

# Optimal Income Strategies

## Trump's Disruption Lifts U.S. Equities, EU Regains Investor Interest

- Cooling US inflation and lower yields support equities, though Trump's policies pose inflation risks.
- Strong US Q4 earnings and deregulation benefits make Financials attractive, while Tech continues to draw investors.
- Preference for European sovereign bonds – Weak Eurozone growth and a dovish ECB create opportunities.

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### What's happening?

The U.S. economy remains resilient but is expected to slow as consumer spending moderates. President Trump's administration has prioritized migration and deregulation through a series of executive orders, while trade policy remains uncertain. Inflation is likely to stay elevated, weighing on growth prospects. We anticipate GDP growth of 2.3% in 2025, slowing to 1.5% in 2026.

In the Eurozone, economic activity remains sluggish, with early indicators pointing to weak momentum in the first quarter. While U.S. trade policies have yet to significantly impact the region, rising energy prices have nudged inflation higher. However, this is unlikely to deter the ECB from easing monetary policy. We expect GDP growth of 1% in 2025 and 1.3% in 2026.

China continues to grapple with economic headwinds, with domestic demand under pressure and external trade softening. Consumer caution is dampening spending and inflation, prompting expectations for further stimulus measures in March aimed at restoring confidence. We forecast growth of 4.5% in 2025 and 4.1% in 2026.

Emerging markets face increasing risks from tariff threats, while currency policies and inflation pressures are likely to limit central banks' ability to ease monetary policy. Some central banks may struggle to implement rate cuts as inflationary pressures persist, particularly in response to U.S. policies.

Global central banks are adjusting to shifting economic conditions. The U.S. Federal Reserve is expected to pause its easing cycle after a final rate cut in March or later this year or even no cut, adopting a cautious stance amid inflationary policy initiatives. The European Central Bank is likely to push rates into accommodative territory as economic momentum remains weak. Meanwhile, the Bank of England is expected to cut rates four times this year. In contrast, the Bank of Japan has raised rates to 0.50%, marking a 17-year high, with another 0.25% increase expected unless trade tensions escalate.

**Positioning & Performance:**

	GLOBAL OPTIMAL STRATEGY			OPTIMAL STRATEGY			DEFENSIVE OPTIMAL STRATEGY		
	Dec-23	Dec-24	Jan-25	Dec-23	Dec-24	Jan-25	Dec-23	Dec-24	Jan-25
<b>Net Equity</b>	<b>65,5%</b>	<b>87,9%</b>	<b>71,5%</b>	<b>54,1%</b>	<b>76,3%</b>	<b>62,2%</b>	<b>34,4%</b>	<b>34,6%</b>	<b>33,4%</b>
Equities	63,0%	79,7%	75,6%	60,0%	72,9%	69,6%	33,7%	37,0%	30,1%
Equities derivatives	8,6%	13,9%	-1,2%	-0,8%	5,2%	-5,3%	0,7%	-2,4%	3,3%
Risk Mitigation Strategies	<b>-6,1%</b>	<b>-5,7%</b>	<b>-2,9%</b>	<b>-5,1%</b>	<b>-1,8%</b>	<b>-2,1%</b>	<b>0,0%</b>	<b>0,0%</b>	<b>0,0%</b>
<b>Fixed Income</b>	<b>21,3%</b>	<b>5,0%</b>	<b>6,3%</b>	<b>33,5%</b>	<b>23,6%</b>	<b>24,4%</b>	<b>28,5%</b>	<b>62,9%</b>	<b>56,2%</b>
Govies	1,0%	0,0%	0,0%	1,0%	0,0%	0,0%	0,0%	0,2%	0,2%
<i>Bond Derivatives</i>	8,1%	45,0%	34,4%	9,4%	27,4%	26,7%	17,5%	10,4%	11,0%
High Yield Credit	1,2%	1,0%	1,1%	3,4%	5,6%	5,6%	10,5%	16,3%	16,4%
Investment Grade	17,3%	3,9%	5,1%	26,5%	17,6%	18,5%	17,9%	46,0%	39,3%
Emerging Debt	1,8%	0,1%	0,1%	2,6%	0,3%	0,3%	0,0%	0,5%	0,3%
<b>Diversification</b>	<b>3,4%</b>	<b>11,6%</b>	<b>12,2%</b>	<b>1,5%</b>	<b>2,2%</b>	<b>2,1%</b>	<b>5,6%</b>	<b>5,9%</b>	<b>7,3%</b>
<b>Cash &amp; Money Market</b>	<b>9,8%</b>	<b>-4,4%</b>	<b>10,0%</b>	<b>10,7%</b>	<b>-1,9%</b>	<b>11,2%</b>	<b>31,6%</b>	<b>-3,4%</b>	<b>3,1%</b>

In early January, we reduced exposure to risky assets following the Fed's December meeting, which dampened market sentiment and triggered a broad selloff. With U.S. rate expectations shifting higher and equities already vulnerable, we opted for a more cautious stance, anticipating better opportunities in a more liquid market.

We have moved back to a more modest overweight position in global equities, as the latest U.S. inflation data reinforces our confidence in a cooling trajectory, despite a resilient labour market. While equities remain in the "Danger Zone," where high rates pose risks, the easing of long-term yields offers relief. However, Trump's "America First" policies could still stoke inflation, making yield movements a key factor to watch.

Within equities, we favour the U.S. market, particularly Financials, where deregulation and fiscal support present compelling opportunities. The strong start to the Q4 2024 earnings season, led by robust financial sector results, further supports this positioning. Meanwhile, Tech continues to attract investor interest, benefiting from a lack of regulatory headwinds. In Europe, equities have also gained momentum, with luxury, industrials, and healthcare leading the way.

On the fixed income side, we reinforce our preference for European sovereign bonds. While U.S. front-end rates may price in further cuts as disinflation persists, the Eurozone's weaker growth outlook and the ECB's dovish stance make its bond market more attractive. Additionally, Trump's trade policies could push up the U.S. Treasury term premium, further reinforcing our positioning.

We have maintained our allocation to gold. Gold rose close to its October all-time high ending January up +7% to just above \$2,800 as the yellow metal is viewed as a reliable hedge against inflation and uncertainty related to Trump's policies which pushed investors into the safe-haven asset.

## Outlook

Donald Trump's return to the presidency has been marked by swift action, particularly in deregulation, which aligns with his pro-business stance. While his "America First" agenda remains a concern for inflation and market stability, his trade policy has been less aggressive than feared, offering temporary relief to investors. However, tariff threats persist, and an escalation could push interest rates higher..

After a hesitant start to the year, equity markets rebounded following softer-than-expected December inflation and retail sales data, easing concerns over a hawkish Fed. Long-term yield retreated from their highs, benefiting long-duration equities like Industrials and Homebuilders. This shift provided an opportunity to rebuild our equity overweight, reinforcing our conviction that inflation and Fed policy will remain key drivers of market sentiment.

The Q4 2024 earnings season began on a strong note, led by Financials, as major U.S. banks posted robust results fuelled by higher interest margins and strong trading activity. We continue to favour U.S. Financials, which stand to gain from deregulation and fiscal stimulus under Trump. Meanwhile, the breakthrough in AI by China's DeepSeek has introduced short-term volatility in semiconductor stocks, particularly NVIDIA, sparking debates on AI-driven valuations and long-term growth potential.

In Europe, equities saw renewed investor interest after a lacklustre 2024, with the luxury sector driving CAC 40 outperformance. While economic sluggishness and U.S. protectionist risks remain concerns, the weaker EUR/USD could bolster export-driven sectors, supporting corporate earnings.

Fixed income markets experienced volatility, with yields fluctuating in response to shifting Fed expectations. The recent drop in long-term yields has offered some relief, yet short-term rates remain elevated amid ongoing policy uncertainty. The market is currently mispricing the risk of a rate hike, despite a divergent economic landscape where cash-rich tech firms thrive while highly leveraged companies struggle. Similarly, wealthier U.S. consumers are benefiting from rising stock prices and crypto gains, while lower-income households continue to face mounting financial pressures. This economic divide underscores the challenge facing the Fed as it balances growth resilience with inflation risks.

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