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Capicura Partners – Outlook 1st Quarter 2025

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Full tills instead of empty stockings

- ***Swiss National Bank surprises again – Investment distress for CHF investors***
- ***Europe regulates – USA innovates***
- ***Deregulation neutralizes tariffs***
- ***Republican Sweep bodes well for US equities in the short run***
- ***With increased equity exposure into the New Year***

Despite all the adversity and challenges which 2024 held in store, global financial markets did remarkedly well both in equities and in bonds. US equities (again) stole the limelight and put on an impressive show first driven by technology and later in anticipation of a new government. Although Swiss equities have gained an above-average 7% since the beginning of the year (Swiss Performance Index), they rank at the lower end of the global equity indices. In addition, growth stocks have once again outperformed value stocks. Bonds have also been a delight this year, as both yields (EUR, CHF, USD) and credit spreads have fallen sharply.

«Investment distress 2.0»

The recent decline in CHF interest rates and the fact that nominal interest rates are barely in positive territory brings back memories of a difficult CHF yield environment. With 10-year Swiss government bonds offering a yield of just 0.27%, investors cannot compensate for the real loss of purchasing power due to moderate inflation of currently 0.70%. Despite the multiple interest rate hikes in 2022 and 2023, CHF real interest rates have been negative since 2020 (see Fig. 1).

Fig. 1) Real interest rates in Switzerland *(10y Swiss government yield minus annual inflation)*
Data: Bloomberg / Chart: Capicura Partners

With its 50 basis points interest rate cut last Thursday, the SNB once again surprised most market participants (including us). With a key interest rate of 0.50%, we are not far from the unpopular negative interest rates. For this reason, we consider CHF money market and bond investments to be unattractive. In this difficult interest rate environment, "boring" equities with stable business models and solid dividend yields of more than 3% are a "real" alternative. This applies mainly to the currently unpopular three major Swiss "bond-like" stocks. However, when we look beyond the Swiss border, our investment difficulties seem benign as our neighbours are up against multifaceted challenges.

«Political and economic stagnation in Europe»

The eurozone continues to struggle with stagnation and political uncertainties, particularly in the two largest economies. Germany cannot shake off its reputation as the "sick man" of Europe and has been confronted with industrial weakness for some time now. The break-up of the current coalition is a reflection of the ongoing disagreements in politics and has further destabilized the country. France is facing similar economic and political challenges, which is reflected in unusually high yields on French government bonds. It is kind of absurd that France currently has to pay as much for its debt as Greece. These developments underline the growing mistrust and nervousness on the old continent. The expected interest rate cuts by the European Central Bank (ECB) should bring short-term relief, but the structural problems remain unresolved. Political unrest, high taxes, overregulation and a lack of innovation are just some of the reasons that have led to the clear valuation discount of European equities compared to their US peers (see Fig. 2). The US has impressively demonstrated how business-friendly policies and sustained high levels of investment into new technological developments, such as artificial intelligence can have a positive impact on markets and investor sentiment.

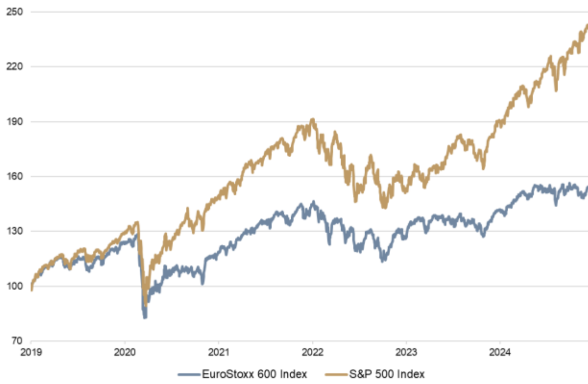

Fig. 2) EuroStoxx 600 Index vs. S&P 500 Index
Data: Bloomberg / Chart: Capicura Partners

«US import tariffs are overrated»

The positive trend on the US equity market is underpinned by a growing economy. The recently published labour market data, corporate figures for the third quarter of 2024 and economic growth are solid and do not indicate an economic downturn in the first quarter of 2025. The election victory of the Republicans under the leadership of Donald Trump has created additional euphoria among investors. On the other hand, the expansionary fiscal policy and the planned increase in import tariffs have increased the risk of inflation flaring up again. This is leading to rising interest rates at the long end of the yield curve. Depending on the level of import tariffs, and assuming they are implemented as threatened, US companies will generate lower profits due to higher costs. However, this effect could be neutralized by the planned reduction in corporate taxes and deregulation. Although the tariff issue is disturbing, we are convinced that Trump's bark is worse than his bite.

«American stocks with momentum»

We expect that the new balance of power in the US Congress (in favour of the Republicans) will enable the new president to implement his business-friendly policies. This is positive for the US equity market in the short-term. However, the sales and earnings expectations for 2025 are very optimistic and therefore harbor potential for disappointment. In addition, the valuation of the S&P 500 Index is at very high levels with an expected price/earnings ratio for 2025 of 23x compared to the long-term average of 18x. Many analysts still warn of the high concentration of the "Magnificent 7" (32.9%), which continues to have a strong influence on the index's performance. However, it is rarely mentioned that the largest seven stocks in the EuroStoxx 50 and the SPI Index, among others, also have a cluster risk of 34.6% and 56.8% respectively and have led to below-average performance in Switzerland, particularly in the last three years.

«The Bulls are (still) in charge»

Animal spirits and cash flows indicate that the current rally is not over yet. Most of the momentum remains focused on the US, as many European companies are struggling with their home-grown problems.

The combination of robust growth in the US economy, falling interest rates and a pro-business policy from January 2025 has prompted us to increase our equity allocation by 3%-points via the equally weighted S&P 500 Index at the expense of bonds following the November elections. The path of least resistance for equities remains to the upside and once the Santa-Rally concludes the year, markets should continue to please the bulls in the first quarter of 2025!

Fig. 3) Bear vs. Bull Cartoon by HEDGEYE

Our constructive positioning is designed to make the most of regional divergences. We feel comfortable starting the new year with an elevated equity allocation, as CHF bonds are currently unattractive.

Asset Allocation	
Cash	*6%*
Fixed Income	*22%*
Equities	*53%*
Alternative Investments	*19%*

Fig. 4) *Suggested asset allocation for a Balanced Portfolio in Q1 2025*

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With this in mind, we wish you and your families happy holidays and a good and healthy New Year!

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