt to deport asylum seekers	• Some deportations, though practicalities will dictate magnitude • Increased anti-immigration rhetoric rapidly slows immigrations	Stickier inflation pressures result in higher US interest rates, attracting capital from around the world. US / Mexico tensions also escalate.

Source: J.P. Morgan Asset Management. Data as of 12 November 2024.

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