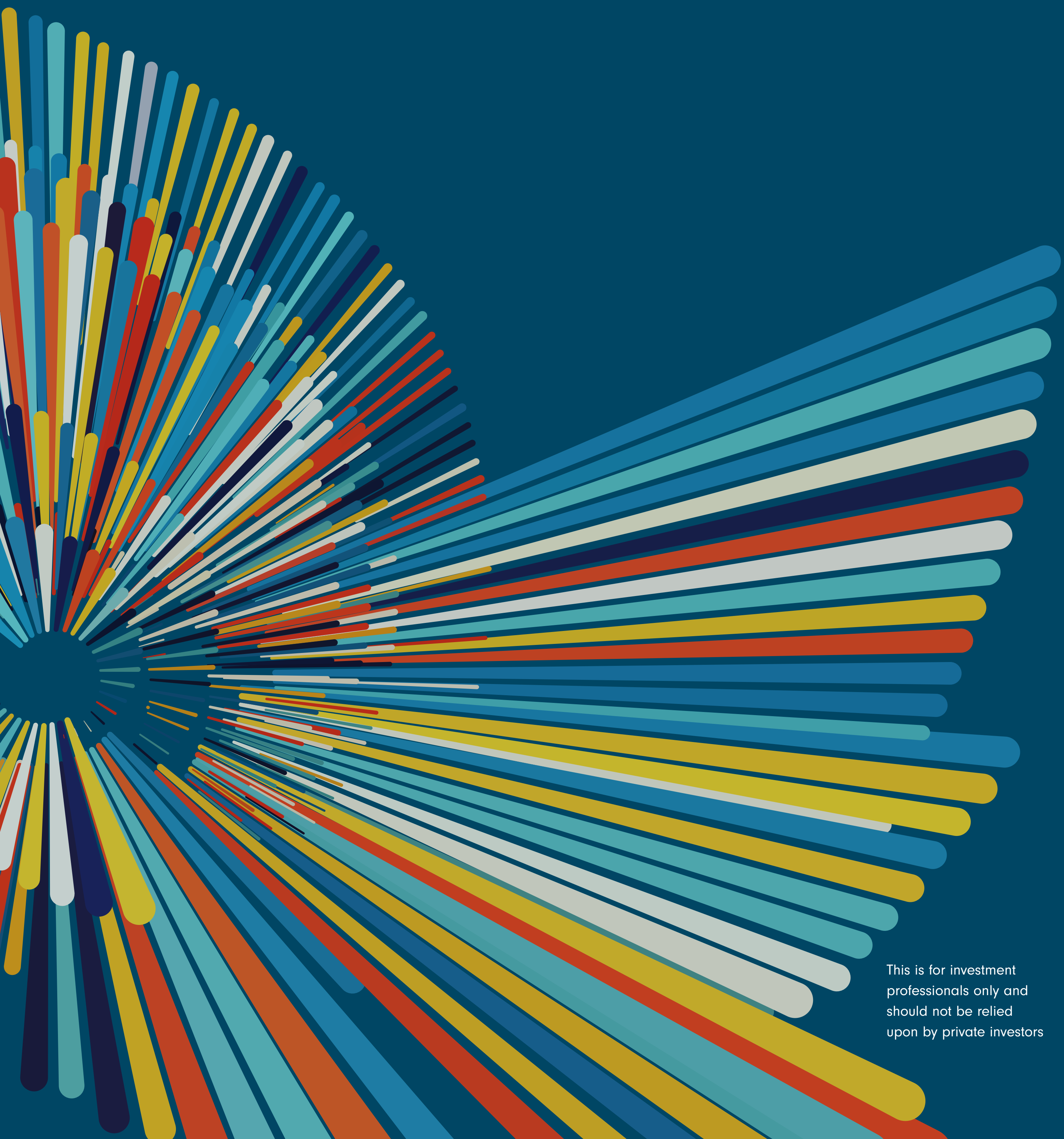
Outlook 2025

Research-powered investing

The divergence dividend



This is for investment professionals only and should not be relied upon by private investors

Foreword

For 55 years we've helped investors navigate changing markets. In times of transition, this experience and depth of analysis become more valuable than ever.

As we look ahead to 2025, we find ourselves at an inflection point in the global economy. The world has moved on from the single-minded focus on fighting inflation that defined the post-Covid years. Profound changes are under way across a range of countries, asset classes, and sectors.

The coming year will reward investors who can identify and capitalise on these changes.

Our network of investment researchers and analysts across the globe provides us with deep, first-hand insights into companies and markets. This research capability, combined with our active management approach, allows us to identify opportunities that arise when markets begin moving in different directions and offers our clients a distinctive advantage.

We look forward to partnering with you in 2025 and beyond.

Keith Metters
President
Fidelity International

Contents

Outlook 2025

All change

The year ahead promises a different environment for financial investors, but it is clear earnings in many areas will improve and the global mood is positive.

Niamh Brodie-Machura
Co-Chief Investment Officer,
Equities

Andrew Wells
Chief Investment Officer,
Fixed Income, Multi Asset and Private Assets

There is an inevitable divergence, J William Fulbright noted at the height of the Cold War, between the world as it is, and the world as man perceives it. For a long time over the past couple of decades, most of us at least agreed on the direction of travel. That is no longer the case. But the resulting divergence in policies, economic performance, and geopolitics present a strong range of opportunities for market participants in 2025.

Most prosaically, growth, inflation and interest rates across the world's biggest economies are liable to head in very different directions in the months ahead and there is far more doubt about those paths. As our macro team lay out in their outlook, authorities in the United States, China, and Europe are liable to have very different concerns over the course of the year.

A landmark US election result raises the odds of an outright reflation of the world's biggest economy. We are mid to late cycle, and not end of cycle, creating a volatile environment that should generally be good for risk assets but puts a premium on getting investment choices right. Valuations of a number of past winners are elevated, but the mood in general is positive.

As companies and consumers find their way through the new landscape, on **equities** we conclude that reflation will boost earnings, easing fears over higher corporate valuations. A pro-business, pro-innovation administration should prove helpful and lower interest rates should benefit capital-intensive industries and help cyclicals outperform. Optimism prevails in Japan and India.

Our **multi-asset** team run through some of their top picks, recommending we look beyond the previous stars to patches of the market that have been more neglected in the enthusiasm for AI and tech. They highlight US mid-caps, for thematic investors future financials, for income investors non-US duration, CLOs, and short dated high-yielding credit, and for drawdown-aware investors the value of absolute return strategies.

Fixed income investors meanwhile face tight spreads that are priced for benign economic conditions. With public sector deficits projected to expand, the prospect of tariffs and trade disputes, and ongoing geopolitical tension, there is a case that less optimistic scenarios are being underpriced. This represents a potential source of value in credit markets.

We worry in general about the lack of a clear path to slow the growth of public debt over the course of the next four years. Stagflation may yet still be a threat. Politics likewise hang over a profoundly complex picture for currency markets. Donald Trump has said he would like a weaker dollar, but the market reading of his policy platform is it will do the opposite. We will see if that holds.

What China does on stimulus - and with its stock of US Treasuries - looms large. A stabilising Chinese economy is welcome news for Europe, but it will not lend enough strength to the continent to fully recover in the next 12 months, while the dollar is a crucial factor for emerging markets.

The need for a diversified portfolio to spread risk also makes the case for **private assets**. Going into 2025, with many markets still on the cusp of recovery, prices are low and there are opportunities for investment that could deliver solid returns in the medium to long-term.

In short, investors will need a flexible approach. Detailed, deep research into the businesses and markets they invest in will be at a premium. Divergence, as Fulbright said, is inevitable - and this year it will pay to watch the differences.

Macro

US poised to reflate

A material shift in politics makes reflation of the US economy our base case for 2025.

Salman Ahmed
Global Head of Macro and
Strategic Asset Allocation

A resounding victory for the Republicans in November's election has shifted the economic outlook for 2025 meaningfully. The US soft-landing scenario that we confidently held as our base case for most of 2024 should give way to reflation as we move deeper into 2025, but an economy whose exceptional growth propped up the rest of the world in recent years may also now turn inward and become more protectionist.

Growth-supportive policies propped up by more fiscal easing should push inflation higher, reducing the risk of a US recession and recalibrating our assessment of the current business cycle to mid-to-late stage. But other major economies, and in particular Europe and China, will have to navigate a shift in US trade and industrial policy that is likely to weaken their own growth prospects and put downward pressure on domestic inflation as external demand slows.

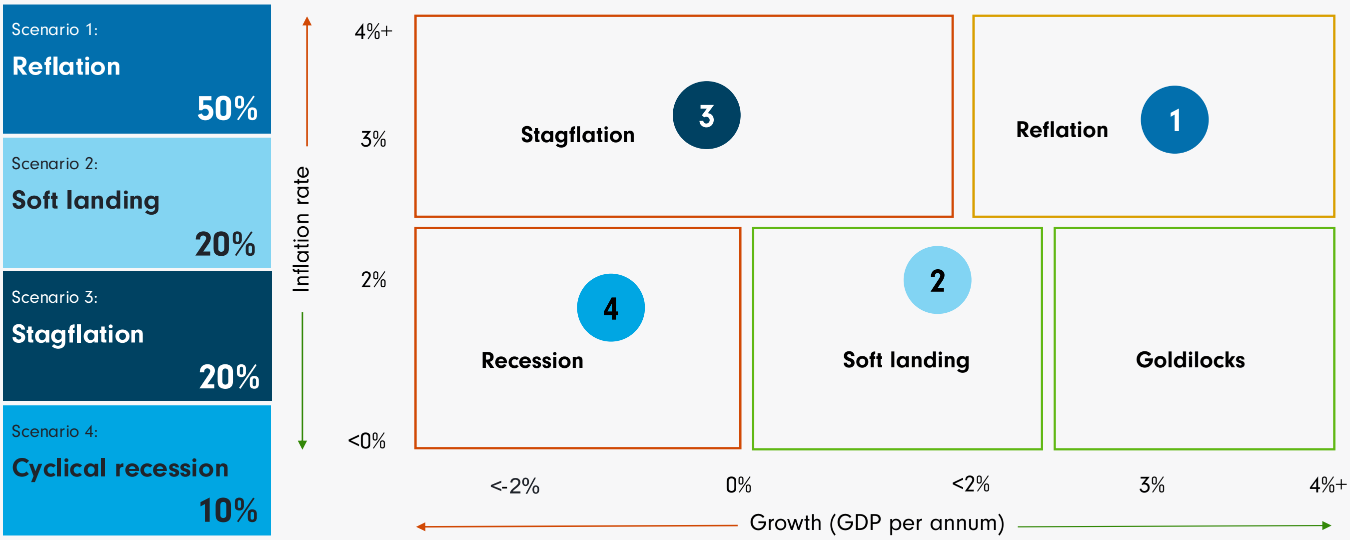
Put together, these divergences will support US growth in 2025, but rising government debt burdens is the underlying, longer-term trend. We believe public finances are fast reaching their limits and that above-target inflation is likely to become the least costly option for an orderly resolution to the problem of debt sustainability.

Beyond the changing policy mix in the developed world, we also have to keep a close eye on geopolitical developments both in the Russia-Ukraine war and in the conflict in the Middle East, which could create headwinds for the overall global macro environment.

US exceptionalism

Expansive fiscal policy and significantly higher tariffs are likely to be the centrepieces of a second Trump presidency. The economy is in good shape: a strong consumer, solid private sector balance sheets, and a labour market that has softened but is historically strong have reduced the risk of recession. Against that backdrop, the changes the new administration has set out meaningfully increase the odds of outright rises in US inflation from the second quarter.

Four scenarios for US in 2025



Note: Inflation rate measured by US Core Personal Consumption Expenditures Price Index.
Source: Fidelity International, November 2024.

We assume that the much-discussed tariff rates (60 per cent for China and 20 per cent for the rest of the world) are maximalist rates aimed at negotiations that may take place if the new administration presses ahead with its protectionist goals. The rates that emerge may well be lower, but their impact on an economy that has consistently outperformed expectations over the next year would be substantial.

On the fiscal policy front, we think that the extension of Donald Trump's Tax Cuts and Jobs Act (TCJA), along with additional tax cuts, may expand the deficit to an extraordinary 8 per cent of GDP. That should drive nominal GDP growth significantly above trend and aid the headline numbers next year, but its longer-term sustainability is more questionable. Especially if tariff policy is more aggressive and front-loaded than we are assuming, the risk of stagflation in the quarters that follow grows. Reduced net migration could add to these risks by dampening growth and exerting upward pressure on wages and services inflation.

That said, recession only returns as a serious risk if, in the face of an inflation shock, the Fed pivots to a hiking cycle. The likely terminal rate for the central bank's easing cycle is now higher than before the election. We expect we will still be in some form of an easing cycle as we enter 2025, at least until the impact of tariffs, any significant changes in immigration, or the fiscal policy expansion becomes clearer.

Europe's structural challenge

The Eurozone economy has been almost stagnant since 2023 and it faces a range of cyclical and structural challenges. For 2025, we expect a cyclical upswing as falling inflation and lower interest rates help resurrect corporate capex and consumer confidence. Stronger real disposable income and easier financing conditions should start releasing elevated excess savings to spur consumption growth.

However, potential tariffs from the US are a downside risk, particularly for the auto sector, and the resulting trade uncertainty could reduce growth by up to half a percentage point. Germany in particular would be hit while facing additional uncertainty from snap elections that may come as early as the first quarter.

We expect the European Central Bank (ECB) to cut rates quickly to 2 per cent, followed by gradual easing to 1.5 per cent by the end of 2025. More aggressive tariffs risk provoking additional and accelerated easing, although the central bank will need to keep one eye on any currency weakness against the dollar.

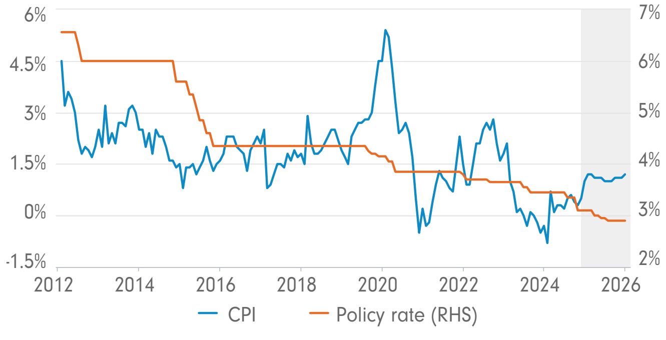
Facing similar headwinds, the UK has slightly outperformed the Eurozone in 2024, and we expect this momentum to strengthen in 2025. The Labour government's more expansive budget is likely to be boosting growth already and the UK economy, being more services-oriented, is less exposed to the risk of a trade war. With a tight labour market, improving growth, sticky wages, and now less restrictive fiscal policy, we expect the Bank of England to go slower on rates than the ECB.

China's policy pivot

China's quest for a slower but more sustainable model of growth focused on domestic consumption and higher-end manufacturing is advancing, but not without bumps in the road. The policy pivot by the politburo in late 2024 signals a decisive move to resolve the issues that have depressed domestic demand, namely the property sector, local government debt, a lacklustre equity market, and poor consumer confidence. All eyes will be on the progress of the broad moves announced at the time of writing, as well as whatever the authorities follow up with over the months to come.

Shoulder to the wheel

Chinese monetary support continues to grow



Source: Bloomberg, Fidelity International, November 2024.

One big question is whether the levels of growth China needs can be delivered if the US simultaneously burdens companies' biggest sales market with heavy tariffs. The manufacturing sector is steadily upgrading, especially in new and emerging industries, providing support for overall growth both from rising capex and external demand. Domestic consumption, however, has not yet picked up significantly. While the policy moves may help stabilise the property market, we do not expect the return of strong growth in 2025. Rather it may move to a new, lower equilibrium.

Other drivers of growth are emerging and may receive more policy support. An urbanisation push should include improved infrastructure and connectivity among cities. The energy transition is a priority, with incentives for energy saving in everything from home appliances to electric vehicles. Lastly, Beijing may devote more effort and resources to resolving local government debt issues, freeing authorities to do more to support households.

As ever, we will be well into next year before the authorities publish the growth target for 2025, but the consensus of market forecasts is below 5 per cent, even after the boost from stimulus.

The spillover of the new measures may vary across different economies, with some emerging markets benefitting more than others from lower-value, higher-quality imports from China. In general, the country may continue to export deflation if the policy easing delivered to the economy remains contained and moderate. If additional US tariffs are imposed, past experience also tells us that Chinese companies are likely to prove agile in response, softening the impact on corporate earnings. Beyond that, macro stabilisation policies will be crucial in deciding China's economic fate over the next year.

Equities

New avenues

A decisive US election, political ructions in Europe, and the first signs of Chinese fiscal action spell more volatility for stock markets in 2025. And new roads to returns.

Niamh Brodie-Machura
Co-Chief Investment Officer, Equities

Ilga Haubelt
Head of Equities, Europe

Marty Dropkin
Head of Equities, Asia Pacific

Top convictions for 2025

- **US stocks** will outperform rest of the developed world on earnings
- **Japanese shares** still a strong bet as reforms improve returns
- Nerves over valuations make the case for **income**

Pound for pound, macro and monetary policy should deliver a positive environment for stock markets going into 2025. The business cycle will enter a new stage - but the year will also see geopolitics resound ever more loudly.

The trends we have seen dictate recent price moves may have further to run. But we can expect new directions and a broadening of areas of growth in markets. These are exciting times for equity investors.

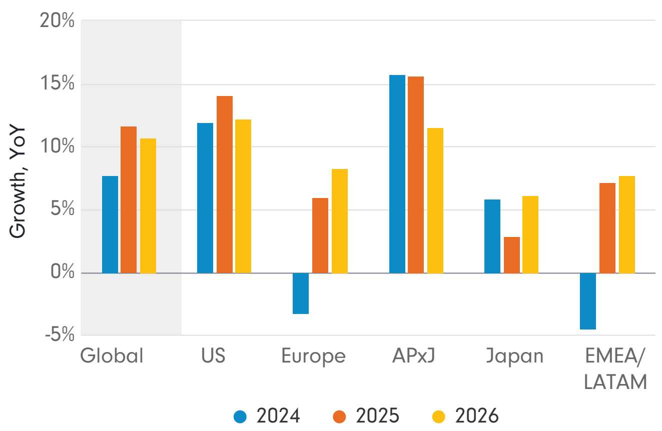
Global trends

For good or bad, a landmark Republican election victory is likely to reinforce American exceptionalism. Even before November's poll, we expected US corporate earnings to increase by 14 per cent in 2025, beating most other regions and the global average in terms of growth, return-on-equity, and the level of net debt. The election has fanned optimism in the market that the coming year will prove pro-business, pro-growth, and pro-innovation. There are risks to some sectors from potential tariffs and further trade frictions between the US and China, but at least some of any resulting reflation will be helpful for earnings and ease fears over higher corporate valuations.

Nevertheless, investors will have to be more discerning in where they look this year. The AI trend is a case in point. On the one hand there is a debate about valuations of the big tech companies; Nvidia and others are still hitting record highs and there may be further to run, but our attention is also turning to which companies are next in line to benefit. Those who facilitate the use of AI are one obvious group but ultimately many less directly related industries and consumers will also be beneficiaries. Apple made a fortune from smartphones, but their arrival fuelled growth across a wide range of existing and new businesses. Less than a third of companies have so far embedded AI and machine learning in their operations, but more than 70 per cent plan to: its impact on the economy will broaden. It is an area where American leadership is crushing and unquestionable.

Regional views

Aggregate earnings growth estimates through 2026



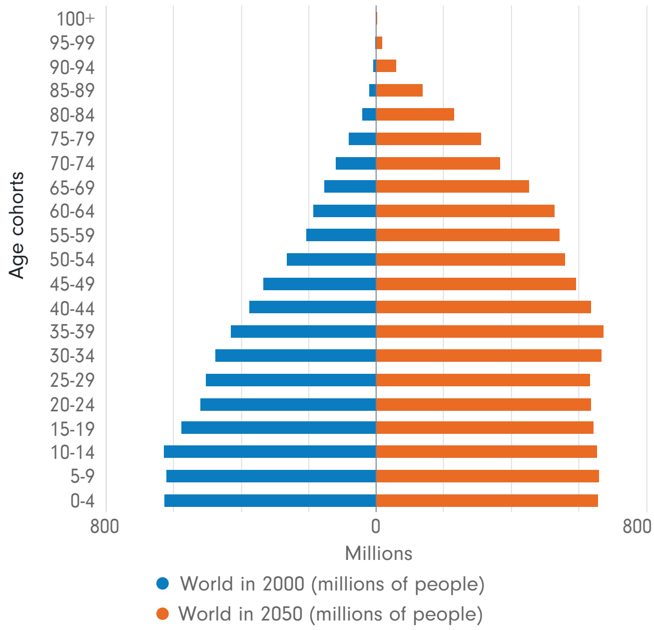
Source: Fidelity International, November, 2024.

The other big structural trends of this decade will continue to play out in 2025 and will be worth watching. The breakthrough in anti-obesity drugs is significant but, like AI, Ozempic and others have the potential to change the game in areas well beyond the small list of healthcare index constituents currently profiting. There are already hints of knock-on effects in how people use hospitals and gyms, and other use cases are developing.

Healthcare has another notable structural driver: the global population aged over 65 will double by 2050 and the proportion of incomes we spend on keeping ourselves healthy will continue to grow.

An ageing world

Demand for healthcare will grow strongly in the decades to come



Source: Fidelity International, HSBC, UN Population Database, February 2021.

Homeshoring

While it's widely expected that the Republicans may repeal some areas of President Biden's Inflation Reduction Act including electric vehicle credits, manufacturing incentives should be more protected given a large proportion of investments are located in Republican-held districts. The onshoring trend has gathered momentum and has bi-partisan support. We are seeing manufacturing activity driving growth and investment in middle-

America and our research shows it will add 2-3 percentage points to the base growth rate of fixed investment in coming years.

The picture for small-and-mid-cap segments may prove more complex. An ongoing rally has put straight much of the discrepancy in valuations with the top end of the market, but the coming year will provide different impulses. Tax cuts would benefit small businesses, as would lower financing costs. But the latter will evaporate if price rises force the Fed to change tack and immigration and tariffs bring threats to growth and spending on the ground.

In general, both the soft landing or reflationary scenarios outlined by our macro team for the months ahead bode well for earnings of early cyclical stocks. And if the new administration reflates the economy and reduces regulation it should bode well for US financials and value sectors.

Trade risks

Going into 2025, we see sentiment and fundamentals metrics as supportive of Japan. It remains on track for reflation with strong wage growth, and capital expenditure and shareholder returns will increase steadily over time. The percentage of Topix companies outperforming the index has also been on the rise, as investors scout for beneficiaries of the country's corporate governance reforms.

One caveat is that a strong yen combined with higher interest rates could hurt earnings later in the year, especially in the consumer discretionary sector, where overseas sales outweigh domestic demand for carmakers and durable goods exporters.

On the other side of the developed world, there are significant challenges. Recent profit warnings by European industrial and automobile companies, as well as lacklustre sales by consumer discretionary names, signal that doubts over Chinese demand could weigh heavy on these shares. Our macro team's modelling also suggests a partial implementation of the tariffs floated by Republicans would knock as much as half a percentage point off German and Eurozone GDP.

On the flip side, the arrival of a concerted campaign of monetary loosening should in theory be helpful for European cyclicals, but the cheaper and more defensive bet currently is income: returns from dividends and share buybacks combined in some areas of the market are running at as much as 8 per cent and are better priced.

Asian potential

In China itself, we prefer sectors that are already high on the government's policy agenda: technology, high-end manufacturing, consumer, and healthcare. We're conscious that Chinese equities can be volatile, and that many companies have rebounded from depressed to fair valuations on the policy pivot. The good news is that there's no shortage of stocks with clear paths to earnings growth in this massive market.

China is positioning to preserve, but not reignite, economic growth. Policymakers recognise the need to stabilise home prices; they are not about to jeopardise the hard-won progress they've made in reducing debt by reflating the housing market. An incremental recovery in Chinese equities is the most likely outcome.

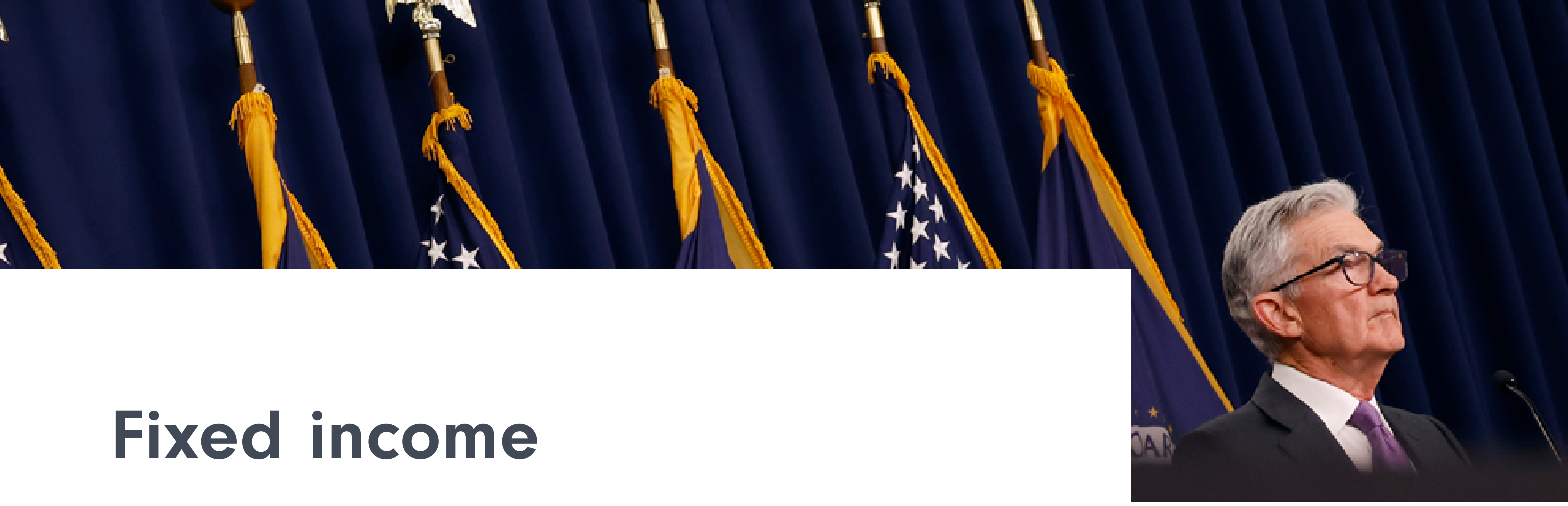
Elsewhere in emerging markets, Indonesia has good growth and earnings momentum, but banks' dominance makes the market vulnerable to interest rate cuts. While liquidity is much thinner for global investors, the Asean region widely stands to benefit from the secular trend of supply chain diversification and an increasing share of foreign direct investment from across the world.

India will again be a bright spot for long-term investors. Although some foreign flows are taking profit after the recent rally, and extreme weather is disrupting agriculture, the country's prospects remain solid, underscored by advantageous demographics and investments in infrastructure and manufacturing. And that's why domestic investors are still buying.

Earnings are everything

No one can know with certainty the future of US-China relations, or predict commodities' trajectory precisely, should conflicts in the Middle East escalate further. But with volatility comes both risk and returns.

The outlook for earnings growth globally remains robust and our view on equities going into 2025 is generally positive. However, with valuations high, smart money will be looking for the right homes as the economic cycle turns. Our approach is to stick to the fundamentals, while staying vigilant and disciplined on valuations. This will guide our thinking through 2025 and beyond.



Fixed income

Rates make return journey

After navigating an interest rate hiking cycle, fixed income investors face a completely different challenge in 2025.

Steve Ellis
Global Chief Investment Officer, Fixed Income

Lei Zhu
Head of Asian Fixed Income

Top convictions for 2025

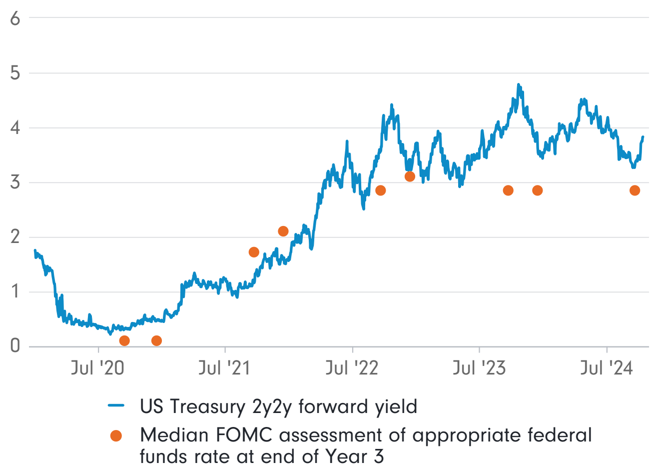
- **Defensive US dollar investment grade** - to shelter from recession risks
- **Global short duration income** - to lock in decent all-in yields
- **Asian high yield** - to capture attractive carry and spreads compression

A dominant theme for fixed income markets in 2025 will be where US interest rates find themselves at the end of this rate cycle.

Investors' estimates of where the terminal rate will trough have proven volatile. For example, when the Federal Reserve cut rates by 50 basis points in September to 5 per cent, surprising many who were expecting only 25bps, the market's assessment of the terminal rate went up rather than down. The logic was that by doing more to address growth risks sooner, the Fed wouldn't need to reduce rates by as much overall.

As the chart shows, this put the market at odds with Fed policymakers' more dovish outlook for rates over the next two years.

Fed dot plot shows policy pessimism



Source: Bloomberg, Fidelity International, October 2024.

Any new tariffs are likely to push inflation higher, making a case for the terminal rate ending up above what the market is pricing in at the time of writing (around 3.5 per cent), as does the expected increase in the US fiscal deficit next year.

There are, however, other forces in play.

US recession looks underpriced

Investors looking for value in fixed income should note that the market struggles to price things like geopolitical risks, which have clear potential to hurt economic growth.

The recent hiking cycle has also been unusually benign for credit issuers. Corporate net interest costs have actually gone down for those who locked in lower rates on their debt when yields were at multi-year lows and then benefitted from parking their cash balances in short-term deposits or money market funds, earning high interest rates. Where issuers have felt pain, distressed exchanges have accounted for most defaults so far this year (54 per cent in the year to end-September[1]), lessening the impact on investors. But at some point, issuers who locked in lower rates will have to refinance, a fact that will weigh increasingly on investors' and policymakers' minds as 2025 progresses.

The US has also just had an election in which 68 per cent of voters told exit pollsters the economy is "Not so good/Poor".[2] Whatever economic indicators might imply, Americans clearly don't feel well off.

If US growth does deteriorate over the next 12 months, the Fed may have to cut more aggressively than expected, meaning a lower terminal interest rate. With credit spreads currently tight, there is a risk-reward case for adding US duration with a bias towards holding higher quality credit.

China: waiting for more

A big focus heading into next year is the timing and extent of China's stimulus measures, and their potential to boost growth domestically and across the wider region, but also to export inflation. As we wait for Beijing's next move, and any response to US tariffs (if and when they happen), it's worth considering the picture facing credit investors in 2025. For example:

- China's property sector now makes up around 5 per cent of the JP Morgan Asia Credit Non-Investment Grade index, down from over 30 per cent at its peak. This is a stronger, more balanced index.
- The average rating of Asian high yield bonds is now BB, with rating upgrades likely to continue, particularly in frontier Asian economies and in the BB category, where some rising stars are emerging.
- Asian high yield spreads are attractive at over 500bps, above their 20-year average, leaving room for compression. With an average duration of just two years, Asian high yield bonds are also less sensitive to interest rate moves.

[1]S&P Global: Default, Transition, and Recovery: The Pace Of Global Corporate Defaults Slows, October 2024.
[2]ABC News: Exit Polls for 2024 US Presidential Election: Results & Analysis, November 2024.

These factors create a favourable environment for Asian high yield credit, especially if we see continued Fed easing as well as more monetary easing and stimulus from China.

Investment grade Asian bonds also look good. The supply of Asian US dollar investment grade bonds has shrunk significantly, with issuers reluctant to borrow in dollars at high interest rates compared to local markets, while investor demand remains high. Expectations of a stronger dollar in 2025 would be unlikely to reverse this trend.

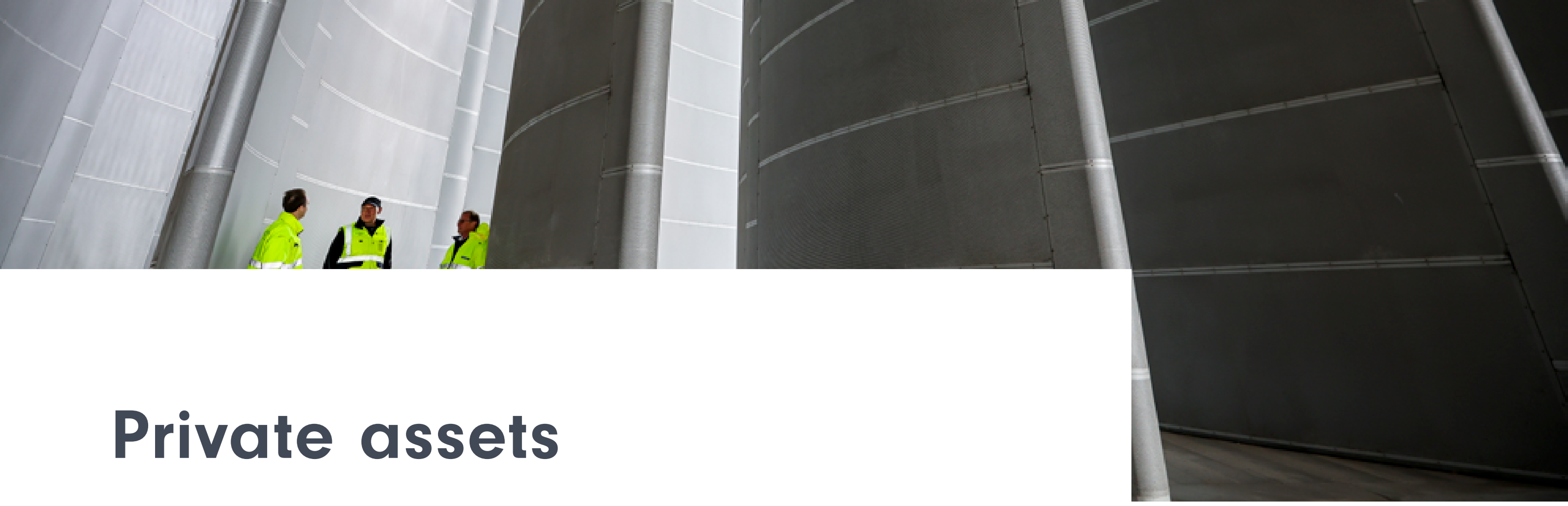
Monetary policy outlooks

The next 12 months should see a jump in fiscal spending from the US and China. Markets may have greeted this prospect with euphoria, but it's a sign that all is not well with the underlying growth picture – one that is further threatened by increasing geopolitical tensions.

To address these concerns, we expect the Fed will want to be the most proactive about bringing rates down to a neutral level. This was evident when it followed up its bumper September cut in November with a further 25bps, although it may yet be constrained by resurgent inflation. There is a strong possibility of stagflation in the US, in which case the Fed might have to prioritise growth. The European Central Bank also has an eye on stickier wage and services inflation, although structural economic weaknesses in the Eurozone, particularly in Germany, make a case for being overweight duration here.

Further Fed cuts would free central banks in China, Korea, and Indonesia, for example, to go further in cutting their interest rates, supporting Asian bonds. Alternatively, a less dovish Fed policy would give the Bank of Japan more room to normalise policy following its first hike in 17 years in March 2024.

In practice, central banks will all have to run their own race. Keeping pace with each one will be part of the challenge for fixed income investors in 2025.



Private assets

Time to diversify beyond public markets

Investors would do well to counterbalance their public holdings by increasing exposure to private investments.

Noa Shoham
Head of Research and
Co-Portfolio Manager,
Private Assets

Neil Cable
Head of European
Real Estate Investments

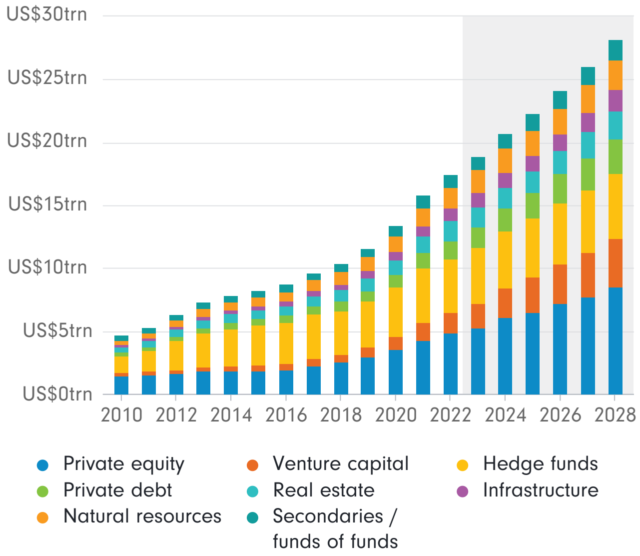
Top convictions for 2025

- **Private equity** is still the largest raising asset class, and given how quiet the IPO markets have been we believe mid-market provides the best risk-return options
- **Infrastructure** is likely to provide more opportunities as growth in digital infrastructure and renewable energy assets is supported by the supply-demand imbalance across both sectors
- **Senior direct lending** continues to offer interesting options for exposure to secured private loans, with interest rates expected to stay at relatively raised levels for longer
- **European office space** is on the verge of recovery and with prices currently low has potential for strong returns over the next two to three years

Private assets are on the cusp of a new cycle and we expect the first half of 2025 to offer up attractive prices for what promises to be a strong vintage of investments.

It will be a cycle where private markets come into their own. The asset class has conclusively left its niche reputation behind, with extraordinary growth over the last five years. The range and sophistication on offer to investors – no matter what their strategic priorities – are reaching a new level of maturity.

Alternative AUM by asset class



Excludes funds denominated in Yuan Renminbi. Does not include secondaries in private debt. Data for 2023-2028 is forecast. Source: Preqin Global Report: Real Estate 2024; Fidelity International, November 2024

As in the public markets, investors can build their private portfolio based on their own risk-return profile. Growth-oriented investors can opt for high allocation to private equity funds - whether buyout, growth, or even venture strategies - while an income-focused investor will tend to add private credit or core infrastructure exposure that will provide a steady return of distributions. A diversified private assets portfolio can combine all asset classes.

A turnaround story

We anticipate that 2025 will be a good year for private equity. After years in which buyout activity has been stymied by global volatility, the pent-up demand for new deals and strong financing bid are all likely to contribute to a higher level of deal-making. We're already seeing this in the US, and we expect to see it in more heavily-regulated Europe too, even though it tends to be more defensive, particularly across software, technology, and services sectors.

Any uptick in new private equity-backed buyouts will of course also improve the prospects for direct lending funds that finance and sponsor these M&A deals, and for the buyout funds that already make up the majority of the private equity market.

Direct lending has enjoyed plenty of attention in recent years thanks to high interest rates. Although that backdrop is likely to shift in 2025, all of the European and US general partners (GPs) we're speaking to report their direct lending funds are still growing. Returns are fading from the 10-11 per cent that was offered a year ago when liquidity was more stretched, but direct lending GPs' returns are holding at around 7-9 per cent - clearly still very compelling.

Given the diversification now offered in the private credit universe there is certainly a strong case for its inclusion in a portfolio. Some 96 per cent of European companies with revenues over USD $100 million remain unlisted[3], while globally the median age of a company at IPO has shifted from four years in 1999 to 12 years in 2020.[4]

For those investors looking for further ways to diversify, the increasing maturity of the secondaries market may be interesting in 2025. Once a speciality product used only by

[3]For companies with last 12-month revenue greater than $100 million by count to April 2024; S&P Capital IQ
[4]IPO Data, Jay R. Ritter

distressed sellers, secondaries has now become a huge market that offers access to holdings of previous vintages. GP-led transactions have become more common here - now making up around half of the market globally - and are likely to continue in 2025 across private equity, credit, infrastructure, and real estate, as managers roll their holdings into different vehicles to release any available financing.

We have particularly strong conviction in the prospects for the offices sector, especially in the brown-to-green strategy of renovating buildings to become more carbon-neutral.

Strong and steady

Elsewhere, if an investor is looking for more stability in a portfolio, infrastructure and real estate offer long-term investments with attractive entry prices available in the first half of 2025.

The two big drivers of the infrastructure market at the moment are digital assets and the energy transition. The increase of data consumption will be further enhanced by AI and by growing renewable energy demand, while the evolution of AI also means more data centres (and so more infrastructure opportunities) and further investment in private equity-backed software firms.

There are questions about how the energy transition programme will develop in the US under the new administration, but given that some of the biggest planned projects are in red states, we do not expect these to be cancelled altogether. Europe still has a much stronger focus on the transition, whereas midstream and traditional energy continues to play more of a role in the US market.

The turnaround in private assets in 2025 is likely to be most noticeable in European real estate. Now is a wise time to get into the market given there are low prices and plenty of assets available. The growing importance of logistics has been well documented, and rightly so: the widescale adoption of online shopping, accelerated by lockdowns, and the nearshoring of supply chains will boost demand for warehouses across the year. But we have particularly strong conviction in the prospects for the offices sector, especially in the brown-to-green strategy of renovating buildings to become more carbon-neutral, and in particular for those portfolios that do not already hold office assets.

Although both the US and European markets are dislocated going into the new year, the level of oversupply in US offices has been far higher, and the market there for this subsector looks less attractive than Europe. But we do also expect to see more demand for residential assets across both Europe and the US due to structural undersupply.

Multi Asset

Late cycle with a twist

We are positive on risk assets despite being later in the cycle.

Matthew Quaife
Global Head of Multi Asset Investing

Henk-Jan Rikkerink
Global Head of Solutions and Multi Asset

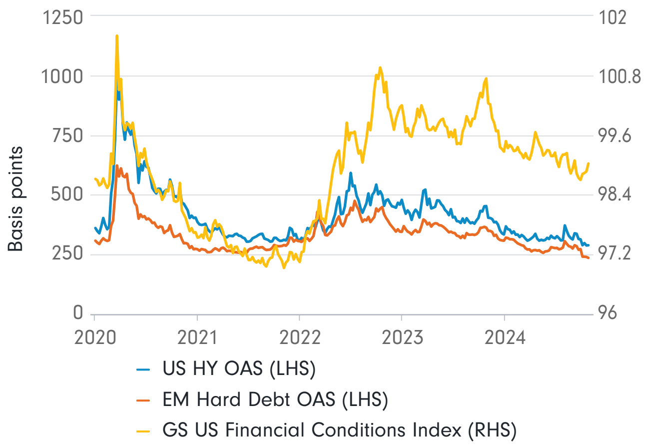
Top convictions for 2025

- **For the tactical asset allocator:** US mid-caps offer a way to capitalise on the country's positive earnings momentum while avoiding the higher valuations of the market's biggest names
- **For the income investor:** Easing policy and high yields are good news for carry trades. But, given risks posed by US fiscal inflation, we are looking to non-US duration, CLOs, and short-dated high yield. Inflation-linked treasuries should also offer some protection
- **For the thematic investor:** A basket of future financials. The 2025 backdrop suits this asset class, and by putting together a basket that is future proof, there is the potential for long-term excess returns too
- **For the drawdown-aware investor:** Heightened use of options-based strategies make sense as this part of the cycle will increase realised volatility. Diversification and returns should be available through upping absolute return strategies

We've been here before. It's normal for markets to act more erratically during the later stages of the cycle. Yet beneath the market's jitters is a generally positive environment of continued economic expansion in the US, and signs the Chinese government is committed to deploying broad-based stimulus in an attempt to support its economy.

All this amounts to an encouraging backdrop for risk assets, even if it promises turbulence too. Our message is this: stay invested in equities, seek carry trades, and be prepared to take advantage of market volatility.

Financial conditions look supportive



Note: OAS = option adjusted spread. Source: Macrobond, Fidelity International, October 2024.

The US's continued resilience should serve as a tailwind for equities, but there are some areas we particularly like. One is mid-caps. These avoid the higher valuations of big technology giants, while offering decent profits and the chance to benefit from late-cycle reflation. It's not just the US either - the earnings cycle appears to be broadening and should revive other mid-cap names in places like Japan and Europe too.

Likewise, within individual sectors, the prudent approach is to look beneath the shiniest stars. Take AI: undoubtedly huge potential, but investors cannot ignore the sky-high expectations priced into the Magnificent Seven stocks. The risk is that market capitalisation-weighted portfolios become overly concentrated and exposed to disappointment. We prefer to look at the picks and shovels underpinning the trend - smart grids and data centres, for instance - where valuations look more reasonable.

Nor do you need to look to the tech giants for the world's best structural growth. Positive demographics, economic reform, and a shift in production away from China will continue to underpin select equities for years to come in places like India and Asean.

Transition materials are also of interest to long-term investors, acting both as a key to decarbonisation efforts and an inflation hedge. For 2025, it will be difficult to separate their fortunes from the situation in China. If the country's stimulus programme exceeds expectations, it's likely to bolster the green energy market and boost metals' value – and vice versa.

Elsewhere, selected REITs (real estate investment trusts) have attractive valuations, and our bottom-up research analysts envisage a biotech upswing after a tough few years.

Carry on trading

Easing policy in both the US and China, combined with a contained default environment, creates a positive backdrop for credit and 'carry trades'. However, with credit spreads approaching the most expensive valuations seen historically – priced for perfection, just like the Magnificent Seven – we will be selective.

There are some high real yields on offer in emerging markets, where investors display much less optimism. We believe several EM central banks could move rates lower than markets expect. That means we like high-yielding local debt markets and select EM FX, such as Brazil and South Africa.

In developed markets, given the positive fundamental backdrop but rich valuations, we look for relatively high yields and lower sensitivity to movements in credit spreads. Our research analysts are positive on shorter-dated high yield, the illiquidity premium embedded in CLOs, and high-quality bank credit.

How to position for the unknown

An air of uncertainty still surrounds expectations heading into 2025, especially in light of the change in administration in the US. In circumstances like these, our approach is to position portfolios to take advantage of the current conditions while making them able to weather a range of different scenarios.

For instance, government bonds have once again moved to a negative correlation with equities, providing relief to multi-asset investors looking for portfolio protection. Conversely, the Republican sweep unlocks the potential for even larger deficits and reflationary economic policies domestically. As such, we see good value in moving out of nominal US government bonds into inflation-linked treasuries. We will also look to other government bonds – from Germany to New Zealand – to gain portfolio protection while mitigating the risks of higher fiscal deficits and inflation.

Moreover, we believe that options-based and absolute-return strategies can respectively offer downside protection and diversification in portfolios even when bonds fail. These are increasingly valuable in an asset allocator's toolkit given latent inflation risks.

These are just some of the variables we must account for through 2025 as the dust of the 2024 sandstorm begins to settle.

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