ODDO BHF

MARKET *view*

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An Investment year filled with uncertainty

> *All things considered, despite various challenges and uncertainties, we approach the new year with a blend of caution and optimism. With disciplined action, 2025 should also present compelling investment opportunities*

Political risks have dramatically increased worldwide over this year. Looking ahead, the geopolitical and geoeconomic uncertainties seem unlikely to subside in the coming year. The return of Donald Trump to the White House introduces another unknown variable, as no one can reliably predict which policies he will pursue, or which campaign promises he will fulfill. At the same time, numerous conflicts, wars, and crises are shaping the global landscape. It remains unclear how long Ukraine's defensive lines can withstand Russian attacks, and what a possible resolution to this conflict might look like. In the Middle East, the fall of the long-standing Syrian dictator Bashar al-Assad has created another source of political uncertainty. Finally, the ongoing tensions in the South China Sea and the Horn of Africa also require close attention.

In our view, one thing is already apparent for 2025: volatility in the financial markets is likely to increase. The year now ending, 2024, has performed surprisingly well—far better than anticipated at its outset. Next year, political events could more frequently trigger erratic movements in financial markets. Investors are accustomed to operating in a world of uncertainty; after all, that is the essence of wealth management—to prepare client portfolios for the unknowns of the future. Based on our experience, international diversification will be essential in the coming year. German investors in particular tend to overconcentrate on domestic stocks and bonds. By judiciously expanding into international investments, they can reduce their portfolio's overall risk while securing a suitable return.

From a global perspective, the German economy will likely remain among the laggards in 2025. According to the German Council of Economic Experts, the country's GDP will shrink by 0.1% this year and grow by only 0.4% next year. "Compared to international peers, Germany is clearly falling behind economically," state the five experts in their mid-November annual report.[1] They forecast global GDP growth of 2.6% for both 2024 and 2025.[2] While we also expect growth to slow in the United States next year, we anticipate the U.S. economy will still expand at a notably stronger pace than Germany's and outperform the broader European region as well.

However, we do not consider stronger U.S. economic growth the primary reason to invest in American equities.

Rather, investors should consider the U.S. market for structural reasons. U.S.-listed companies generally achieve higher returns on capital than their German counterparts. The United States has produced numerous global leaders in various sectors, especially in technology—computers, operating systems, data storage, semiconductors, social media platforms, e-commerce, artificial intelligence, and many other areas related to these key technologies. One major reason is that innovation can be developed, financed, and brought to market more effectively in the U.S. We believe this factor largely explains why American companies have established a significant lead in terms of equity returns compared to their German and, more broadly, European peers.

Although equity markets—especially in the United States—are now trading at high valuations, we see no evidence of a speculative bubble forming, despite the performance of recent years. Still, equity investors should avoid short-term bets and incorporate shareholdings into a long-term portfolio strategy. Even if the coming year brings higher volatility and, thus, greater complexity to the markets, we remain convinced that equities deserve a stable place in a forward-looking, long-term investment plan.

That said, rigorous stock selection will be more important than ever next year. We systematically exclude companies with excessively high debt or unconvincing business models. This is also a key reason why we will continue to steer clear of the Chinese equity market. In our view, China must first bring local government debt and the ongoing real estate sector crisis under control before we consider investments.

While the global economic environment may not provide a tailwind in 2025, we expect that the U.S. Federal Reserve and the European Central Bank will gain additional scope to lower interest rates next year. This should help steepen yield curves. In the United States, President-elect Donald Trump's economic program may lead to a further increase in U.S. debt and potentially higher risk premiums on U.S. government bonds. The combination of interest rate cuts at the short end of the yield curve and stronger capital demand at the longer end should also result in a steeper yield curve in the U.S.

As a result, investors focusing on shorter maturities should be prepared for significantly lower interest returns when reinvesting. Nevertheless, the bond markets still offer attractive opportunities to lock in acceptable yields. Corporate bonds, for instance, currently provide a yield of around 3% for BBB-rated, five-year maturities in the EUR segment, and nearly 5% for the equivalent U.S. dollar bonds (source: Bloomberg). Although credit spreads are generally modest, they remain justified given persistently low default rates. In absolute terms, we consider these yields appropriate for a low-risk portfolio component.

All things considered, despite various challenges and uncertainties, we approach the new year with a blend of caution and optimism. With disciplined action, 2025 should also present compelling investment opportunities.

[1] German Council of Economic Experts: Addressing failures, modernizing with determination. Annual expert opinion. 24-25, November 2024, p. 1.

[2] Ibid., p. 3.

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