HOUSE VIEW

SAILS UNFURLED FOR 2025

BancaMarch

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STRATEGIC POSITION

ASSET ALLOCATION

ASSET CLASS	-2	-1	NEUTRAL	+1	+2
LIQUIDITY		■			
FIXED-INCOME				■	
EQUITY			■		
ALTERNATIVE			■		

FIXED-INCOME	-2	-1	NEUTRAL	+1	+2
SOVEREIGN DEBT		■			
United States			■		
Euro			■		
CORPORATE BONDS				■	
Investment Grade				■	
High Yield			■		
EMERGING MARKET DEBT				■	
CONVERTIBLE BONDS			■		

EQUITY	-2	-1	NEUTRAL	+1	+2
EUROPE			■		
UNITED STATES				■	
EMERGING MARKETS			■		
REST OF WORLD		■			

ALTERNATIVE	-2	-1	NEUTRAL	+1	+2
LIQUID		■			
ILLIQUID				■	

CURRENCIES	-	NEUTRAL	+
DOLLAR		■	
POUND STERLING		■	

MACROECONOMIC OUTLOOK

The economic cycle will continue to enjoy a tailwind as it heads further into 2025.

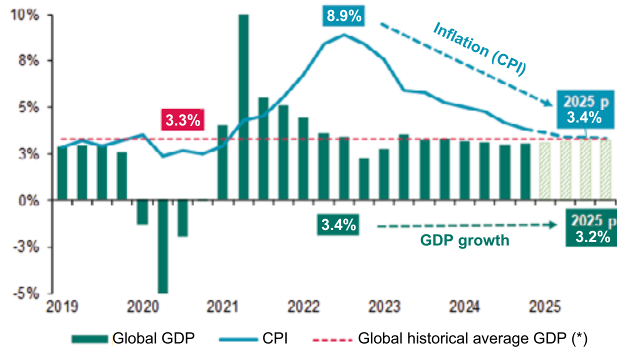
We are now venturing into the fifth year of a cycle that has been able to shake off the turmoil left by the pandemic, the outbreak of war in Ukraine —causing the biggest inflationary shock since the 1980s—, and the highest interest rates we have witnessed since the beginning of the century.

We are not moving the bow; it is vital to filter out the political noise while keeping the rudder steady and focusing on the course of the economy. Despite the immense geopolitical upheaval caused by Trump's second coming, activity data continues to point to sustained global growth and inflation steadily "normalising".

Against this backdrop, the wind will continue to be light and from the tail. Given the prospects of an extended cycle, we are keeping our sails unfurled in a year that we reckon will bring positive returns among the main asset classes.

1. GROWTH SUPPORTED BY INFLATION ON THE BACK FOOT

Sources: Bloomberg, O.E. and Banca March



(*) Since 1980.

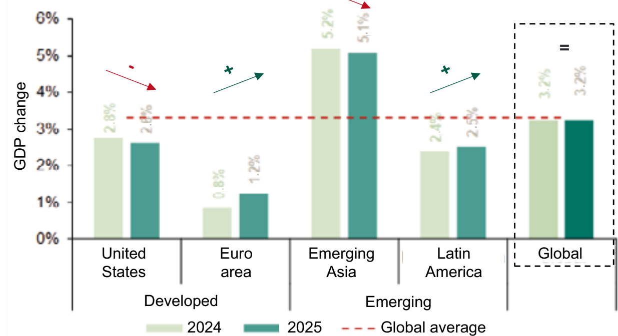
Globally, we expect GDP to grow by 3.2% this year, similar, albeit slightly below, the historical average.

Contained unemployment rates and rising wages should allow household income to recover further, in turn allowing private consumption to continue driving economic activity. All this will take place while the disinflation process rumbles on and the global CPI should be close to +3% by the end of 2025, i.e. rates already a far cry from the +9% recorded in 2022 and at more "normal" levels, even lower than the +3.5% average over the decade leading up to the pandemic.

This soft landing will continue to be headed up by the United States, where growth will slow slightly to +2.6%. Meanwhile, in the Eurozone, we should see the economy pick up and grow by +1.2% this year (vs. +0.7% in 2024). As for China, the stimulus measures have failed to kick-start domestic demand, which is still shackled by the real estate crisis, and the introduction of higher tariffs will further curb growth in the Asian giant.

2. MORE BALANCED GROWTH AMONG REGIONS

Sources: Bloomberg and Banca March

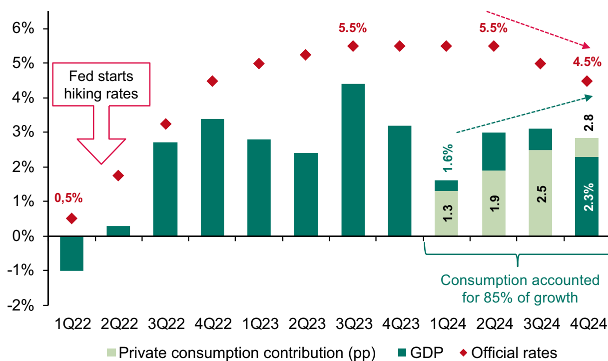


The US economy will continue to lead the growth.

The latest data is conclusive, showing that the U.S. economy closed out another year with healthy growth on the back of private consumption. In 2024 as a whole, growth was +2.8%, more than 85% of which was down to the contribution made by consumption. These positive figures come more than two years after the start of the Federal Reserve's monetary tightening cycle and confirm that, on this occasion, the increase in official rates has not triggered a sharp slowdown in economic activity (see Figure 3).

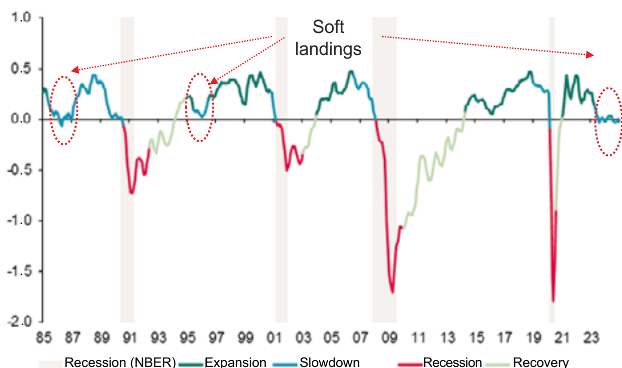
3. SUSTAINED GROWTH MORE THAN TWO YEARS AFTER THE START OF THE RATE HIKE (UNITED STATES)

Sources: Bloomberg and Banca March



4. OUR INDICATOR IS SIMILAR TO OTHER "SOFT LANDINGS" IN THE PAST

Sources: Bloomberg and Banca March



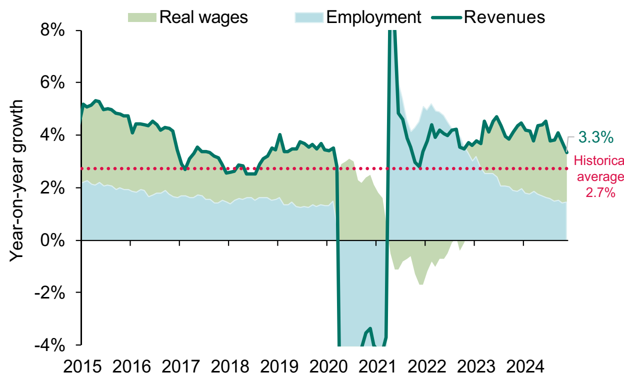
A trend that ratifies our aggregate momentum indicator, which has risen in recent months and points to a trend akin to past episodes of a "soft landing" (1985 and 1995; see Figure 4).

More still, 80% of the components of this indicator are either recovering or expanding, which supports our outlook for sustained growth over the coming quarters. It should also be noted that the only areas that point to more a subdued cycle are M&A and construction permits, components that should be kick-started, given that we have already left behind the period of tighter financial conditions.

Consumption and productivity are two engines running at full throttle.

5. REAL WAGES WILL SUPPORT CONSUMPTION (UNITED STATES)

Sources: Bloomberg and Banca March



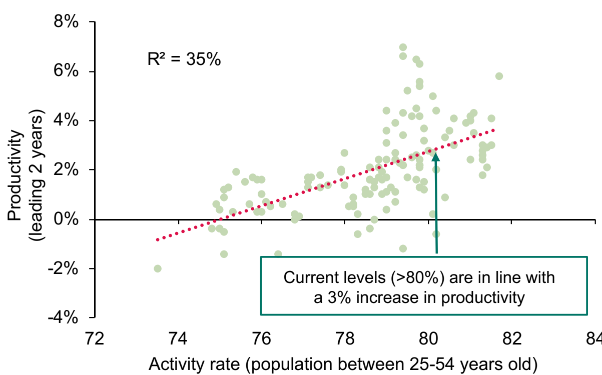
If we look ahead to 2025, our outlook for consumption is fairly bright. Although job creation is slowing, households will continue to gain purchasing power as wage growth outpaces inflation.

"Real" income, growing at 3%, is above the historical average, which we reckon will be more than enough to support private consumption.

While it is true that low unemployment rates and a shortage of skilled labour are typically associated with an increase in inflation in the short term, it is also true that, on many occasions in the past, these conditions were the catalysts for an improvement in productivity in the mid run. If we look at the trend in the labour force participation rate and productivity since the beginning of the 1990s, we can see that this connection is stronger and employment rates above 80% —such as those reported in the United States over the last two years— are often a prelude to productivity growth of 3%.

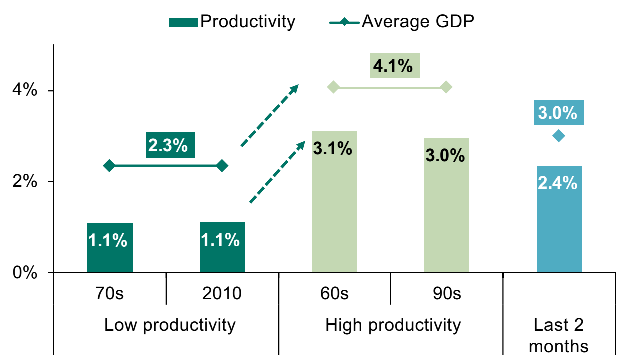
6. HIGH LEVELS OF EMPLOYMENT IN MEDIUM TERM TEND TO IMPROVE PROCESSES AND EFFICIENCY

Sources: Bloomberg and Banca March



7. HIGHER PRODUCTIVITY WILL LEAD TO HIGHER GROWTH (UNITED STATES)

Sources: Bloomberg and Banca March



Given the current context, marked by relentless technological progress and a race towards digitalisation, we believe that the likely implementation of process improvements will be a decisive factor in extending the current economic cycle and will also be accompanied by an acceleration in aggregate growth (Figure 7).

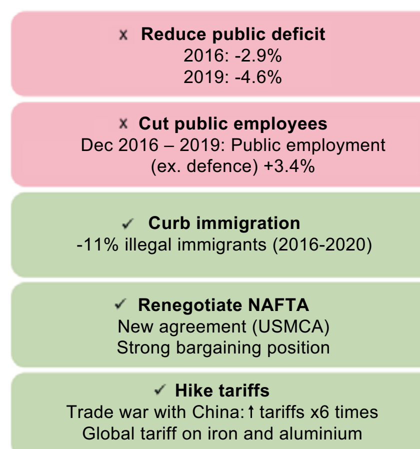
The second coming of Trump: less room for manoeuvre due to the public accounts.

Donald Trump's triumphant return to the White House and his aggressive rhetoric herald uncertainty, but are also reminiscent of a scenario we already saw back in 2016. In the Trump 1.0 era, we witnessed a wide array of both promises and threats, many of which were deliberately exaggerated or were intended more as a bargaining tool.

On the subject of immigration, the 2016 election campaign already included a hodgepodge of some of the measures Trump is now proposing once again. Among them, the elimination of birthright citizenship, an executive order that in the past was found to be unconstitutional, given that a 2/3 vote in favour is required in both houses of Congress. Right now, the one signed on 20 January 2025 is temporarily blocked.

8. MAGA 2016: PROMISES VS. REALITY

Sources: Source: CBO, Department of Homeland Security (DHS), Office of Personnel Management (OPM) and Banca March



What did come to pass during Trump 1.0 was tougher border controls with Mexico and a reduction in illegal immigration. Despite certain accounting difficulties, government estimates point to a reduction from 11.8 million unauthorised immigrants in 2016 to 10.5 million in 2020.

Another recurrent theme is the search for further government efficiency. In a bid to succeed, the Department of Government Efficiency (DOGE) has been set up, this time with Elon Musk at the helm. In 2016, Trump pledged to reduce the number of public employees (ex. defence) by freezing government hiring, but in reality this executive order lasted only 79 days and, during his tenure, public employees increased by 3.4%.

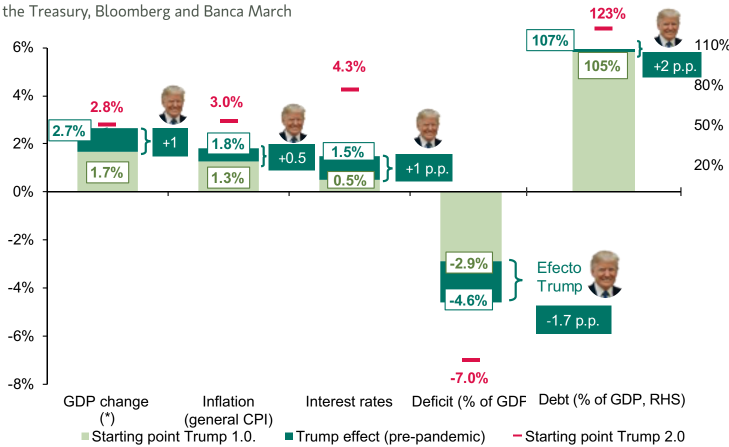
Beyond what he did and what he did not do, what he can do now is the key issue. The Republican party wields absolute political legitimacy, with control of the government and both houses of Congress, as indeed was the case during the first two years of Trump 1.0. However, the starting point of the economy is now different and the public accounts are worse than before, thus limiting his leeway.

During his first term, he inherited lower inflation levels of +1.3%, versus +3% in 2024, which will require meticulous care in pressing ahead with new tariffs to avoid any excessive impact on consumers; Something he already did in the past and, might we add, in the midst of a tariff war with China. Trump chose to delay, from September to mid-December, the implementation of tariffs on $160 billion in Chinese imports —including mobile phones, laptops and toys— to avoid, during a key holiday shopping period, the possibility of heavy price contagion. Notably, despite his bulldog-like trade belligerence during his first term, inflation did not shoot up excessively, rising only +0.5 pp in three years, while the CPI remained below the +2% target.

The main obstacle now facing Trump is a deteriorating fiscal imbalance: public debt is at 123% of GDP, up nearly 20 pp versus his arrival in 2017, and a deficit of 7% is forecast for 2024, the highest among major developed economies. During his first term, tax cuts led to lower revenues, and this was not offset by a reduction in spending. The "Trump effect" increased the deficit by almost twofold p.p. without being able to adjust budgets.

9. LESS ROOM FOR MANOEUVRE FOR THIS TERM OF OFFICE

Sources: CBO, Department of the Treasury, Bloomberg and Banca March

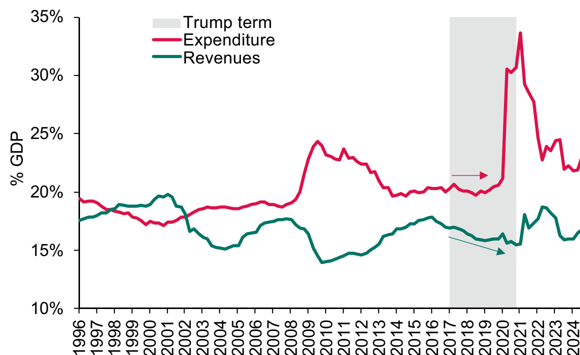


(*) For change in GDP: "Trump 1.0 starting point" is the cumulative and annualised growth of Obama's term and the "Trump Effect" includes Trump's term between 2017 and 2019 (ex. COVID-19).

In this context, the task of curbing spending will be a major challenge, given the limited number of items that can be targeted. Interest payments on debt are inevitable and Trump is not willing to cut the defence budget. Meanwhile, mandatory expenditures are those for which, to be cut, the law must be changed through a 60-vote majority in the Senate, considering that Republican senators currently make for a total of 53. They include programmes such as Medicare, Medicaid, Social Security and benefits for military retirees, so just among the Republican senators, there is no certainty that a consensus will be reached for such changes. Therefore, the maximum leeway would be for 2.4% of GDP relating to discretionary spending, which is also difficult to cut out entirely, as it finances critical areas such as education, medical research, the administration of justice and transportation.

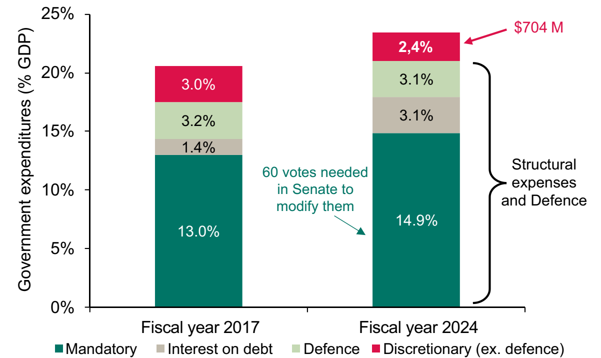
10. DURING HIS PREVIOUS TERM, HE REDUCED REVENUES, NOT EXPENSES.

Sources: Bloomberg, CBO and Banca March



11. CUT PUBLIC SPENDING? MIRACLES DO NOT EXIST

Sources: Bloomberg, CBO and Banca March

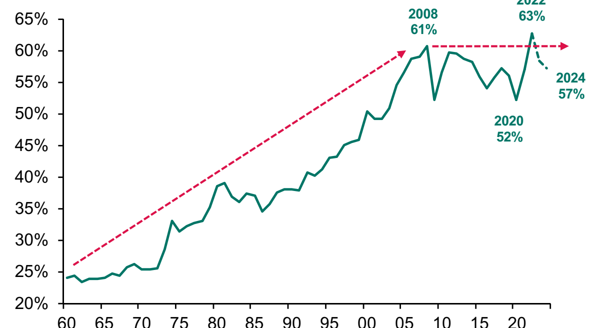


We do not expect to see a decline in global trade, rather a slowdown, and services will continue to gain in strength.

On the foreign policy front, one of Donald Trump's campaign thrusts was the threat of new tariffs on imports; a strategy we already saw during his previous term, when in 2018 he unleashed a trade war against China by multiplying tariffs on goods from the Asian country by a factor of six. In our view, Trump's second coming will not mean the end of global trade, but rather a slowdown from currently very high levels.

12. GLOBAL OPENNESS INDEX (EXPORTS + IMPORTS AS % OF GDP)

Sources: Bloomberg and Banca March



International trade has been virtually stagnant for over 15 years and the increase in trade barriers point to a slowdown of sorts, mainly on the goods side, while services will play more and more of a role; over the past 15 years, their share of global trade has risen from 23% to approximately 30%.

While the threats made on the campaign trail were fairly general (tariffs of 60% on China and between 10% and 20% for the rest of the world), a policy that would bring the average tariff rate to levels of 17.7% —something not seen in almost 100 years— during his first few days in office, these have been shifting towards specific countries. More precisely, Trump has just signed three executive orders imposing, as of 4 February, tariffs of 10% on imports from China and 25% on Mexico and Canada (with the exception of purchases of Canadian energy products, which will be 10%).

Although this stance may raise fears of a sharp reversal in global trade, we tend to think that continued “tariff bullying” and trade threats are part of a negotiating strategy that has already been used in the past. Let’s not forget that, during his first term, Trump was pretty belligerent at the outset but then became more conciliatory to reach more moderate agreements, including the renegotiation of the NAFTA (North American Free Trade Agreement) between Mexico, the United States and Canada. Moreover, the new tariffs could be repealed in the future if the objectives of greater control over immigration, the fentanyl problem, and a rebalancing of the U.S. trade balance are achieved; perhaps something that the executive orders hint at.

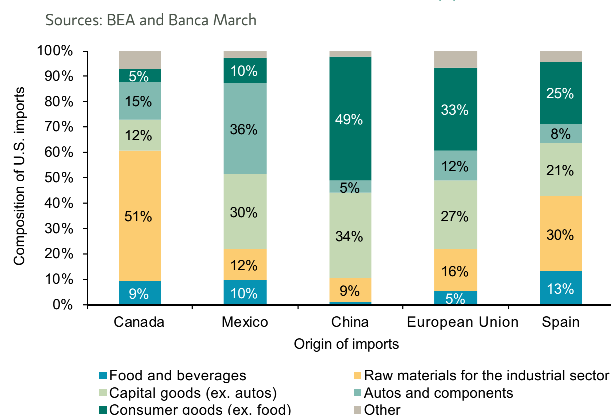
While there are valid reasons for the United States to increase its tariffs, for them to be effective, they must be targeted at specific sectors.

From a conceptual standpoint, Donald Trump’s tariff threats are more than justified. Regions such as China, the EU, Mexico and India all charge higher tariffs on U.S. goods compared to what they pay when exporting their own. Moreover, in all these cases, the balance of trade in goods is negative when looking at things from the side of the United States and, in extreme cases such as China, stands at around $280 billion.

Under this criterion, the main regions that should be in Trump’s sights are China, the EU and Mexico, while Canada will probably also be affected for reasons of proximity, plus various political factors. However, for tariffs to be effective, they need to be as targeted as possible, thus ruling out the idea of a universal tax.

13. COMPOSITION OF U.S. IMPORTS (*)

Sources: BEA and Banca March



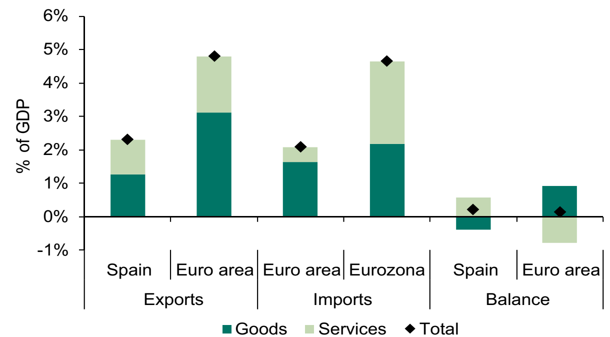
(*) Raw materials used in industry (energy products, chemicals, etc..); capital goods (machinery, equipment, semiconductors, etc.).

To give an example, half of all imports received from China are consumer goods, followed by capital goods, which account for 34% of the total. It is quite a different story when it comes to products imported from Mexico, with automobiles being the biggest segment (36%), while consumer goods represent barely 10%. In the case of the EU, the main sector is consumer goods (33%) while, in the particular case of Canada, it is raw materials to be used in industry (51%). In Spain’s case, the largest relative exposure comes from foodstuffs and raw materials used in industry, especially chemical products (14.4% of total exports).

However, for the most part Spain is less directly exposed to tariffs than the wider euro area. Spanish exports bound for the United States account for half of the total in terms of GDP, and the difference in the composition of the trade balances is particularly significant. Spain exhibits a surplus when looking at trade in services, which are less susceptible to tariffs, while the euro area faces greater risk because it exports a higher proportion of goods compared to those it imports from the United States.

14. TRADE BALANCES WITH THE UNITED STATES: SPAIN LESS EXPOSED THAN THE EURO AREA

Sources: Bank of Spain, Eurostat and Banca March

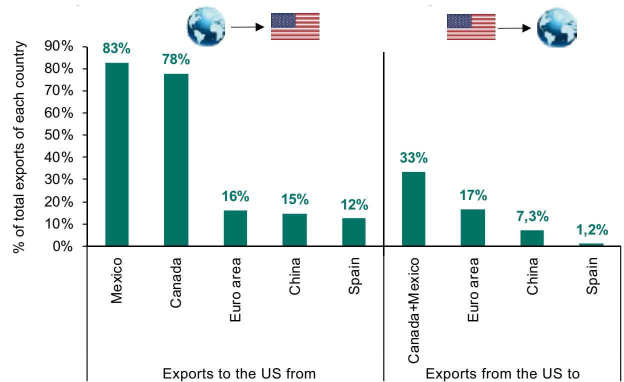


While the U.S. would suffer less in the event of a trade war, it would not be immune to the effects. If all of Trump's threats come to pass and the threatened countries respond with protectionist retaliation, U.S. GDP would be dented by 1%.

Aside from the question of how the United States ultimately implements its tariffs, it is also important to analyse the effects of possible retaliation by other countries. Although the United States enjoys a privileged position as it buys more than it exports (see Figure 15), Canada and Mexico alone account for 33% of its total exports, followed by the euro area (17%) and China (7%). Put differently, these four regions account for 57% of its total exports, so even if Trump heads up the negotiations, the United States would also stand to lose from an all-out trade war.

15. EXPORTS OF GOODS TO AND FROM THE UNITED STATES (*)

Sources: FMI and Banca March

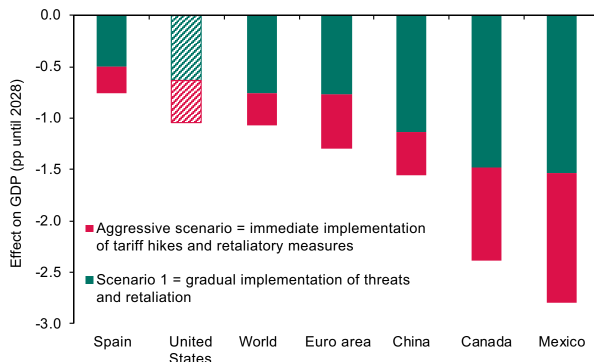


(*) Euro area and Spanish exports to the United States exclude trade between the countries of the monetary union.

In terms of GDP, Canada and Mexico —the two countries most reliant on the U.S. for exports— would take the biggest hit on their growth outlook. According to our estimates, and assuming that: (a) the world's biggest economy slaps tariffs of 60% on China and 10% on other trading partners in a staggered manner over 2026 and 2027; and (b) the other countries retaliate, the GDP of Canada and Mexico would dip by 1.5 percentage points (pp) between 2025 and 2028. Meanwhile, the GDP of the North American giant would fall by 0.6 pp over the same period, while euro area GDP would shed 0.8 pp.

16. ESTIMATED CUMULATIVE REDUCTION IN GDP

Sources: O.E. and Banca March



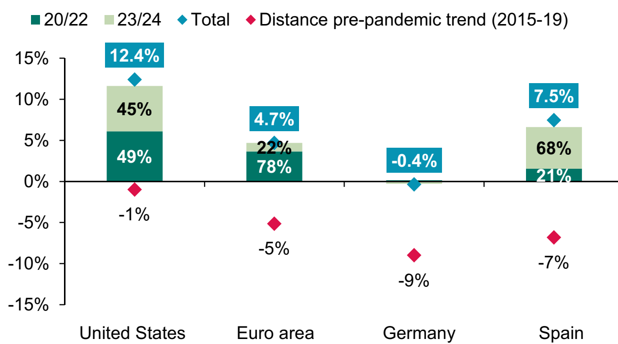
If we assume a more aggressive scenario, in which tariffs are swiftly introduced this year, businesses would have little time to adapt and the impact on growth would be greater. More precisely, tariffs of 45% on China and of 10% on the rest of the world would cause the GDP of Mexico and Canada to fall by between 2.5 and 3 pp over four years, while euro area GDP would retreat by almost 1.5 pp and U.S. GDP by 1 pp.

Euro area: damaged, but not sunk.

The horizon for the euro area is still full of dark clouds, particularly for Germany and France, its two largest economies, which must now also contend with a highly unpredictable trade policy from the United States, their main trade partner. Since the end of the pandemic, Europe's recovery has been lagging behind that of other powers, especially in comparison with the U.S. economy (see Figure 17). At year-end 2024, GDP was just 4.7% above pre-pandemic levels, a far cry from the result achieved by the United States (+12.4%).

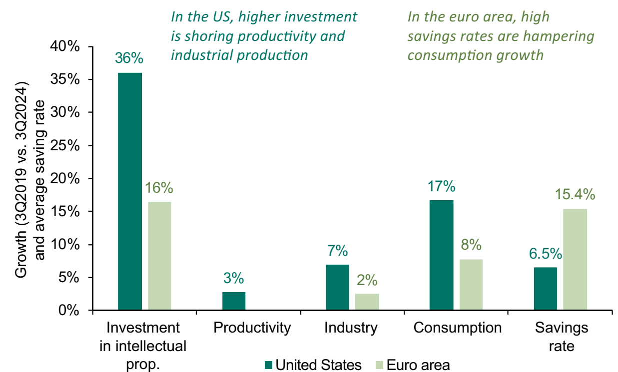
17. THE EURO AREA CONTINUES TO LAG WAY BEHIND (GDP GROWTH FROM 2019)

Sources: Bloomberg and Banca March



18. PERSISTENT CHALLENGES: LOWER INVESTMENT, LOW PRODUCTIVITY AND HIGH SAVINGS

Sources: Bloomberg and Banca March



This sizeable disparity in growth capacity is definitely a structural problem that will be hard to reverse in the short term. Looking at the fundamentals, over the last five years, investment in intellectual property has soared by +36% on the other side of the Atlantic, while in the euro zone it has increased by 16%; undoubtedly one of the factors explaining the notable difference in productivity growth between the US economy (+3% on average since the pandemic) and the stagnation in Europe.

Meanwhile, as we can see in Figure 19, this sluggish reactivation of the economy has not thwarted a strong recovery in employment or stopped the unemployment rate from reaching a record low for the region (in December it stood at 6.3%). Although the latest figures point to a slowdown in job creation, the high vacancy rates remain above the historical average, even in those countries that have endured a recession, such as Germany, thus confirming a certain labour shortage and suggesting that employment will hold up over the next 12 months.

19. A RESILIENT LABOUR MARKET

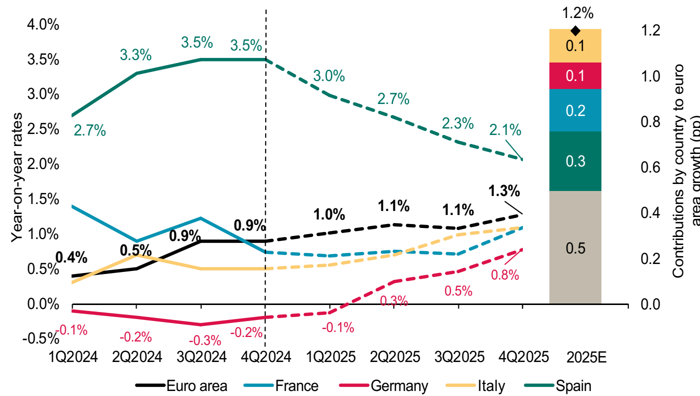
Sources: Bloomberg and Banca March

(*) For vacancy rates in the euro area, Germany and Spain, quarterly, the latest data is for 3Q 2024.

(**) Vacancy rate: proportion of unfilled demand for workers. Vacancies/(Those in work + Vacant positions).

20. EXPECTED GDP GROWTH IN THE EURO AREA

Sources: Eurostat, O.E., Bloomberg and Banca March



A resilient labour market and high household savings rates are factors that will continue to shore up consumption within the region, coupled with further declines in financing costs and a revival of credit following the ECB's recent rate cuts. These drivers should pave the way for an increase in consumption, making our outlook for the region one of a slow recovery, with growth likely to slow as we move through the year. In 2025, the region's GDP will grow at a rate of 1.2%.

If there is one economy with the capacity to implement stimulus measures and needing to turn things around, it is Germany.

This scenario of slow but steady growth within Europe will depend on the performance of its main engine: Germany goes to the polls on 23 February in an election framed by the need for economic restructuring. Its structural woes are well known and will not be solved in the short term (its industry is still struggling to absorb the shock of having to look elsewhere than Russia for its gas, while also facing increased competition from China), as Germany loses competitiveness amid reduced investment.

However, if there is one economy in the world with the capacity to press ahead with fiscal stimulus measures, it is Germany. First, because its public debt remains very contained at 62% of GDP, while its deficit is 2.6%, ratios that would allow the new government to design a stimulus package without threatening the sustainability of the nation's public accounts.

However, the new government will have to decide whether to do this via the approval of special funds or by amending the debt brake clause in the constitution, although to achieve this, it would need the support of 2/3 of the Bundestag; a tough ask given the current polling figures.

China: awaiting stimulus measures to avoid "Japanification".

After China met its growth targets of 5% in 2024, Trump's arrival in the White House will be a new hurdle for the economy of the Asian powerhouse. While industrial production has already managed to resume its pre-pandemic growth path, consumption is still struggling to get off the ground, given the housing crisis that has been raging for several years now. We believe that the measures announced so far fall short of the mark and, in many cases, are too vague, and that more stimulus is needed, mainly on the fiscal side.

As long as the government fails to restore consumer confidence, fears over a possible "Japanification" will remain. This deflationary threat now facing China is plain to see in its sovereign rates: for the first time ever, the yield demanded on Chinese long bonds exceeds that of their Japanese counterparts. More precisely, the yield on the Chinese 30-year tenor has fallen from 3.2% in early 2023 to just 1.9% today. Meanwhile, that of its Japanese counterpart has risen from 1.6% to 2.2% over the same period.

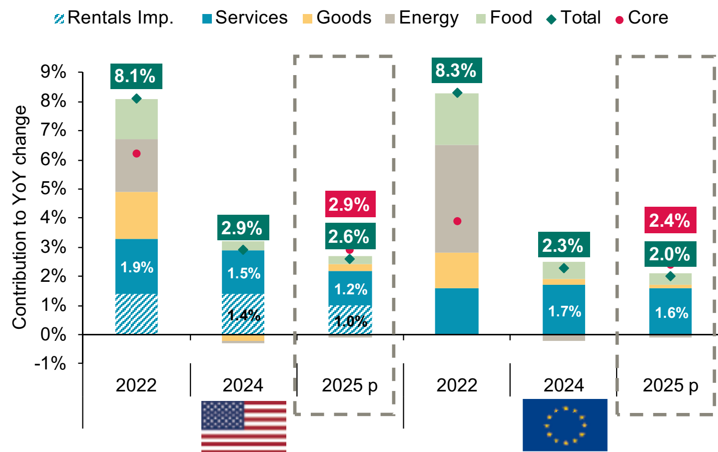
We will be keeping a close eye on the impact of the tariff measures that Trump ultimately decides to implement, and on possible new stimulus measures introduced by the Chinese authorities.

Inflation will continue to retreat, albeit with bumps in the road.

Late 2024 provided some encouraging signs that inflation will continue to normalise. In the United States, the CPI ended last year at +2.9% YoY, though what really matters is that core inflation is continuing to relent: the price of services slowed somewhat, rising by just 4.4% YoY in December, their gentlest increase since 2022. In the euro area, the figures paint a similar picture, with average inflation of 2.3% at year-end 2024, with the price of services also growing at rates of 4%.

21. INFLATION OUTLOOK

Sources: Bloomberg and Banca March



In view of these figures, and with inflation having reached its highest level since the 1980s in 2022, the deflationary process is well under way around the globe and is now in a "comfort" zone of sorts for central banks.

Looking ahead to 2025, inflation will continue to retreat, though at a slower pace. Sustained wage growth will keep inflationary pressures alive, mainly in the price of services, which will show greater downward resistance.

This trend will be most visible in the United States, where we expect to see an average inflation rate of 2.6%, with core inflation hovering around the 3% mark (see Figure 21). Looking at the euro area, we do think that the ECB's inflation target of 2% will be reached by mid-year and that the core rate will also subside to 2.4% from 2.8% on average last year.

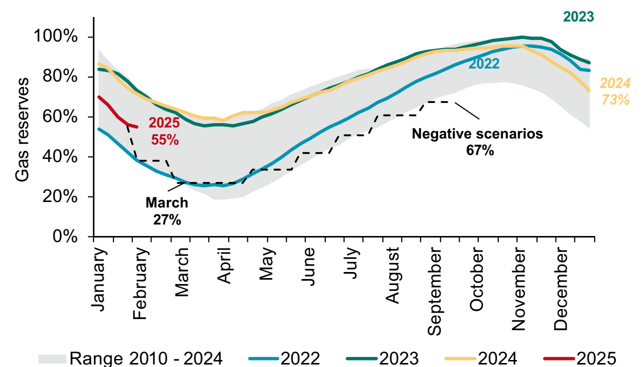
Moreover, energy will no longer be a tailwind in 2025. Although gas stocks will make it through the winter fairly comfortably at current levels, a less favourable base effect on the gas price side will exert pressure on inflation.

When it comes to energy inflation, we will see opposing effects. On the one side, weak demand from China and rising US production will help to keep oil prices in check, while natural gas will remain under pressure in Europe due to supply constraints, which happens to be one of the main upside risks to European inflation.

A colder start to the year than in 2024 has brought gas stocks down to 55%, well below the 72% seen last year at this time. That said, Europe will not be running out of gas, with reserves bottoming out at 27% in March even if we draw a worst-case scenario (assuming a total cut in imports from Russia and 15% increase in demand, which would cause consumption to be 7% higher than in the winter of 2020–2021. From March onward, they would start to recover and would surpass 67% —a fairly workable level— by late September or thereabouts.

22. GAS RESERVES IN EUROPE

Sources: Bloomberg, ENTSOG and Banca March



Come what may, and while we believe that the worst-case scenarios can be avoided, the favourable base effect of gas on inflation will dissipate in the coming months. Looking at the figures, European gas prices hit a low of 22.8 €/MWh in February 2024 —the average for the first quarter of last year was 27.6 €/MWh— far below the current level of 53.1 €/MWh.

CENTRAL BANKS

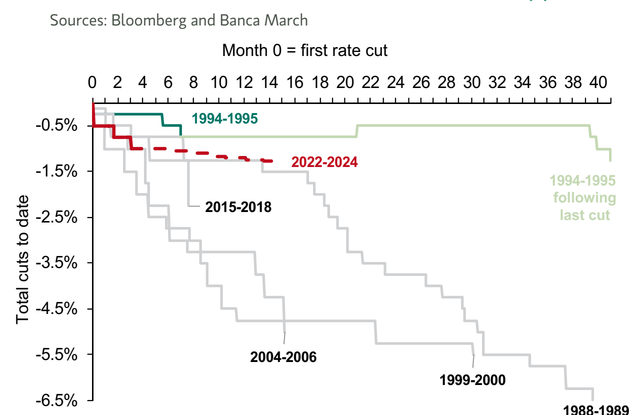
The ECB and the Fed are falling more and more out of sync, with the latter taking things more slowly given the healthier state of its economy and the second coming of Trump. We expect to see two cuts this year for the Fed and three further cuts for the ECB.

Given the threat of new tariffs from the Trump administration and their potential impact on prices, we reckon that the Fed will take a breather at its next few meetings and that the first rate cut will take place towards the middle of the year. As long as the economy holds up on the back of consumption and employment remains resilient, according to our own estimates and employing the Taylor rule, it is highly unlikely that policy rates will fall below the 3.75%–4.00% range.

In contrast to what usually happens when the Fed starts cutting rates aggressively to counter a sharp contraction in activity, this time rates will remain in tightening territory for the next few months or so. A situation that resembles what happened during the soft landing of 1994–1995, when the central bank —chaired by Alan Greenspan at that time— kept the price of money unchanged for eight straight meetings after cutting rates by 75 bp.

23. FED: EPISODES OF OFFICIAL RATE CUTS (*)

Sources: Bloomberg and Banca March



(*) For the 2024 estimates, we rely on the futures curve, on the assumption that the cycle of rate cuts will end in December 2025.

Looking at the euro area, we expect to see three further cuts this year, which would push real rates into negative territory towards the end of the year. The cuts on this side of the Atlantic will be more prolific due to slower growth in the euro area and the fact that inflation in the region is running at rates close to the 2% target. To give an example, two of the region's big four economies —Italy and France— recorded price changes of below 2% in the last month.

Despite moving at different speeds, both the ECB and the Fed have cut the price of money by 75 bp so far. However, the meetings held in late January marked the start of a new phase, in which each central bank will take a different path. This will be hugely important for the other asset classes, mainly in the euro area, where investors will have to contend with negative real official rates.

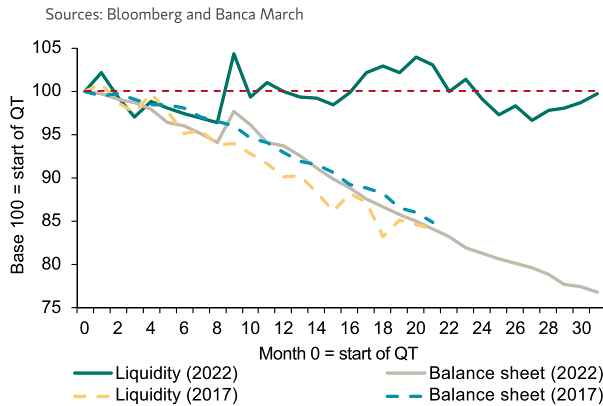
Despite the ongoing balance sheet reduction process, liquidity has not been heavily affected in the United States.

One of the reasons for the strong performance of the US economy following such a sharp reduction in the Fed's balance sheet relates to the trend in liquidity within the system. More precisely, in the 31 months that have transpired since the rate cut process began back in June 2022, the institution led by Powell has shed assets equivalent to 12 pp in terms relative to GDP (well above the -5.1 pp under the Quantitative Tightening (QT) of 2017) and notably this has hardly affected the amount of available money within the economy.

We define this concept as the difference between total assets versus reverse repo operations (a mechanism whereby the Fed temporarily withdraws money from the market) and the General Treasury Account (money held by the Treasury at the Federal Reserve).

24. FED: TREND IN LIQUIDITY AND ASSETS

Sources: Bloomberg and Banca March



As the diagram shows, liquidity has remained unchanged despite the Fed's sweeping balance sheet reduction process, while assets have fallen by roughly 23%; quite a different story to what happened back in 2017, when both the balance sheet and the liquidity of the system fell at similar rates (around -15%).

Balance sheets will return to pre-COVID levels in terms relative to GDP by the end of 2025, assuming the current pace is maintained.

In the case of the Fed, if the monthly cap of $60 billion set in April 2024 (37% below the previous cap) is maintained, we estimate that a balance sheet of around 20% of GDP will be reached towards the end of the year.

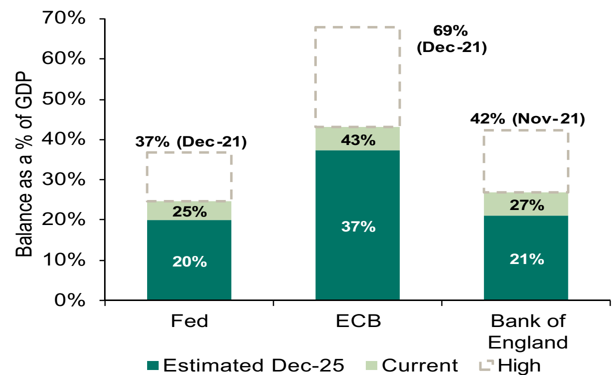
As for the ECB, the main change is that this year it will not be renewing the maturities associated with its pandemic emergency purchase programme (PEPP), which represents 25% of total assets.

According to our estimates, these maturities would make the balance sheet 1.9 pp lighter relative to GDP. Moreover, the maturities of the asset purchase programme (APP) have not been renewed since July 2023, which will knock off a further 2.9 pp. All in all, total assets will fall 37% of GDP, slightly below the level seen in January 2020.

In conclusion, we still believe that policy rates should not be viewed in isolation and that the level of monetary policy easing will also depend on the pace of the balance sheet reduction process.

25. CENTRAL BANK BALANCE SHEETS, AS A % OF GDP

Sources: ECB, Bloomberg, Fed and Banca March

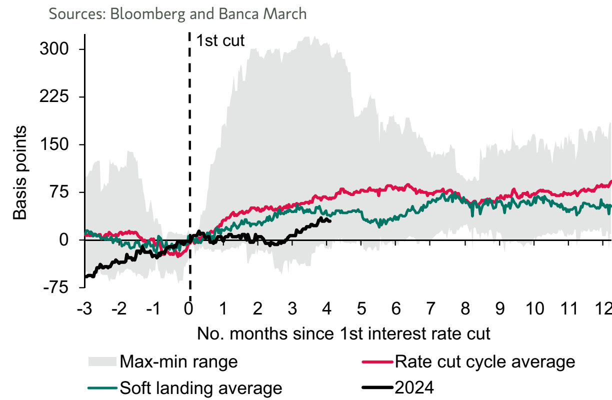


FIXED INCOME

Long maturities under pressure in early 2025 following the re-emergence of the term premium.

26. TREND IN THE 10 – 2 YEAR CURVE FOLLOWING THE FIRST CUT IN OFFICIAL RATES

Sources: Bloomberg and Banca March



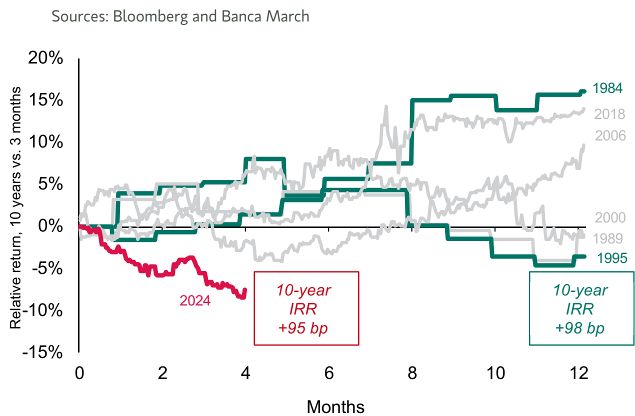
We have seen heavy selling pressure on the long end of the sovereign curves in early 2025. However, the reasons explaining these movements vary from region to region. In the United States, the uptick was down to the strength of the economic cycle and a less aggressive Fed. Meanwhile, in the United Kingdom, the return of "bond vigilantes" concerned about the government's fiscal capacity, has been the main catalyst for the increase in 10-year rates.

As we explained back in November of last year, the term premium often rises when official rates are cut. While the intensity of this increase varies from cycle to cycle, in a soft landing scenario the reference tends to rise by 50 bp on average running from the first rate cut. Judging by the movements seen in recent weeks, we would be close to reaching that average, although in mid-January, a more benign December inflation figure has slowed sales on the long side.

We believe that this year, agility and tactical positioning within the curve will be crucial, as a more volatile environment due to tariff uncertainty and US foreign policy may spark a knee-jerk reaction from the market, as indeed we saw in early January. On this occasion, the yield spread between the 10-year bond and the three-month bill reached its lowest point in all rate-cutting cycles since 1984, surpassing that of the 1995 soft landing.

27. RELATIVE RETURN ON THE 10-YEAR BOND VS. THE 3-MONTH BILL FOLLOWING THE FIRST OFFICIAL RATE CUT

Sources: Bloomberg and Banca March



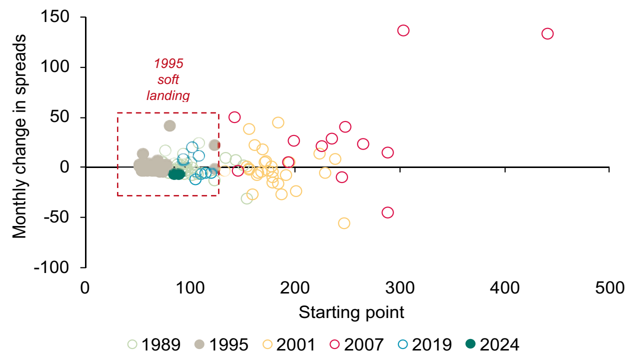
In our view, inflation will not rise significantly over the coming quarters, so we remain fairly confident that the Fed will continue to cut rates throughout 2025. Currently, break-even inflation expectations on sovereign bonds and swaps are around +2.5%, the same as the average for the last 10 years. Assuming that this historical relationship holds, 10-year bonds should offer a yield to maturity of around 4.3%.

Notably, the latest spurt in rates has increased the asymmetry in terms of duration returns. For instance, looking at a 12-month horizon, a 10-year US sovereign bond can offer a yield of 4.6% purely because of the coupon effect plus price convergence, which is already higher than what a 1-year bond can offer, which currently offers a yield some 40 bp below. On top of this layer, we can add the price effect, which will depend on where the 10-year rates are in 12 months' time. In our case, we believe they will be below current levels, so aside from the coupon we expect to see a positive price effect that would push yields up to 10% assuming 10-year rates ultimately return to the 4% mark. However, if we are wrong and rates head the other way (say 5%), the 12-month return would still be positive, albeit more modest (+1.7%). As can be seen, it would be very hard for us to reach a capital loss scenario, and we also happen to have plenty of room for manoeuvre, as further progress will be made in curbing inflation throughout 2025 and policy rates should continue to decline.

The soft landing of the economy will help to keep a lid on credit spreads, allowing investment grade bonds to offer yields above sovereign bonds. We maintain our preference for European credit, with high yield and hybrid debt functioning as extra performance levers.

28. SPREADS AND MONTHLY CHANGES 12 MONTHS AFTER THE FIRST INTEREST RATE CUT

Sources: Bloomberg and Banca March



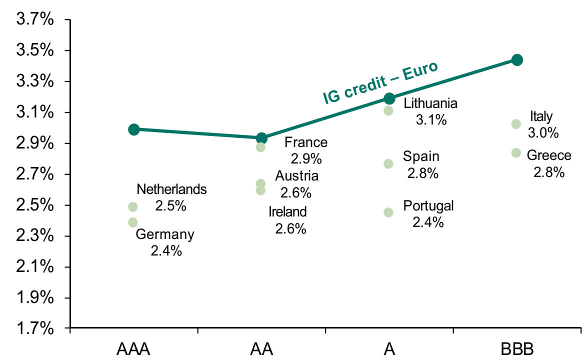
IG credit spreads ended 2024 very close to cycle lows in the United States and close to the 100 bp barrier in the euro area. This allowed both US (+4.2%) and European (+4.5%) credit to outperform sovereign comparables of equal or longer duration (+2.3% and +2.5%, respectively, in the 3–5 year tranche) and the European money market (+3.5%) in 2024. As we move into 2025, spreads have remained stable, despite the high volatility affecting sovereign debt.

While credit spreads are currently low by historical standards, especially in the United States, we do not expect to see any major widenings in a context of near-average economic growth and improving financial conditions. If we look back to 1995 —the very paradigm of soft landings—, spreads moved only slightly; in the worst month they widened by 45 bp, hovering most of the time around the 100 bp mark.

We therefore continue to prefer high quality credit, especially European credit, given its wider spreads vis-à-vis US credit (95 bp vs. 78 pb). Moreover, once sorted by credit rating, European corporate bonds continue to offer higher yields than European sovereign bonds of the same quality, especially when we look at the AAA and BBB tranches.

29. DURATION-ADJUSTED IRR BASED ON CREDIT RATING

Sources: Bloomberg and Banca March



30. PERCENTAGE OF BB-RATED DEBT WITHIN HIGH YIELD INDICES

Sources: Bloomberg and Banca March

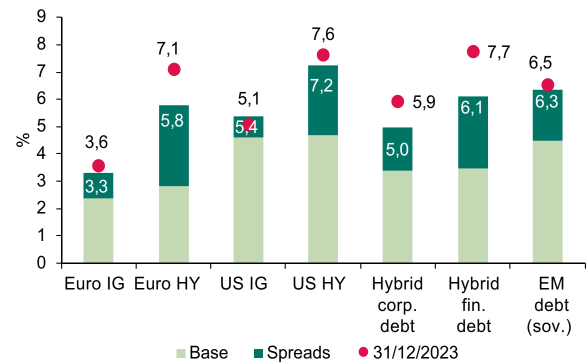
In the high yield segment, we remain neutral, after a year of high returns (8.2% in both the United States and Europe —the highest return segment within the fixed income universe). Although the price increases have left the starting spreads somewhat narrower, current yields remain attractive and are in the high range for the last four years. Moreover, with the exception of Europe, the returns now being demanded are not so different from the starting point a year ago.

Meanwhile, the demanding prices are justified by the higher quality of the existing debt. For instance, in Europe, more than two thirds of the index has a credit rating of BB, the highest in the high-yield debt spectrum.

In conclusion, we still believe there is value to be had in the lower quality corporate bond segments, which are likely to be somewhat more volatile in 2025 than last year over tariff uncertainty, but still have room to offer differential returns versus sovereign bonds of the same duration. By region, we maintain our preference for the European high yield segment. We can also see the appeal of the extra yields offered by hybrid corporate/financial debt, which has a better average rating than HY (closer to BBB).

31. IRRS BY CREDIT SPECTRUM

Sources: Bloomberg and Banca March



EQUITIES

The stock market is climbing upward, amid a cycle that is set to continue.

32. LAST YEAR WAS A GOOD YEAR FOR STOCK MARKETS

Sources: Bloomberg and Banca March

YTD	Global	S&P 500	Europe	Emerging m.	China
Technology	30.8%	35.7%	11.6%	18.6%	38.8%
Telecoms	30.2%	38.9%	11.1%	14.1%	25.7%
Financial	21.2%	28.4%	19.9%	6.8%	37.3%
Cons. Dis.	19.1%	29.1%	1.2%	10.1%	10.5%
Index	**15.7%**	**23.3%**	**5.8%**	**5.1%**	**15.7%**
Industrial	10.8%	15.6%	12.9%	-1.1%	21.1%
Utilities	8.8%	19.6%	-2.6%	0.4%	15.1%
Cons. Def.	1.9%	12.0%	-5.0%	-13.0%	-9.5%
Health	-0.2%	0.9%	2.5%	-1.9%	-20.8%
Energy	-1.4%	2.3%	-9.1%	-9.1%	13.8%
Materials	-10.0%	-1.8%	-4.8%	-21.4%	7.7%

The year closed with gains for equities, for the second year running and with US markets delivering stellar performances (S&P 500 +23%; Nasdaq +33%) compared to more moderate growth in Europe (Stoxx 600 +8.9%) and emerging markets (+5%). By sector, we witnessed the meteoric rise of technology (+30.8% at global level), communication services (+30.2%) and financial services (+21.2%), while on the flip side we have health (-0.2%), energy (-1.4%) and materials (-10%).

However, the stock market gains took place within an extraordinarily narrow range of names: the Magnificent 7 contributed 55% of the total return of the S&P 500, with none of the usual technical corrections and in a bullish stock market cycle still young in historical terms (this cycle is just 2.2 years old vs. an average of 5 years).

DeepSeek causes waves in the AI segment.

The news announced by this Chinese AI startup, just a few days ago, has caused jitters within the markets by unveiling an advanced AI model (R1) capable of competing with US solutions such as ChatGPT, offering similar performance at a substantially lower operational and training costs. While it is true that the technology is open source and accessible to everyone, there are doubts as to whether the real cost of its development is genuinely as low as the 6 million dollars being claimed. There are also doubts over the supposed absence of high-end chips, the origin of the data, and whether or not it has been able to leverage on the existing solutions created by other companies.

If confirmed, it would be a "disruption within a disruption", meaning less need for high-capacity semiconductors, and also with lower requirements in terms of processing capacity and energy requirements, and without the need for new data centres. In any case, the news is still very confusing and there is no assurance whatsoever that everything being claimed is actually true. For instance, the way the costs have been measured is not uniform, as steps such as data cleaning —used to train the algorithm— may have been omitted.

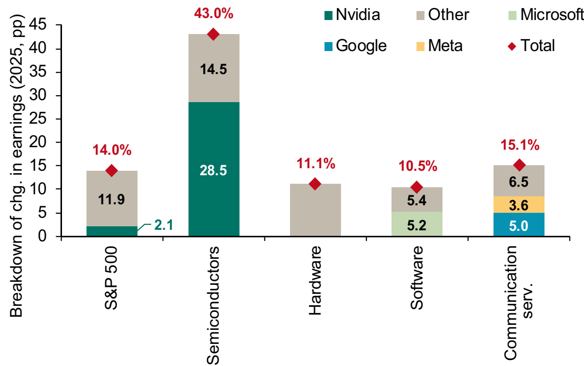
Nvidia would be one of the biggest losers if this new paradigm is confirmed, because it markets the chips offering the highest processing power and therefore commands the highest margins in the industry (50% on average). Nvidia's potential problem is not in its valuation, with multiples of 27 times in line with its main competitors, but in the sustainability of its growth. The Chinese app could make the computational power advantage less of a big deal, thus reducing the need to invest so much money in high-end GPUs. However, an alternative avenue has emerged through what is known as the Jevons paradox, whereby making a technology cheaper to implement increases its use, meaning that DeepSeek could even fuel further sales growth.

At any rate, the emergence of a new competitor may be bad news for a few names (Nvidia, OpenAI, Alphabet or Meta), although we reckon it will be good for productivity and the economy in general.

To what extent could a potential fall in Nvidia's share price pose a systemic danger? Nvidia is the second largest company in the MSCI World, and alone is responsible for 13% of the S&P's entire gains from the 22 October lows. In terms of 2025 earnings (estimated), Nvidia is expected to contribute 15% of all index growth. Sizeable figures that inevitably generate uncertainty, as everyone nervously waits for all the new information to be confirmed. Apart from this, we believe that there are segments in technology, such as cybersecurity or software, that will continue to perform well, as they are more isolated from this new disruptive event.

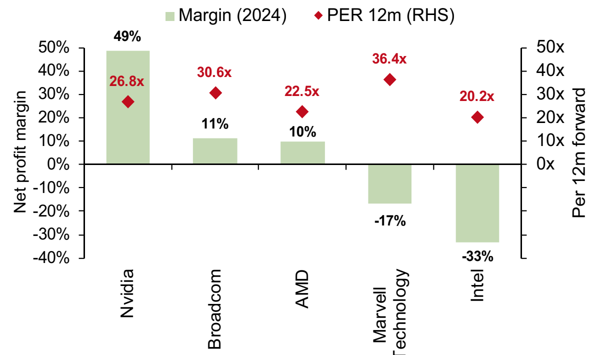
33. NVIDIA ACCOUNTS FOR 66% OF SEMICONDUCTOR PROFIT GROWTH

Sources: Refinitiv and Banca March



34. THE VALUATION IS NOT THAT HIGH CONSIDERING PROFIT MARGINS

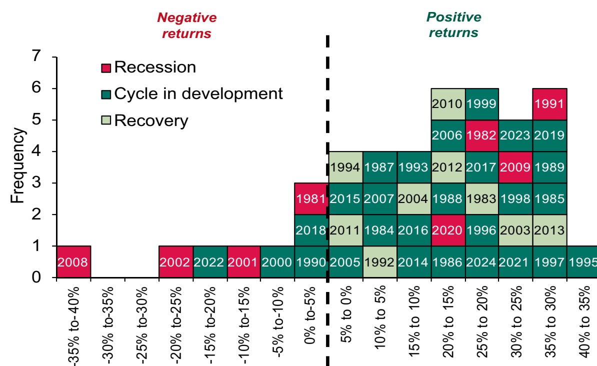
Sources: Refinitiv and Banca March



Constructive given the resilience of the economic cycle.

35. S&P 500 RETURN BY YEAR AND PHASE OF THE CYCLE (*)

Sources: Bloomberg and Banca March



(*) Recession and recovery are phases of our cycle model, while the other two (expansion and slowdown) come together in the developing cycle.

Timid but sufficient growth in the global economy will support earnings growth, which is the main fuel for further stock market gains.

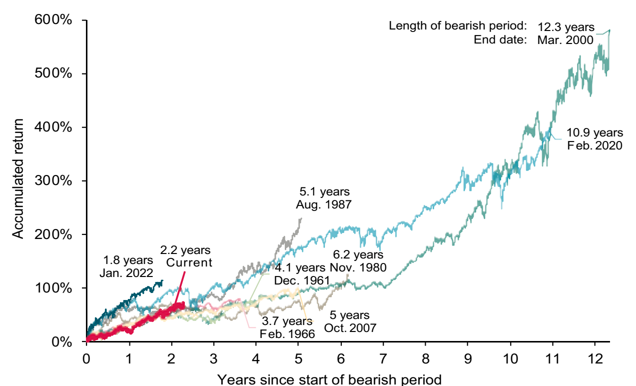
When interest rates fall and the economy achieves a soft landing, stock markets tend to rise. On average, the S&P 500 has added 17% in the 12 months since the first rate cut, yet so far —over the four months since September— the market barely managed to gain 7%.

A relatively young stock market cycle that has only been running for two years compared to an average duration of five years.

After the low reached in October 2022, the bull market has now been running for two years and three months, with growth that is in line with the historical average (+70%). These figures reveal that the current course of equities is not as explosive or long-lasting as it has been in average terms, and should be viewed in a context where the positive years far outnumber the negative ones (80% of the time since 1981).

36. S&P 500 FOLLOWING THE FIRST INTEREST RATE CUT(*)

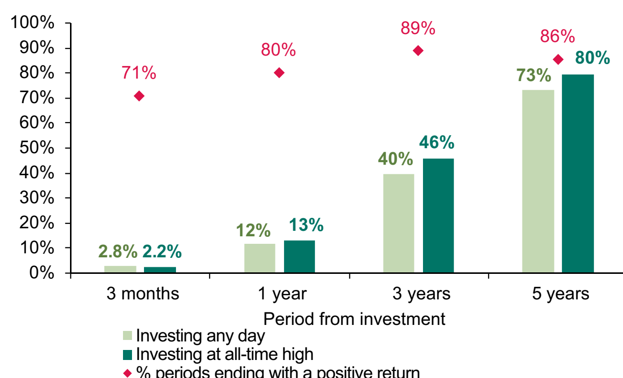
Sources: Bloomberg and Banca March



Historically speaking, buying at highs has not been a bad strategy.

37. S&P 500: RETURNS FROM INVESTING AT ALL-TIME HIGHS

Sources: Bloomberg and Banca March



The S&P 500 has seen some dizzying price increases over the last two years (+20.3% in 2023 and +31.8% in 2024), yet we still believe that we should remain invested in equities.

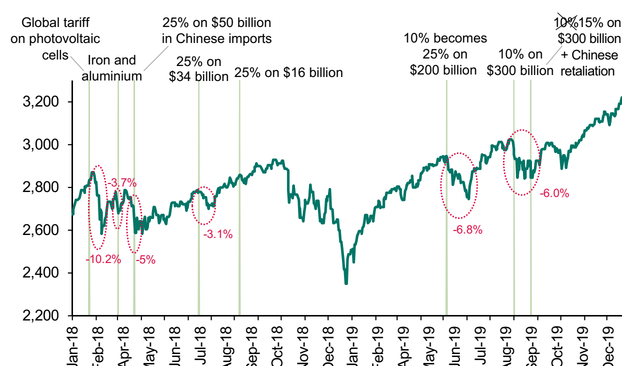
As the figure shows, with data since 1972, it is plain to see that the strategy of buying when the market is at an all-time high is more profitable in the medium run than investing on any other average day, no matter how counterintuitive that may seem. This strategy, which benefits from the pent up momentum of the indices, provides up to 6 pp higher returns over a three-year time horizon. These figures should be viewed as a call to action, looking at the medium term, and as a means of avoiding excessive liquidity positions.

Lessons learned from the Trump 1.0 tariffs: *America first* and volatility means opportunity.

Despite this empirical strategy and starting from neutral exposure levels in our portfolios, we should be prepared for a more volatile scenario following the relative calm seen over the last few months, as 2024 was an exceptionally atypical year due to the straight-line nature of the increases. More precisely, it was the third longest period in 20 years in which the S&P 500 did not post a daily decline of more than -2%; a streak that ultimately ended in July after more than a year and a half (356 consecutive trading sessions).

38. S&P 500 AND TARIFF ANNOUNCEMENTS

Sources: Bloomberg and Banca March



In our view, a tougher and more intransigent US trade policy, coupled with demanding index valuations and the recent emergence of China in the race to conquer the AI market, will lead to greater volatility in the stock markets and offer opportunities to increase risk, given what is proving to be a resilient economic cycle.

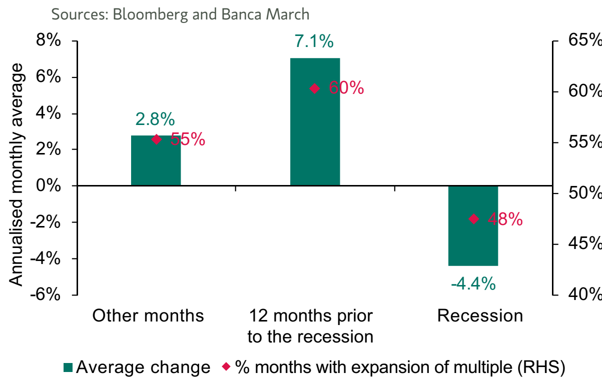
We expect to see 9.2% growth for the global stock market, driven by corporate earnings.

The stock market's potential for 2025 is predicated on an improvement in corporate earnings, which we believe will boost the MSCI World by 9.2% throughout 2025. To be more precise, we expect earnings to improve by around 10% (slightly less than the consensus view of 12%), thanks to an economy that continues to deliver an overall nominal GDP increase of over 5% and a more evenly spread out earnings outlook among the various sectors of the economy (all sectors expected to grow in 2025).

We have also chosen to be conservative when it comes to the multiple, as we expect to see a very gentle contraction as we head further into the year, even though multiple contractions are more common in a recession. We remain wary, mainly due to valuations that are currently at 18x earnings, 13% above the historical average.

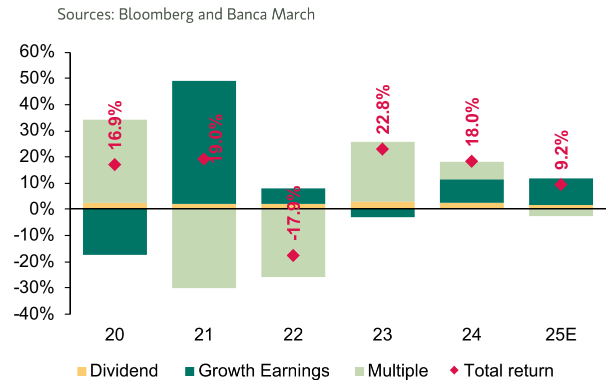
39. MULTIPLE BY CYCLE SCENARIO(*)

Sources: Bloomberg and Banca March



40. MSCI WORLD: BREAKDOWN OF RETURNS

Sources: Bloomberg and Banca March

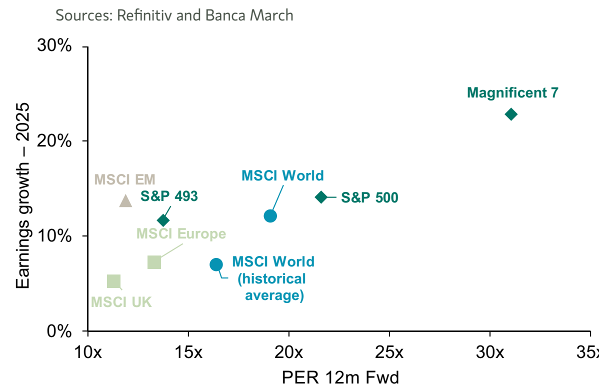


(*) Recession marked by the NBER.

Our regional preference remains the United States. Higher quality business, a heavier tech segment, a more evenly distributed growth profile, and a better relative performance in relation to Trump's tariff threats.

41. PER 12 (E) VS. EARNINGS GROWTH, 2025

Sources: Refinitiv and Banca March



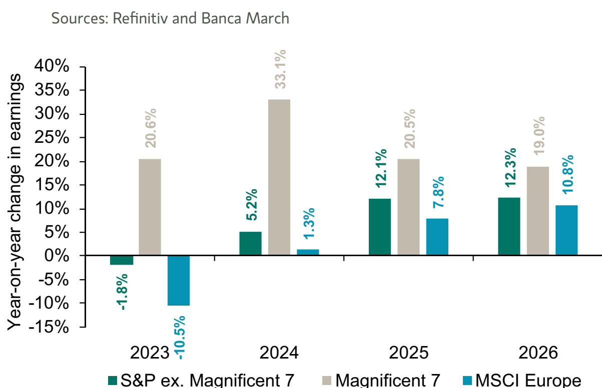
By region, we maintain our bias for the United States. a country whose listed companies continue to outperform other regions in terms of the quality of their core businesses and expected earnings growth. The S&P 500 is able to transform 9 dollars of free cash flow for every 100 dollars of sales, compared to 8 in Europe or 7 among emerging markets. Moreover, US companies will grow more than their European counterparts, and at similar valuations once adjusted for the effect of the Magnificent 7.

If we look more closely at earnings dynamics, we can see that a large part of the expected growth for 2025 (34%) is still down to the performance of the Magnificent 7. Even so, the earnings of the remaining 493 companies will climb to levels of 12.4%, 2.1 times more than that seen in 2024. The US also happens to have a heavy tech segment —currently our favourite and the one promising the highest expected growth (32% for the S&P 500 and 18% for the S&P 493)— when compared with other developed markets such as Europe (8%) or Japan (14%).

Last but not least, with international trade expected to be rattled once again by the United States, the high domestic exposure of US companies (almost three-quarters of sales) offers a refuge amid the volatility sure to ensue from Trump's announcements. This was demonstrated during Trump's previous term, when US equities outperformed the other international indices.

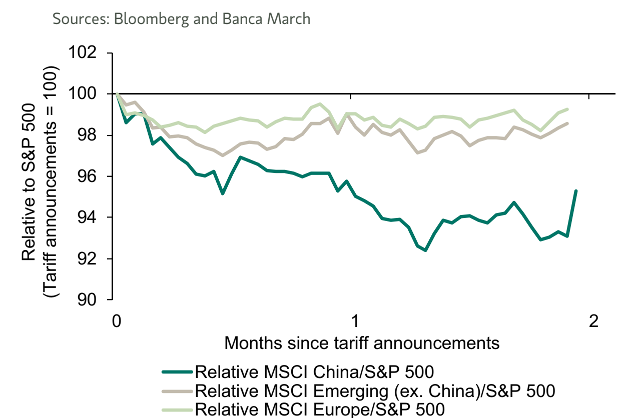
42. EARNINGS PERFORMANCE BY INDEX

Sources: Refinitiv and Banca March



43. INTERNATIONAL INDICES VS. S&P 500 FOLLOWING THE TARIFF ANNOUNCEMENTS

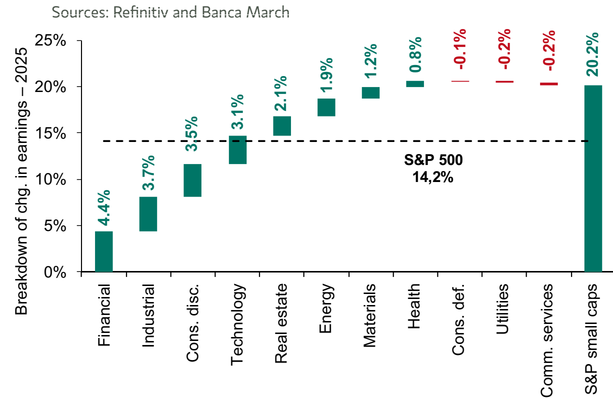
Sources: Bloomberg and Banca March



We continue to favour the US domestic front, with a preference for medium and small US companies, which will outperform large companies in 2025 on the back of lower financing costs and increased corporate activity.

44. S&P SMALL CAPS: SECTORAL CONTRIBUTION TO EARNINGS GROWTH

Sources: Refinitiv and Banca March



Aside from large US corporates, we genuinely believe it is essential to add an extra layer of padding providing even more exposure to the US economy, this time through medium and small US companies.

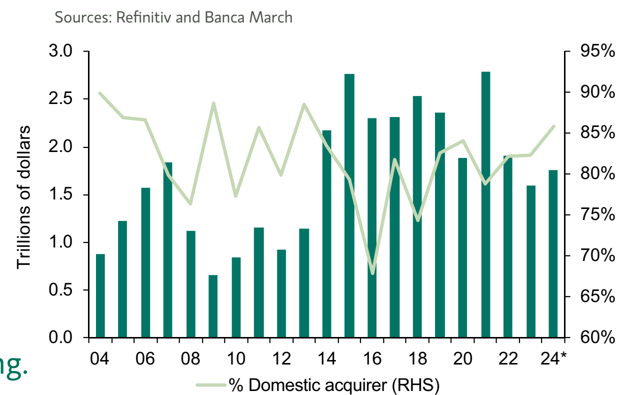
In our view, domestic businesses stand to benefit from the new administration, which will provide further support for earnings growth that is already outpacing that of large companies (+20% vs. +14%), especially among financial and industrial companies, supported by a steepening yield curve and a reduction in borrowing costs, respectively.

On the last point, it is worth noting that the corporate world within this segment is more leveraged than large companies (4.6 times net debt to EBITDA vs. 1.5 times for the S&P 500), which has been one of the biggest drags on these companies in recent years. With the rate cuts finally under way, lower borrowing costs will allow them to increase their net margins and therefore increase their profits. Moreover, this transmission or feed-through will be faster among small and medium-sized companies than in the case of large companies, as more than half of the debt held by the former is at a floating rate, compared to 24% at larger companies.

Another interesting factor will be the upswing in corporate activity also arising from the normalisation of borrowing costs. We expect this new business to push up the multiples and unlock the true value of these types of companies. What's more, a significant proportion of mergers and acquisitions in which a US company is the target are carried out by companies from that country, meaning there would be no objections from the government with Trump in charge.

45. UNITED STATES: M&A VOLUMES WITH DOMESTIC TARGET COMPANY

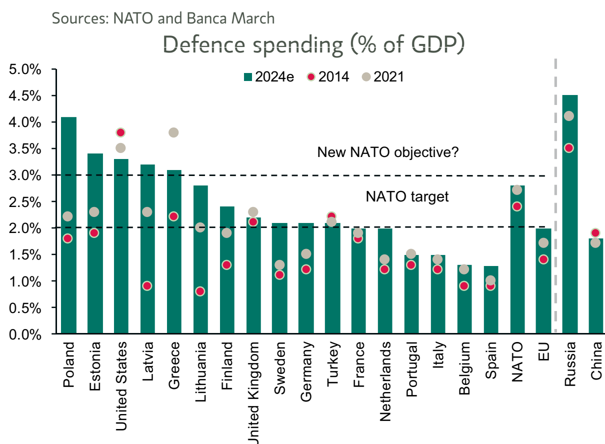
Sources: Refinitiv and Banca March



Trump's return will mean higher defence spending.

46. THE RUSSIAN THREAT BOOSTS DEFENCE SPENDING

Sources: NATO and Banca March



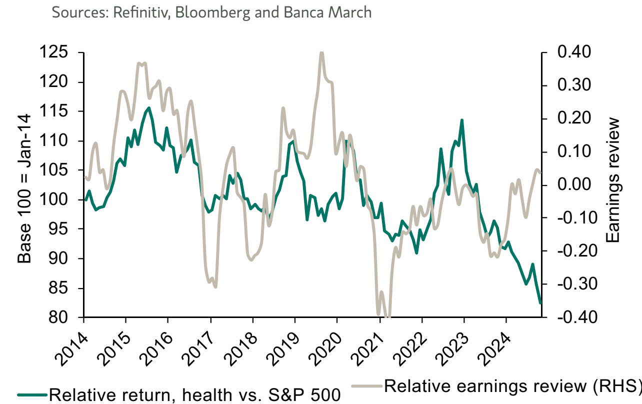
Military spending has continued to increase, with 23 countries now meeting the NATO target (vs. only six in 2021). Trump's return to the White House will undoubtedly lead to an increase in the spending target. Just a week ago, he called on NATO members to raise it to 5% of GDP, which will undoubtedly put pressure on Europe. The spectre of a return to a covert cold war lays bare the low level of defence R&D in Europe (only 4.5% of the total vs. 16% in the United States), with ample room for further spending on cybersecurity activities, as well as low levels of military equipment.

Notably, if we compare the levels now with those existing at the end of 1992 (the end of the Cold War), there are currently 77% fewer combat tanks, 60% fewer combat aircraft, and 50% fewer submarines among the European allies as a whole.

Health sector: growth potential not yet reflected in share prices.

47. DIFFERENTIAL GROWTH AND GOOD VALUATIONS

Sources: Refinitiv, Bloomberg and Banca March



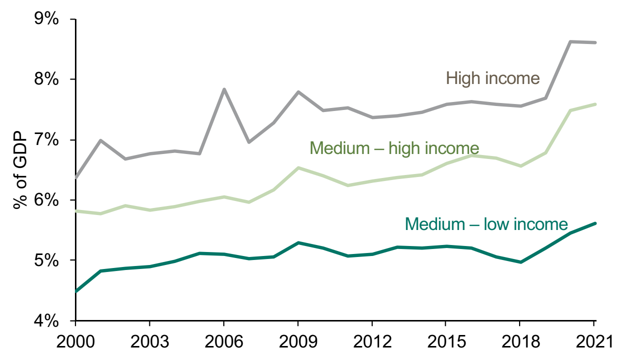
Healthcare companies have started 2025 on a stronger footing (+6.6% MSCI sector index), although it is only a partial recovery from the previous declines (-9% since the end of August). Underlying this is the political and regulatory uncertainty associated with the arrival of Robert F. Kennedy Jr. as U.S. Secretary of Health, given his often critical views of the pharmaceutical industry. Also doing little to help are the discussions surrounding the reduction of drug prices in the country, disappointment over the launch of certain novel treatments, or the drought in corporate activity seen throughout 2024 (the first year in the last decade in which no corporate transactions worth more than $5 billion took place).

Despite this context, we maintain an optimistic view due to the industry's defensive nature and high growth potential. Notably, among the safe-haven sectors, the healthcare sector happens to have the highest growth expectation (+22% EPS 25 (e)), as well as the largest discount in terms of valuation with respect to its historical average (PER of 16.7x current vs. 17.9x on average). This optimism is also fuelled by a high level of innovation within the industry, with key advances in treatments for obesity, genetic therapies, cancer or dementia, or high exposure to the dollar (>40% of revenues). Moreover, the integration of AI promises to optimise productivity within the sector by improving diagnoses and reducing errors in clinical trials.

We have also factored in that the ageing population will ensure continued growth in healthcare spending which, coupled with lower borrowing costs for smaller pharma companies as interest rates continue to come down, should stimulate corporate activity within the industry. This context provides further assurance of secular earnings growth in the sector, with an average EPS increase of 7.5% annualised between 2007 and 2026 (e), higher than the 6.5% forecast for the MSCI World over the same period.

48. HEALTHCARE SPENDING WILL CONTINUE TO INCREASE

Sources: Source: Bloomberg, Refinitiv and Banca March



CURRENCIES

The dollar gets off to a strong start in 2025.

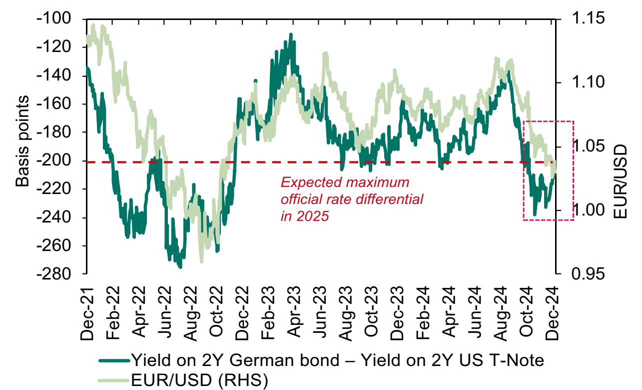
As happened back in 2016 following his first election win, Donald Trump's resounding victory in the US presidential elections has reinvigorated the greenback. The US currency moved from 1.12 EUR/USD back in October to end the year at 1.026 EUR/USD, a level it is currently replicating following the imposition of tariffs on Mexico, Canada and China.

Despite the greenback's strong forward momentum, not everything is playing in its favour.

The monetary policies of the Fed and the ECB start to pull apart. In the case of the euro area, anaemic growth coupled with inflation close to its target have prompted the ECB to set a rate-cutting target of -100 bp for the year as a whole, with one cut per quarter. The Fed, meanwhile, has more room for manoeuvre on the economic front and the futures market reckons that it will cut by just 50 bp in 2025, thus making it a favourable interest rate scenario for the greenback.

49. 2Y SOVEREIGN SPREAD VS. EUR/USD

Sources: Bloomberg and Banca March



Moreover, the US economy is buoyant, supported by a resilient labour market and strong consumption, which are in turn supporting the dollar. Meanwhile, the euro area as a whole has seen more subdued growth, supported by the southern service economies and weighed down by the industrial and political crisis in the Franco-German axis. Despite expectations of a partial recovery heading into 2025 (to +1.2%), the euro area is expected to grow by less than half that what the US economy will achieve (+2.6%), which also plays against the single currency.

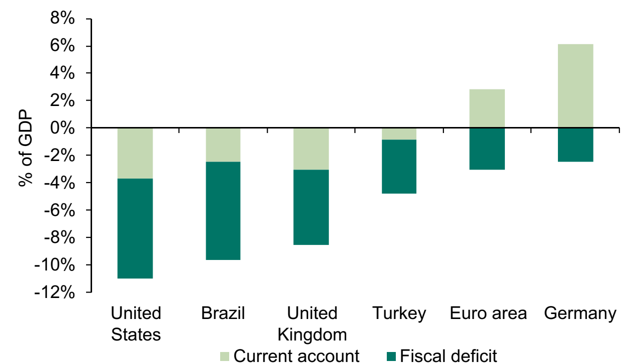
Other factors supporting the dollar include strong global demand for the currency from central banks, and the fact that the dollar maintains its historical and unique role when it comes to international trade. The US also happens to have higher real rates than other major economies.

In spite of everything, the punishment being inflicted on the euro may end up being too much, thus limiting the dollar's upside potential. The US public deficit looks to have closed 2024 at around 7% of GDP (vs. 3% for the euro area) and could continue to grow if, as was the case during Trump's first term, the planned tax cut is not then followed by a similar —or greater— reduction in spending. This further distortion of the fiscal imbalance and the ongoing overvaluation of the dollar in terms of purchasing power parity (PPP) make it harder for the greenback to continue gaining ground in the long term.

50. TWIN DEFICITS INCREASE IN 2024

Sources: Bloomberg and Banca March

Aggregate c/a and fiscal balance (% of GDP)



The dollar will continue to hold the lead, although its appreciation potential will likely diminish from current levels.

The expected range for the euro/dollar pair is 1.02/1.09 (EUR/USD). Although the dollar continues to show its resilience, supported by an interest rate differential and growth, the upside potential is more limited from the current levels.

The pound sterling closed out a positive 2024 in its relationship with the euro.

The British currency ended 2024 at 0.827 EUR/GBP, up 4.8% against the euro. This movement was a reflection of moderate growth within the local economy, inflation way off the Bank of England's target (core inflation +3.2% YoY in December) and just one rate cut of 25 bp to 4.75% at the last three meetings. Since then, the price has retreated to levels of 0.84 EUR/GBP, as the nation awaits the release of the new budgets, worse activity data and uncertainty over US tariff policy.

The UK's possible entry into recession, currency divergence with the euro area and the country's new budget will set the course for the euro-pound pair in the coming months.

On the economic front, activity is losing steam and it is becoming increasingly likely that the UK economy will have contracted in 4Q24, following the stagnation seen in 3Q24. This aspect heaps more pressure on the Labour government, which presented a 2025 budget with economic growth as a priority objective, and dominated by the biggest tax hike since the post-war period, coupled with a significant increase in public spending. It is a budget that, all things said, portends a slower correction of the public deficit and also poses upside risks to inflation.

Meanwhile, on the monetary policy front, the dilemma is only getting worse for the Bank of England, which is caught between still high inflation and upside risks, and structurally low growth. In our view, the interest rate differential between the two regions and the outlook for the coming quarters will continue to set the tone. The Bank of England (BoE) is expected to cut rates only twice in 2025, to 4.25% in a cycle more aligned with the Fed than with the ECB, creating a still favourable spread for the pound against the euro.

After closing hedges at around 0.86 EUR/GBP, and with the arrival of a government more closely aligned with the EU, our view is now somewhat more constructive.

In short, lower rate cuts in 2025 should support the pound, although the misalignment of its public accounts raises some concerns, which could eventually weigh on the currency. Our view on the pound is now somewhat more constructive, what with the arrival of a new government that sees eye to eye with Europe and a BoE that is somewhat more cautious than the ECB when it comes to cutting rates. We would look to sell at levels near 0.82 EUR/GBP and look for an entry point at 0.86 EUR/GBP.

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