QUARTERLY MARKET REVIEW

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The fourth quarter of 2024 saw incredible divergence of performance across equity markets. The U.S. enjoyed what looked very much like a speculative bounce as investors were quick to get excited about all the ways that incoming President Trump might be good for business. Conversely, outside the U.S. doom and gloom were the order of the day as the market pondered the potential impact of possible tariffs.

The Fed continued with modest rate cuts, while warning that expectations for further action in 2025 should be tempered as the economy remains robust and the specter of inflation lingers. Indeed, on the surface it could be argued that several of the incoming president's policies may prove to be inflationary. Against this backdrop, bond yields soared, and the dollar surged higher.

World equities, as measured by MSCI ACWI, returned -1.0% for the quarter. The U.S. was the standout performer, as the S&P 500 posted 2.4%. This was more than 10% ahead of the developed ex-U.S. and emerging markets, as the MSCI EAFE index fell -8.1% in USD terms and the MSCI Emerging Markest index dropped -8.0%. Of course, much of this was down to the strength of the dollar, and in local currency terms EAFE was down much less at -0.6%, while emerging markets were down -4.4%. Value was actually a modest winner in the developed ex-U.S. space, but in the U.S., growth won by an incredible 11.5%. At a global level, therefore, value was a big loser, as MSCI ACWI Value returned -4.7% for the quarter while MSCI ACWI Growth posted 2.6%.

Bonds had an extremely difficult quarter, with the 10-year nominal yield climbing 77 bps to finish the year at 4.58%. Meanwhile, the 10-year real yield rose a slightly smaller 61 bps to 2.24%, leaving the breakeven inflation figure up 16 bps at, a still pretty benign, 2.34%. Against this backdrop, traditional bond investors did poorly, although credit investors fared better as spreads generally tightened to provide an offsetting source of positive return. The Bloomberg U.S. Aggregate index returned -3.1%, the ICE BofAML U.S. High Yield index posted 0.2%, and the JP Morgan EMBIG Diversified index was down -1.9%.

Outlook

In these uncertain times, it is more important than ever to pay attention to valuation. Value enjoyed a solid quarter, and year, in developed ex-U.S. markets, although this was swamped on a global level by the dominance of growth in the U.S. Indeed, the last couple of years have demonstrated that strong investor sentiment towards growth and excitement in AI innovations cannot be underestimated. We are content to maintain our emphasis on value as we know that positive sentiment cannot bolster overly optimistic valuations based on unrealistic growth expectations indefinitely. Despite the ongoing uncertainty and volatility, we maintain a modest, but meaningful, exposure to our Resource and Climate Change strategies as Clean Energy stocks have fallen to very favorable valuations. It is still surprising that markets have not reacted with more disappointment to the Fed's cautious approach, and it remains to be seen what will happen if they are ultimately underwhelmed by central banks' actions. With the latest surge in the dollar, the divergence in valuation between the USD and many overseas currencies makes the case to invest outside the U.S. even more compelling.

Our views, and positioning, have not markedly changed and we reiterate many of the suggestions we offered last quarter:

– Exploit this global growth bubble with a long cheap value/short expensive growth equity strategy.

– Avoid the growth bubble completely by investing in liquid alternatives, although pure alpha strategies may struggle to compete for capital given the attractiveness of some traditional assets.

– Skirt around the growth bubble by pivoting your equity exposure to equities outside the U.S., focusing on value, and deep value, in particular. One very intriguing area is Japan small cap value, which further benefits from the cheapness of the yen along with improving governance.

– Although U.S. equities, in general, look to be the most expensive, the relative pricing of the cheapest fifth of the market, or deep value, looks an intriguing opportunity.

– Clean Energy looks to be trading at very cheap valuations given its future potential, though a note of caution here as the challenges of the last 18 months may not be over and it could be a bumpy ride.