2025 OUTLOOK

LISTED ASSETS - JANUARY 2025

Trump is making a comeback: are Europe and China next?

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Editorial

The political agenda in 2024 was quite busy, with some scheduled elections and others that were unexpected. This all led to uncertainty, which was further fuelled globally by continued armed conflict in Russia-Ukraine and the Middle East and tensions in the South China Sea. However, these were not the only consequential events of the year. Climate change triggered a significant number of natural disasters, such as the devastating floods that hit Spain in November.

The US election results put an end to the suspense that had gripped the country for so long, but the fundamental elements that prevailed in 2024 will extend into 2025, i.e. political uncertainty on both sides of the Atlantic, major geopolitical risks, and the need to adapt to and mitigate climate change.

ECONOMIC PERFORMANCE POLARISATION

We had reiterated our confidence in the US economy this time last year. Although the political landscape is changing, the country's economy still seems to be on solid footing. Donald Trump has made many announcements, but we still do not know how he is going to steer his trade policy. While this is creating instability, the US economy remains dynamic. That said, we are aware of the negative repercussions that a trade war could have on the rest of the world.

As 2025 kicks off, we can see that Asia's economic growth is also robust. The US and Asia are therefore the world's two economic growth drivers, with Europe caught in between.

"In the short term, there are no signs that Europe will be able to overcome all of its challenges", confirms Hervé Guez.

In Germany, the industrial sector, especially the automotive industry, continues to struggle, and a trade war would only exacerbate this situation for the country that was once Europe's economic growth engine. In France, the prospect of a solution to the country's political crisis faded during the last few months of 2024, raising questions about its ability to attract foreign investment. Spain and Italy are faring well, but they both need the support of a strong Europe.

"The economy is becoming increasingly polarised. We see evidence of this polarisation in the world's major economic zones and also within sectors and companies. This is why it is becoming more challenging to invest in any given trend as a whole, and we must invest selectively across and within the themes that are shaping the global economy", argues Jens Peers.

Despite the risks, we would not completely rule out the possibility of a market rebound, especially in Europe and emerging countries towards the end of the year. Efforts to deliver a structural economic turnaround in Germany after the country's snap election in February would be good news. Such a rebound is more plausible as Europe's consumers have sizeable savings and many of the region's businesses boast solid fundamentals. Furthermore, Europe's job market is healthy, and its PMI indices are very low and therefore ripe for improvement. Such a cautious climate, of course, offers investment opportunities. Especially as the market scenario is similar to the one that prevailed after Donald Trump was elected in 2016, certain sectors could perform very well over the coming years.

WORTH WATCHING IN 2025

If Trump and his administration manage to control a potential surge in inflation, US equities could deliver returns in the region of 10% in 2025[1]. **We have identified promising sectors**, first and foremost **healthcare**. The sector is trading at attractive valuations and is set to benefit from R&D and technological advances and innovation-friendly regulations.

We are also positive on **artificial intelligence**. There are clear opportunities with the construction of many data centres and within the ecosystem of AI developers and integrators.

"We are not only interested in providers but also in businesses offering AI applications and those developing services based on AI technology. We are already seeing the positive effects on their earnings", points out Jens Peers.

> Structural trends like resource preservation, adaptation to population change, and the pressing need for climate transition are among our long-term investment themes which also offer attractive short-term investment opportunities thanks to technological acceleration.

The water industry, and all businesses involved in improving water access and water quality, are expected to trend positively. It could be a more challenging year for renewable energy, but we would not rule it out as it offers upside potential. As with the water industry, solutions facilitating access to energy should perform well, especially in those countries that are reluctant to make use of nuclear power. Donald Trump is not likely to reverse the development of renewable energy, as it has been gaining ground in various Republican states and generating sizeable economic gains. The water and energy sectors require infrastructure, networks, and therefore raw materials, including copper, so it will be worth watching commodity prices closely.

"On the other hand, I have some concerns about consumer-related sectors", Jens Peers adds. "Besides facing the threat of inflation, the retail sector might also struggle to hire staff in the US once migration flows are blocked."

NOT FORGETTING THE LONG TERM

While ESG[2] may no longer appear to be a major concern for investors, the investment themes centred around climate, the environment, social issues, and human capital continue to be essential in understanding companies and their strategies, both in the short and long term.

Despite some dithering on the regulatory front, businesses are already undergoing a transition as they understand managing sustainability issues is critical to their risk management and that they must adapt their business models if they want to remain competitive. So, it remains as important as ever to factor in these criteria when assessing a company's quality. The adaptation theme, as businesses prepare for these changes, is a promising investment trend.

Structural trends like resource preservation, adaptation to population change, and the pressing need for climate transition are among our long-term investment themes which also offer attractive short-term investment opportunities thanks to technological acceleration.

In today's highly polarised world, continued uncertainty could create volatility. This will require businesses to be very agile and calls for an active approach to asset management.

THE FUNDAMENTALS OF TODAY AND TOMORROW

Our convictions about the structural trends that are going to shape the future remain the same, regardless of the scenario that materialises in 2025. Even if only for pragmatic reasons, governments and economic actors alike are going to have to adapt to the effects of climate change as it threatens entire regions along with their inhabitants and businesses. Delays on introducing certain environmental and climate policies and regulations are not going to bring the transition to a halt. The drive to ensure good stewardship of humanity, the planet, and its critical resources will transcend unstable politics and economic contingencies and remain central to our investment convictions.

1. Source: Mirova.
2. Environmental, social and governance criteria.

A look back at 2024

1 Stable global economic growth

- The global economy grew by about 3% in 2024, roughly the same as in 2023, driven by services.
- Growth rates varied considerably between regions and between countries.

2 The US is strong as ever

- US economic growth reached 2.8%, buoyed by resilient consumer spending despite high interest rates.
- The dollar appreciated significantly.

3 A multi-speed Europe

- EU economic growth came to 0.8%, with major differences between the region's 'core' countries (France, Germany) and its 'peripheral' countries (Spain, Italy, Ireland) which performed better.

4 Central banks make a U-turn

- Central banks launched a long-awaited cycle of monetary easing.
- The Federal Reserve cut its key rate from 5.5% to 4.5% and the European Central Bank (ECB) from 4% to 3%.

5 Major state intervention in China

- China managed to achieve 5% GDP growth despite economic challenges.
- It launched a massive stimulus plan in the 4th quarter aimed at tackling sluggish consumer spending, the property slump, and deflationary pressures.

Source: Mirova.

6 A busy year on the political front…

▸ The US held its presidential election, France's National Assembly was dissolved, and Germany's coalition imploded.

7 … and on the geopolitical front

▸ The year saw heightened tension between Russia and Ukraine/NATO and in the South China Sea, and continued concerns about an escalation in the Middle East.

8 Credit markets boosted by healthy company financials

▸ Credit markets were buoyed by businesses with solid balance sheets and resilient operating margins, especially in the US.

▸ The high yield[3] segment performed well and investors showed a lot of interest in sovereign bonds issued by Europe's peripheral countries, with yield curves steepening on both sides of the Atlantic.

▸ 10-year yields increased in the first half of the year, while 2-year yields fell sharply, as did inflation.

9 The US in the lead

▸ US equity indices outperformed their European counterparts by 20%, mostly thanks to the Magnificent Seven[4].

▸ The year got off to a good start for equity markets as central banks cut interest rates.

▸ From September onward, investors favored cyclical sectors, prioritizing them over defensive sectors.

10 Donald Trump gets re-elected

▸ There are concerns about the repercussions of his policy guidelines for the economy and global trade, especially about the potential inflationary effects.

Source: Mirova.
3. High yield bonds are bonds issued offering high yields in return for a high level of risk.
4. A group of seven major tech stocks that have recently performed very well on the equity markets, especially in the US (Tesla, Apple, Amazon, Alphabet, Microsoft, Meta and Nvidia).
Past performance is not indicative of future performance.

Our convictions for 2025

MIROVA'S BASELINE SCENARIO[5]

Growth and inflation – the right balance

TRUMP'S RETURN

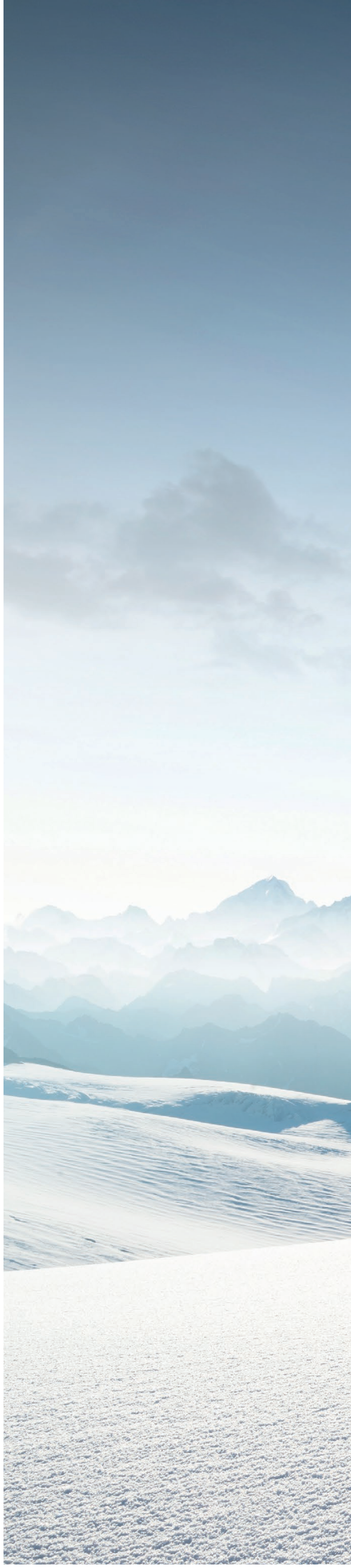
▸ The Trump administration aims for 3% real growth per year, a reduction of the deficit to 3% of GDP by 2028, and an additional production of 3 million barrels of oil per day[6]. The second goal appears ambitious, while the other two seem achievable.

PRO-GROWTH POLICIES

▸ Deregulation, tax cuts, and productivity gains are levers to support growth while mitigating inflationary effects caused by drastically lower migration flows and higher tariffs.

MARKET OUTLOOK

▸ The US equity market will slow whereas Europe's undervalued stocks should benefit from various triggers that might prove more positive than the markets expect.



5. Find out more about our alternative scenarios on page 12.
6. Source: Bloomberg.

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MIROVA'S BASELINE SCENARIO

MACRO PERSPECTIVES

USA

- Growth expected between 2.5% and 2.8% in 2025 thanks to deregulation, tax cuts, and further productivity gains.
- Resilient consumer spending and corporate investment.

Euro zone

- Growth expected between 0.8% and 1% in 2025, mostly on the back of higher real wages and a slight uptick in consumer spending.
- Low inflation, expected at 2% by mid-2025, could encourage the ECB to cut interest rates quickly.

China

- Growth expected between 4.5% and 5% thanks to stronger domestic demand and proactive stimulus policies.
- Inflation is set to bounce back to around 1% by mid-2025.

Main risks

- Higher tariffs, inflationary pressures, and a trade war.
- The threat of geopolitical conflicts and political instability in France and/or Germany.
- Lower consumer spending due to a potential negative wealth effect in the US and a prolonged property crisis in China.

Source: Mirova.

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Good timing on the political and economic front in the US

The year 2025 will kick off with Donald Trump returning to power. Despite his assertions, there is still a great deal of uncertainty about the economic policy he is actually going to be able to implement. Nevertheless, his nominee for Treasury secretary, Scott Bessent, has already set some rather clear guidelines in the form of a "3-3-3" plan. This will involve boosting real GDP growth in the US to 3% mostly through deregulation, cutting the budget deficit to 3% of GDP by 2028, and producing an additional 3 million barrels of oil per day in order to lower energy prices[7].

This is something of a balancing act. By embarking upon such a plan, we reckon that Donald Trump and his administration might manage to achieve 2.5% to 2.8% growth in 2025 while keeping inflation under control, which would enable the Federal Reserve to pursue its interest rate normalisation policy. This is a positive scenario, but will depend on how well the reforms are timed and calibrated.

GROWTH AND INFLATION: THE RIGHT BALANCE

Donald Trump will endeavour to deliver growth for his country by activating a number of levers.

1- Deregulation policies

Such policies are likely to foster innovation and remove barriers to entry in the technology and healthcare sectors. If it is confirmed that certain corporate behemoths are going to be cut down to size – there was talk in the autumn of breaking up Google – this will also create fresh opportunities for America's small- and medium-sized enterprises, which do not always have the means to keep up with the normative rate of inflation.

One advantage of deregulation policies is that they incur no expenditure but can create growth in the short term, thereby limiting the risk of inflation. Longer term, however, such policies can lead to excess and disaster, as with the subprime crisis in 2008.

2- Tax cuts

Tax policy is another lever to be activated. Donald Trump is going to extend tax cuts that were introduced in 2017 and are scheduled to expire in 2025, and he may even suggest cutting the tax rate further for firms producing in the US. This initiative will benefit American households and should cheer the markets.

However, Trump's fiscal stimulus plan might end up being scaled back when it reaches the Senate; although the Senate has a Republican majority, it takes a more moderate line than the President-elect does. Once again, this would limit the inflationary effects that such massive tax cuts would have on the US economy. To offset these tax cuts, the upcoming administration also plans to slash the federal budget, especially government operating costs; however, the $2 trillion in savings announced by Elon Musk seem almost impossible to achieve.

3- Productivity gains

Productivity gains are trending at around 2% and have kept unit labour costs growing by no more than about 2%, as per the Federal Reserve's forecast, despite wages rising by around 4%[7]. These productivity gains have helped to keep margins high, and well above the 15% average for US non-financial firms[7]. Donald Trump and his administration are counting on technology and artificial intelligence to help sustain or even add to these productivity gains at a time when the labour supply is expected to wane, especially for low-wage labour.

He is perfectly candid about his plans to slash migration flows, which is going to have repercussions for the job market and consequently for wage inflation.

If America's government and corporations manage to keep labour costs under control and thus channel inflation, the Fed should be able to maintain an accommodative monetary policy and cut interest rates another two or three times in 2025. So, policy interest rates could head towards a terminal rate of 3.75% by the end of 2025[7].

The drivers of US economic growth, therefore, will consist of deregulation policy, tax cuts, and productivity gains for businesses.

Source: Mirova.
7. Source: Bloomberg.

The AI value chain

Artificial intelligence (AI) is transforming the economy and redefining the way in which we work, particularly with the generative AI boom. Traditional AI has been around for decades, but the development of generative AI has significantly accelerated in recent years.

The artificial intelligence boom is likely to boost productivity significantly as businesses make the most of these technologies to optimise their design and production operations. A PwC study suggests that AI technologies could create significant business opportunities and contribute up to $15.7 trillion[8] to the global economy by 2030[9].

Here we take a look at the AI value chain as a whole, from businesses promoting its development and deployment to businesses making use of it and seeing efficiency gains. We already know which businesses were the first to succeed in the generative AI market, but we firmly believe that the market is under-estimating its long-term potential.

The key enablers of AI include the following:

- **Infrastructure**
- **Cloud platforms**
- **IT advisory**

The main beneficiaries of AI include the following:

- **Software**
- **Energy and utilities**
- **Data centres**

As investors, it is crucial for us to have an in-depth understanding of the driving forces behind these opportunities and to take a highly selective approach when choosing the companies in which we invest, as not all of them are fundamentally strong or taking a sound approach to harnessing the vast potential offered by AI.

AI might be creating a wealth of opportunities but, as investors, we also need to factor in the risks associated with the adoption of AI, including any potential social and environmental risks. AI raises ethical questions such as the risk of disinformation, worsening biases, threats to privacy, and breaches of intellectual property rights. We are therefore keeping a close eye on developments and encourage firms to introduce ethical AI guidelines and set up governance structures. We developed a targeted engagement strategy to address these risks with our investee companies.

AI might be able to create climate change solutions and rise to other environmental challenges in the future, but its environmental footprint is considerable. Global demand for the energy and raw materials associated with AI technologies is increasing in step with the demand for AI-related applications. This is why we are paying close attention to the way these resources are used and the sustainability targets set by the data centres and businesses involved in the AI value chain. We advocate for the development of AI that prioritises renewable and clean sources of energy and that makes use of technologies with high energy yield which can help to minimise carbon emissions.

Click here to read our latest publication

Trending Forward: AI across the value chain.

8. 1,000 billion.
9. Source: PWC, "PwC's Global Artificial Intelligence Study: Exploiting the AI Revolution".

THE LOOMING THREAT OF TARIFF INCREASES

One of the biggest unknowns of the coming year is the impact of higher US tariffs. There is little doubt that tariffs will rise; the uncertainty is more about the magnitude and timing of these hikes. Businesses are therefore reluctant to plan ahead, and investors are concerned - our view is that they are overplaying this scenario when it comes to non-US firms.

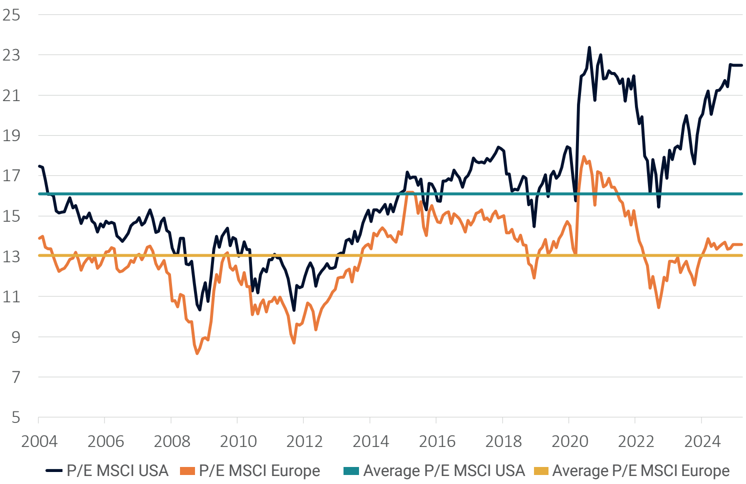
European businesses are unlikely to be hit too hard by higher US tariffs. They generate approximately 25% of their revenues in the US but only a 6% share is likely to come under these new tariff rates as the goods and services concerned are largely produced on US soil. Of this 6% share, just 3% would be taxable as the remainder is generated in sectors deemed strategic by the US administration (defence, healthcare, etc.)[10]. **We therefore believe that Trump's tariffs policy will have relatively little impact on the trajectory of European businesses, and this impact could be mitigated further by the euro's weakness against a still strong dollar**. That said, if the EU wants its economy to bounce back, it will have to find its own catalysts; it will not be able to rely solely on the effects of the US and Chinese stimulus plans.

China, meanwhile, is likely to bear the brunt of US tariff hikes. It is also being targeted by the higher tariffs announced for Mexico as Chinese products transit through this country on a massive scale. One of the big challenges for Asia's giant going forward will be to find other trade markets, but it should nonetheless manage to deliver 4.5% economic growth in 2025[10]. In the short term, China's massive stimulus plan aimed at stabilising its financial system is paying off. We expect the country to bring in further stimulus measures between now and March 2025 and achieve a more conventional economic recovery if the property sector gets back on a healthier footing. Political and trade headwinds will continue to take a toll over the coming years and so will the country's major structural problems (especially its demographics), which are likely to intensify.

MORE MODERATE PERFORMANCE IN THE MARKETS

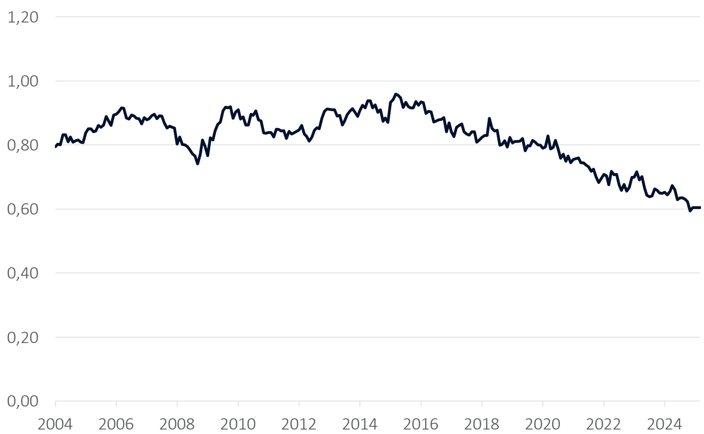
Having gained more than 25% for two years running, US equity markets would be expected to deliver more moderate returns over the years ahead. Stock valuations have reached demanding levels, with an average P/E[11] of 22x[12]. However, earnings growth forecasts for 2025 remain above their historical average and monetary policy is expected to continue easing, which should in theory limit downside potential. Moreover, S&P 500[13] stocks are trading on a median multiple of around 19x, which does not seem excessive considering corporate fundamentals.

PRICE TO EARNINGS RATIO (P/E) OF US AND EUROPEAN STOCKS SINCE 2004



Source: FactSet.

RELATIVE P/E: MSCI EUROPE VS MSCI



Source: FactSet.
Past performance is not indicative of future performance.

Source: Mirova.
10. Source: Morgan Stanley.
11. The Price to Earnings Ratio is a financial metric used to measure the valuation of a listed company. It corresponds to the ratio between a company's share price and its earnings per share (EPS).
12. Source: Bloomberg.
13. A stock market index based on the 500 largest companies listed on US stock exchanges.

We can expect returns of about 10% next year, possibly less concentrated in the Magnificent Seven than in 2024; other stocks could benefit more instead, largely thanks to deregulation.

European stocks, meanwhile, are trading at a historically steep discount of around 30% to US stocks (even after restating for sector bias or excluding the Magnificent Seven). However, there are various potential tailwinds that could come into play over the coming months: a peace agreement in Ukraine, German elections in February paving the way for budget reform, an improved macroeconomic climate in China, and a less harmful US tariffs policy than expected. We do, however, intend to keep a close eye on the political situation in France. Furthermore, the ECB's monetary easing could boost demand for loans. At the same time, consumers will continue to enjoy real wage growth and could reduce their savings rates to increase spending. For all these reasons, we reiterate our constructive position on European stocks out to the end of 2025.

Furthermore, the world's structural megatrends are as solid as ever, for instance those centred around the demographic, technological, and environmental transitions. They still offer a whole array of opportunities, especially those created by excessive market movements triggered by the US elections.

As far as the credit markets are concerned, we remain overweight in our fixed income portfolios. The asset class still offers an attractive risk/reward trade-off as the outlook for credit remains robust under a variety of macroeconomic scenarios. Regarding valuation, we have a preference for European corporate bonds over their US counterparts.

We also reiterate our positive position on the High Yield segment as its technical factors remain favourable (the segment has a supply/demand imbalance and available supply has decreased to the benefit of private debt funds and bank loans).

Our baseline scenario for the market therefore assumes that US policy will manage to find the right balance between growth and inflation and that Europe will struggle, although we would not rule out the possibility of an upturn in the region. Uncertainty about policy roll-out in the US and developments on the global geopolitical stage is likely to generate volatility, especially given how investors are positioned and how stretched valuations are. **We therefore believe it is essential to remain flexible and to take an active approach to managing risk assets over the whole of 2025.**

2025, Bitcoin in the spotlight

The stars could align for cryptocurrency in 2025, as they did in 2023 and 2024. A steep drop in global trade as a result of higher US tariffs would cause foreign demand for the dollar to plummet; on a constant federal deficit basis, this would enhance Bitcoin's safe haven status. All the more so as Bitcoin is being talked up in the US by the Trump administration, which includes Elon Musk within its ranks. The administration is expected to promote Bitcoin as an asset in its own right and, above all, make it easier to mine Bitcoin on US soil. Various countries are racing to do so as many of them are considering building up Bitcoin currency reserves. In the US's case, if for some reason Elon Musk fails to slash the federal budget by $2 trillion as he believes he can (and bearing in mind the country's substantial amount of federal debt), the Treasury would effectively have control over Bitcoin and would thus be able to secure the dollar's status. Trump's administration would be foolish to deprive itself of such power.

Source: Mirova.

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For better... and for worse

Worst case: an inflation surge in the US

With the federal deficit worsening, the job market taking a hit as migration flows slow, and higher tariffs pushing prices up, it is quite possible that fears of inflationary risk in the US will make a comeback this year as inflation would have a major impact on the global economy. The biggest unknowns at this stage include the magnitude of these tariff hikes and the way in which the world's other countries will react. Trump might use tariffs as an international negotiating tactic. If so, his tariffs policy might push inflation up temporarily but would not pose a structural threat as such; it would probably speed up the reshoring of production back to the US, which would boost growth.

However, a trade war combined with strained production capacity (due to budget stimulus and a steep drop in migration flows) would trigger a supply shock and prompt the Fed to halt monetary policy easing. Interest rates, both short- and long-term, could therefore move back up towards 5% and beyond, which would lead to much tighter financial conditions in the country. Borrowing costs would rise, affecting the property sector and household spending as well as curbing corporate investment, all of which are essential drivers of economic growth.

Such a scenario would have serious consequences for the stock markets. Stock valuations are high and share prices might be challenged if businesses are unable to deliver the same margin levels as before. The bond markets would also be affected by higher interest rates and increased risk faced by the corporate sector. With the property market in a slump and the stock markets depressed, the wealth effect would fall off a cliff after having benefited so many Americans for so long. And consumer spending is precisely what drove US economic growth in 2024. If 2025 turns out to be inflationary, the US could then fall into a period of stagflation and recession, which would have negative repercussions for the rest of the world.

The good news is that Donald Trump and his administration are aware that this scenario is all too plausible, and they are therefore likely to consider the financial markets and interest rates as decisive barometers of their policies.

Best case: an economic growth spurt in Europe

An end to the war in Ukraine would undoubtedly be a significant positive for Europe. But it would not be enough to drag its economy out of the doldrums for good, especially as any peace deal would be perceived as fragile in the longer term because Russia is concerned about NATO's presence in Ukraine, while the West has its own fears of Russia. Peace is by no means a fanciful scenario: Trump might make it a personal matter; Ukrainians might welcome some respite after six particularly gruelling months on the front; and although it would not be in Russia's interest given the progress it is currently making in the Donbas region, the country also knows that it would have something to gain from engaging in talks that might force the parties involved to respect what it labels as security guarantees.

An ideal scenario would involve fresh impetus originating from the stark reality exposed by this conflict that European countries need to cooperate more. Such cooperation might, if necessary, take place within an unaltered institutional framework and boost Europe's economic growth potential thanks to a massive long-term investment programme focused on infrastructure and a search for productivity gains.

Germany has the financial reserves necessary to invest: its household savings rate is still among the highest in Europe and its debt/GDP ratio is in the region of 60%. Without further investment, this ratio could even tumble to 40% by 2030, a level the European Commission deems too low. Germany's leaders would undoubtedly prefer to show that they can handle the current crisis without resorting to excessive interventionism. But even in a worst-case scenario, increased investment would have a concrete impact on the budget. It would benefit Germany's economic operators above all, but the effects would also spread to its neighbouring countries to some degree. If we consider all the ingredients - Germany's potential, improved consumer spending, the economic trajectories of Spain, Italy, and Ireland, not to mention the reindustrialisation taking shape in EU member countries - the markets may indeed get a pleasant surprise.

Investments in infrastructure and innovation would thus enable economic growth to bounce back and European stocks to eventually reprice[14]. This would also narrow the gap between the euro and the dollar and the spread between US and European interest rates.

Source: Mirova.

14. Process whereby the value of an asset is adjusted or revalued on the market.

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