Webcast Summary
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2025 Expectations: A New Mindset for Portfolio Design

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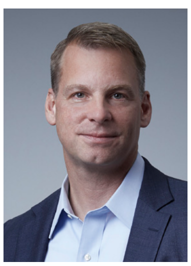

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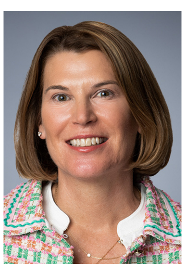

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In Brief

- Understanding long-term capital markets expectations and building diversified portfolios are crucial to navigating this environment.
- Companies that can successfully navigate increased costs and pressures on profit margins will be better positioned to deliver returns for investors.
- Non-US equities with lower relative valuations and low expectations and fixed income assets, with their higher yields and lower risk, should be a key component of a well-rounded portfolio.

The current investment environment is characterized by significant regime shifts, marked by higher interest rates, inflation and increased volatility. Companies must adapt to changing fiscal policies, labor market dynamics and technological advancements. In this rapidly evolving economic landscape, businesses must navigate a complex web of macroeconomic and microeconomic factors to remain competitive and profitable. Understanding these shifts and their implications is crucial for businesses and investors aiming to thrive in this uncertain era.

Navigating post-pandemic economic challenges

The decade from 2010 to 2020 featured low interest rates, low inflation and low growth, creating a predictable and stable environment for businesses and investors. The COVID-19 pandemic disrupted this stability, leading to an environment characterized by higher rates, growth and inflation. Significant government spending in response to the pandemic has fueled economic growth and volatility. Additionally, geopolitical tensions and policy changes have made global trade relationships more unpredictable, adding complexity for businesses operating both domestically and internationally.

In this new macroeconomic environment, companies face increased costs and pressures on profit margins. Labor shortages and rising wages present significant challenges, as segments of the labor market have not fully recovered from the pandemic. The 55 and over age group, in particular, has not returned to the workforce, contributing to upward wage pressures. Companies must find ways to manage higher input costs and pass them on to consumers through pricing power. Those that can successfully navigate these challenges will be better positioned to deliver returns for investors.

Build diversified portfolios as AI transforms businesses

Technological advancements, especially in artificial intelligence (AI), are transforming the business landscape. The true economic value of AI hinges on who can effectively capture and monetize its benefits. While AI may improve productivity and consumer experiences, capturing and measuring a return on investment remains challenging.

AI has the potential to drive efficiencies and innovation but is not a solution for all cost pressures. The market's enthusiasm for AI might be overestimated, as the technology is still in its early stages, with an uncertain economic impact. Currently, AI serves more as a decision-making aid rather than a replacement for human labor. The competitive landscape for AI is becoming increasingly crowded, with many companies competing for market share, potentially leading to commoditization and pressure on profit margins.

For investors, building a diversified portfolio capable of withstanding various scenarios is essential in such uncertain times. Long-term capital market expectations can be a useful tool that can help investors in this process. This strategy involves using both quantitative and qualitative insights to develop expectations across countries, regions and asset classes. Key factors to consider for equities include real sales growth, valuations, profit margins and dividend yields. Within fixed income, current yields, credit spreads and curve shape are key building blocks to determining long-term return expectations.

Stay active in this complex investment landscape

The US market, which currently has both high corporate profit margins and extended valuations, presents unique challenges and opportunities. Historically, profit margins that reached current levels proved to be unsustainable over the long term, suggesting a potential reversion to the mean at some point. This reversion could impact overall market performance, making it essential for investors to consider the broader global equity landscape. Given that the US makes up a significant portion of the global equity universe, its performance will inevitably influence global market trends. Thus, a balanced approach that includes both US and international investments can help mitigate risks and enhance potential returns.

Tariffs and their implications on companies add another layer of complexity to the investment landscape. The uncertainty surrounding tariffs can delay corporate decision making, impacting earnings and increasing costs for both consumers and businesses. This inflationary pressure is particularly challenging for a consumer base already struggling with high living costs. Companies may need to adopt a "just in case" inventory approach, moving away from the "just in time" model to mitigate the risks associated with supply chain disruptions and tariff uncertainties.

The current economic landscape presents both challenges and opportunities for businesses and investors. The shift from a predictable, low but stable-growth environment to one characterized by higher rates, inflation and volatility requires a strategic and adaptive approach. Companies must manage rising costs and leverage technological advancements to remain competitive, while investors need to focus on building resilient portfolios that can withstand a range of scenarios.

The fixed income market, in particular, requires a nuanced approach in the current macroeconomic environment. Despite government and central bank interventions, the bond market independently determines interest rates based on global economic conditions. In today's environment, overweighting fixed income in investment portfolios can be a strategic move. High-quality, long-duration fixed income assets may not offer significant capital appreciation, but they provide a more favorable risk-adjusted return compared to riskier markets. The normalization of interest rates, driven by factors such as growth, inflation and productivity, suggests that fixed income assets will continue to play a vital role in portfolio management.

Conclusion

The evolving macroeconomic environment necessitates a proactive approach to portfolio management. Investors should prioritize diversification, considering both US and international equities, and remain vigilant about inflation and its potential impact on asset correlations. Fixed income assets, with their higher yields and lower risk, should also be a key component of a well-rounded portfolio. We believe active management and diversification will help investors navigate the uncertainties of the current market and position themselves for long-term success.

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