Allianz Global Investors

12/2024

Market Snapshot

Equity Snapshot

United States

US equities were mixed over December. The tech-heavy Nasdaq Composite Index held up relatively well due to ongoing interest in mega-cap growth stocks, but the broad-based S&P 500 Index lost ground as sentiment was knocked by the Federal Reserve's (Fed) more hawkish rate projections for 2025. Small-cap stocks, which had surged in the aftermath of Donald Trump's landslide victory, slumped even more. While the Republican Party will control the White House, Senate and House of Representatives from January, December brought early indications that the president-elect may struggle to win approval for some of his proposals: a federal shutdown was narrowly averted after a handful of Republications voted against Trump's proposals to get rid of the debt ceiling.

The US economy appears in solid health. Non-farm payrolls exceeded forecasts in November, rising 227,000 over the month. The flash S&P Global US composite purchasing managers' index rose to 56.6 in December, the highest level since March 2022. Services activity surged to 58.5, signalling the strongest expansion since October 2021 although manufacturing activity slid to 48.3, indicating the sixth successive month of contraction. Retail sales also beat forecasts, rising 0.7% over November.

US inflation accelerated to 2.7% in November, up from 2.6% in October, although core inflation held steady at 3.3%. The Fed cut rates by 25 basis points (bps) but lowered the number of expected 25-bps cuts in 2025 to two from four at the previous FOMC meeting. The more cautious guidance reflected concerns that progress on bringing inflation back to target may have stalled as well as uncertainty over the impact of Trump's policies.

Europe

European equities closed December with flat returns. The weakness of the euro helped to support the outlook for the region's exporters, although the threat of higher tariffs once Donald Trump regains the White House continued to weigh on sentiment. The political turmoil in France lessened after Michel Barnier was replaced as prime minister after failing to get parliamentary backing for his budget of tax rises and spending cuts. His replacement is former justice minister Francois Bayrou, a centrist politician. Germany, meanwhile, faces elections in February.

The flash HCOB euro-zone composite purchasing managers' index (PMI) came in at 49.5 in December. While that was a modest improvement from November's 48.3, it still represented two consecutive months of contraction, with economic momentum the weakest since the start of the year. Services activity returned to growth, but manufacturing remained deep in contraction territory. The European Central Bank cut rates by 25 bps, its fourth cut of the year, and officials indicated that they are growing increasingly confident that inflation is now near its target.

Asia

Asia ex Japan equities were flat in December but overall finished 2024 with positive returns. Chinese stocks moved higher in the month, buoyed by further signs that Beijing is taking steps to bolster economic growth. China loosened its monetary policy stance for the first time in 14 years, changing it from “prudent” to “moderately loose.” Additionally, China’s policymakers called for efforts to boost consumption and domestic demand at the annual Central Economic Work Conference, a high-level meeting in which top officials plan the next year’s economic agenda. Higher US bond yields and the stronger US dollar pressured some other parts of the region. ASEAN markets were broadly lower. Thailand was the weakest market in the region, with Indonesia and the Philippines also recording moderate declines. Taiwanese stocks rallied modestly, while South Korea stocks lost ground as sentiment was knocked by a political crisis when the nation’s president tried to impose martial law. India also closed the month lower, with economic growth in the third quarter of 5.4% signalling a significant slowdown from earlier in the year. The slowdown likely represents a weak patch caused by weather events and lighter government expenditures amid state elections rather than more structural problems.

Bond

Global bonds sold off on the hawkish tone of the US Federal Reserve despite rates being cut by 25 basis points (bps) in December. Policymakers issued a more cautious guidance, where the number of expected 25-bps cuts were reduced to two from four at the previous FOMC meeting. 10-year US Treasury yields hit a seven-month high of 4.6%. In Europe, despite the European Central Bank cutting rates by 25-bps as expected by the market, Euro-zone bonds did not fare better, where yields of the 10-year Bunds rose to 2.4%. The 10-year Gilts followed the same narrative, where yields rose by 33 bps to 4.6%, a level not seen since October 2023. In contrast, for Japan, the 10-year Japanese Government Bonds were little changed at 1.1% as the Bank of Japan kept rates on hold. Policymakers over at the BOJ were reluctant to raise rates given concerns over the growth prospects of the global economy amid uncertainties and whether Japan’s inflation rate can sustain above 2%. Meanwhile, it was a different narrative in China, where 10-year Chinese yields fell to a record low of 1.7% on the back of loosening monetary policy stance for the first time in 14 years from “prudent” to “moderately loose”.

Outlook

The remarkable Presidential return of Donald Trump compounded a year of exceptionalism for the US stock market as the S&P 500 returned 33% (in EUR) while the MSCI Europe returned just 10%. Sentiment for US equities remains almost uniformly positive amidst a mixed outlook for other major developed markets., despite the strong recent divergence. The extreme excitement surrounding artificial intelligence (AI) and the technology companies that make up one third of the value of the US market partly explain this, but with such high expectations, the evolution and monetisation of AI will be a key theme for 2025. We do however note some early sell-side commentators and our own Multi Asset team slightly lowering their conviction on the US. The 2022 correction remains fresh in the minds of some investors as valuation multiples expanded without the earnings growth to back them up. 2024 was the second consecutive year of sluggish EPS growth across Global indices (MSCI ACWI: 2023 c. 0%, 2024 c. 5%), but significant > 20% index returns per annum. The risk now is market complacency, particularly given elevated valuations in some spaces, and the potential for sudden volatility from unexpected geopolitical or macroeconomic events.

In the US, positive sentiment continues to surround companies that are leveraging AI to cut costs and create new revenue streams, with positive earnings revisions starting to qualify some of these bets. This trend underscores the market's focus on innovation-driven growth, particularly in industries where AI adoption is creating measurable operational efficiencies and competitive advantages.

Europe is typically and rightfully a cheaper market than the US, however the valuation disparity has increased recently. This may present new investment opportunities. Europe’s consensus EPS projection for 2025 is an ambitious 10%, the level it begins at in most years before downward revisions ensue. Lending some credence to this blue-sky scenario is the relatively weak Euro, beneficial to our global exporters that our strategy favours in hunting for high Quality, global market leaders. The US is a key export market where a stronger macro environment can support our local names too, and this month we saw several of our luxury and consumer stocks rising on this fresh optimism. We believe tariffs will have limited impact on our holdings, who diversified supply chains during the 2019 Trade Wars and 2020 Pandemic and are largely already manufacturing locally in the US.

A wildcard remains China: whether continued stimulus can finally spark a recovery or if the structural challenges in its property sector and slowing consumer demand will weigh further on global growth.

In the new year, investors will need to weigh concerns over weak macro prints, sustained earnings growth, inflation in the US, and geopolitical uncertainties... versus pockets of rapid outperformance, likely driven by surging growth in AI and related hotpots like data centres.

In summary as we enter the new year, the balance between cautious positioning given many unknowns and opportunistic investment in transformative technologies will be best navigated by active stock pickers. We welcome the results of the Q4 earnings season, due in the next few weeks, to help clarify the current demand picture and provide a useful update from our companies on their 2025 outlook and strategy.