RAYMOND JAMES

VOLUME 18 | ISSUE 1 | JANUARY 2025

INVESTMENT STRATEGY QUARTERLY

Letter from the Chief Investment Officer

Come On Down! The Ten Themes for 2025

The past two years have been favourable for investors, with the economy and financial markets delivering all the right answers. As we step into 2025, it's a new round, and this one might be more challenging. For inspiration, we're looking at classic game shows. While financial markets are certainly not a game, these shows provide a fitting analogy for the high stakes and strategic thinking required for successful investing. Will the economy and financial markets maintain their momentum? That's the million-dollar question! Our answer is yes, but portfolio decisions will need to be more discerning in the year ahead. As we clear the board going into a new year, here are our ten themes for investors and wealth managers.

1 Optimism Overload: *Family Feud* May Steal the Show

As we move into 2025, optimism across the USA abounds—from Washington policy to the economy to earnings growth. Consumer confidence, business confidence, and investor confidence have soared, particularly since the election. However, this confidence masks some underlying risks. The sequence, timing, and magnitude of new policies will directly impact the economy.

Some policies, like deregulation and border enforcement, can be implemented immediately. But others, such as taxes and broad tariffs, will require Congressional approval. With a thin margin in the House, potentially as little as a one-vote Republican majority, policy passage could be contentious, much like a round of Family Feud. For example, when the Trump tax cuts were passed in 2017, twelve Republicans in the House voted against it. For equity investors, confidence is at a record high, leaving little room for error regarding economic disappointments, a Federal Reserve (Fed) unable to cut rates if inflation picks up, or earnings disappointments. Volatility, historically low, is likely to increase in the upcoming year.

2 Economic Enigma: *Deal or No Deal*

While US economic activity is likely to moderate in 2025, we expect it to achieve its fifth consecutive year of positive growth (RJ 2025 US GDP forecast: 2.4%). In the game show Deal or No Deal, contestants choose from briefcases containing hidden amounts ranging from a penny to $1 million. We think the recessionary 'bad cases'—such as a Federal Reserve-induced over-tightening cycle, a crash in consumer spending, and plummeting business spending—have been taken off the board.

What remains are the 'good cases' that should support economic growth: resilient consumer spending as job growth remains healthy, fiscal spending from programs like the Inflation Reduction Act and CHIPs Act, and continued investment in transformative areas like artificial intelligence. Just as contestants on the show weigh their options and hope for the best outcomes, we anticipate that these positive factors will help sustain economic growth. Assuming the central bank cooperates, the US should remain a standout compared to other developed market economies.

As in the game, though, the outcome is never certain until the last briefcase is opened. Investors must stay vigilant and strategic, ready to adapt to whatever surprises the economic and policy landscape may hold.

Investment Strategy Quarterly is intended to communicate current economic and capital market information along with the informed perspectives of our investment professionals. You may contact your financial advisor to discuss the content of this publication in the context of your own unique circumstances. Published 2/1/2025. Material prepared by Raymond James as a resource for its financial advisors.

3 Monetary Policy: *The Newlywed Game*

The Federal Reserve has a dual mandate—keeping inflation contained and maintaining full employment. While this is not a new relationship, the post-pandemic world has made it feel like they are newlyweds—especially given the surge in inflation that we are hopefully beyond. Just like a couple on The Newlywed Game, the important thing is that this 'couple' will need to live in harmony for the Fed to be able to cut interest rates and maintain the current expansion.

The economic growth we foresee for the US should support healthy job creation. Additionally, the disinflationary environment should continue as energy prices fall, retailers promote discounts, the dollar strengthens, and hopefully, housing prices finally start to retreat. The big wildcard will be the potentially inflationary impact of tariffs, although we believe those risks are overblown.

In the end, while we expect US monetary policymakers to cut rates twice in 2025, the focus should be less on the number of cuts and more on the result. Just as in The Newlywed Game, where the ultimate goal is a happy and harmonious life together, the outcome we seek is the continuation of this expansion. If this is achieved, risk assets such as the equity market should benefit. By the way, fewer Fed cuts remain supportive for US-based savers as cash yields should average above 4% throughout the year.

4 Bond Market *Jeopardy*: Mastering the Yield Board

In the game show Jeopardy!, the answer is a question. In that spirit, we say: "Moderating growth, decelerating inflation, increased volatility, and Federal Reserve rate cuts." If you say, "What could drive interest rates lower?" you are right! And while that 'question' would have won on Jeopardy!, recent US Treasury (and other international) bond market performance has acted to the contrary. Much to the market's surprise, yields bucked the historic trend and moved higher (rather than lower) after the Federal Reserve's initial rate cut, an outcome not dissimilar to the UK experience too.

Here's another 'answer' for the next round of play: "Upside tariff-driven inflation, upside risk to growth, and potentially increased government spending." The correct response is: "What could drive interest rates higher?"

In this Jeopardy! round, the combination of these answers is why we believe longer-term interest rates will be range-bound for much of the year and end up at a similar level to where they are today (2025 year-end US 10-year Treasury yield target: 4.50%). Since short-term bonds are anchored to Fed actions, continued Fed easing is likely to take short-term rates lower and steepen the yield curve. High-quality corporates and municipal bonds are particularly attractive.

5 Equities: Is the *Price* (or P/E) *Right*?

The US equity market has experienced a tremendous rally, with the S&P 500 posting consecutive annual returns of more than 20% for the first time since the late 1990s. While earnings growth has contributed, multiple expansion has been a major driver of this performance. As a result, valuations are on the more expensive side.

Think of it like The Price Is Right. Investors, much like contestants, need to avoid going over the appropriate price-to-earnings (P/E) multiple, as exceeding it can negatively impact their returns. The game that comes to mind is the 'Mountain Climber': the climber ascends steadily, sometimes pausing or moving cautiously, much like stock prices that rise gradually with occasional dips. Just as the climber aims to avoid falling off the edge, investors strive to make informed decisions to prevent significant losses.

While the fundamentals of the market are healthy—a strong US economy, positive earnings growth, and robust corporate activity—equity market expectations need to be dialled back in the upcoming year due to high valuations and potential complacency. We expect stock prices to rise more slowly as company earnings grow faster, helping earnings catch up to current prices. We predict the S&P 500 will reach 6,375 by the end of 2025, with a price-to-earnings ratio of 23-24 times and earnings per share of $270.

6 Market Capitalisation: Winning the Middle *Hollywood Square*

In the game show Hollywood Squares, contestants play a version of tic-tac-toe with the help of celebrities who answer questions. A common strategy, used 70%-80% of the time, is to go for the middle square. This is because the middle square offers the most combinations to win, leading to a more balanced strategy in the game.

Similarly, in the equity market, US large-cap stocks have dominated over the last two years, while small-cap stocks have recently been in the headlines as beneficiaries of aggressive Fed rate cut expectations. However, mid-cap stocks could be well-positioned to outperform moving forward. Like the middle square in Hollywood Squares, mid-cap stocks offer a balanced approach. They benefit from the strength of the US economy and are somewhat insulated from tariff exposure, with mid caps receiving 76% of their revenues from the US compared

Letter from the Chief Investment Officer *(cont.)*

to 59% for large caps. Additionally, mid caps are expected to see strong earnings growth of around 13% in 2025 and have attractive valuations—trading at nearly the largest discount to large caps over the last 20 years.

What could further benefit mid caps over small caps is their financing structure. If the Fed is not as aggressive in cutting rates next year, small caps may not reap the benefits of much lower interest rates as investors had expected. Currently, 41% of midcap debt is floating rate compared to 53% for small caps. From a fundamental perspective, mid-cap companies tend to be of higher quality, with a higher percentage of companies having positive earnings compared to small caps. Additionally, mid caps have elevated exposure to the Technology and Industrials sectors, which should support their performance.

Just as contestants in Hollywood Squares often relied on the centre square for a strategic advantage, mid-cap stocks could be the sweet spot in the equity market, balancing growth potential at an attractive valuation.

7 Sector Selection: *Are You Smarter Than a 5th Grader?*

For our favoured sectors, we're going back to the basics—explaining our strategy in a way that even a fifth grader could understand, just like on Are You Smarter Than a 5th Grader? For 2025, our approach is simple: follow long-term macro themes and focus on sectors with the best earnings potential. This analysis highlights three key sectors: Technology, Industrials, and Health Care.

Technology is like the star student, excelling due to artificial intelligence, constant innovation, and strong corporate investment, which we believe are still in the early stages. Industrials are the reliable all-rounders, benefiting from continued government spending, the reindustrialisation of the US, the AI buildout, and the re-electrification of our power system. Health Care is the underdog with hidden potential, as its attractive valuations don't seem to match the earnings power driven by increasing healthcare needs supported by demographic trends.

Just like in the game show, where you need to pick the right answers to win, investors should look for sectors with the best earnings growth. These three sectors are at the top of the class, with earnings comfortably in double-digit territory.

8 International Equities: *The Weakest Link*

On the show The Weakest Link, the sharp-tongued host asks a series of questions, and the contestant with the lowest score each round hears the dreaded phrase, "You are the weakest link. Goodbye." In the global equity market, the US has consistently been the top performer, much like the strongest link, outperforming other developed markets such as Europe and Japan in eight of the last 10 years. This suggests that the rest of the developed markets have often been the weakest link.

The US is likely to remain the strongest link due to superior economic growth, significantly higher earnings growth, more dynamic corporate leadership, and exposure to our preferred sectors: Technology, Industrials, and Health Care. From a ranking perspective, Japan could provide some competition and ranks just behind the US. Japan is benefiting from an improving economy, a shift away from deflation, and should gain if global growth stabilises in the coming year. Additionally, with the Bank of Japan raising interest rates, there could be a modest appreciation of the yen, supporting dollar-based performance.

9 Selectivity: Market Gains No Longer a *Minute to Win It*

In an environment of stretched valuations—which will likely drive increased volatility and more muted returns—the quick, *Minute to Win It* gains we've seen over the past two years will be harder to achieve. Just like the game show, the next stage of the bull market will present progressively tougher challenges for investors to generate returns, making a critical eye on fundamentals essential.

We caution investors against taking on excessive risk across asset classes. Higher beta asset classes without a solid fundamental backdrop will likely face difficulties in the coming year. For example, with global growth outside the US expected to struggle, commodities (particularly oil) may encounter headwinds as demand growth remains subdued. Within the equity market, companies without positive earnings will likely come under pressure.

Additionally, we anticipate increased dispersion among winners and losers within regions, sectors, and industries. In a shifting policy landscape, 2025 will likely be a year where active management, especially in commodities, emerging markets, and small caps, proves its worth. Investors will need to stay focused and adaptable to navigate the complexities of the market.

10 Asset Allocation: Playing the *Wheel of Fortune*

Amidst the uncertainty of the coming year, it's important to remember the goal of investing: to build wealth. The aspiration of becoming a millionaire, as in *Who Wants to Be a Millionaire?* might seem modest now. When the show started in 1999, $1 million would be worth about $2 million today adjusted for inflation, and around ~$9 million adjusted for equity performance.

America's wealth has grown to record highs. But don't spin the Wheel of Fortune on your own! When you're ready to buy a vowel (i.e., make additional investments), consult with your financial advisor first. Your advisor is like the 'phone-a-friend' or 'lifeline' you can rely on to answer your questions and provide reassurance when faced with pressure-panicked headlines.

We are prepared for the challenges ahead, keeping in mind the expression that applies to all game shows and certainly to financial markets as well: “You’ve got to be in it to win it.” Stay focused and committed!

Lawrence V. Adam, III, CFA, CIMA®, CFP®
Chief Investment Officer

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Trump 2.0: What's New and What's Déjà Vu?

Ed Mills, *Managing Director,* Washington Policy Analyst, Equity Research

The election of Donald Trump to a second term and the GOP sweep of Congress is a repeat of the 2016 election, but we see a considerable debate about the agenda for his second term. Echoing his first term, tax change, tariffs, and immigration all remain at the top of his agenda. In the 'what's new' camp we highlight a much smaller Republican House majority (in the single digits, compared to the 23-seat majority of 2017), but more Congressional allies and a more robust transition team. A key dividing line for the 2025 policy agenda will be agenda items that can be achieved through executive authorities (including tariffs and immigration), and those requiring Congressional authorisation (such as taxes and the debt limit). It will likely be full speed ahead for many of those executive-driven actions given Trump is seeking to avoid the multi-year negotiations that delayed his first term agenda.

The small House majority will introduce new hurdles to the passage of key fiscal legislation, including raising the debt limit, extending the 2017 Tax Cuts and Jobs Act ahead of its expiration in December, and any desired changes or repeals to the 2022 Inflation Reduction Act. A guiding principle for watching Trump 2.0 will be to 'expect the unexpected' and we expect to see frequent diversions from the traditional DC playbook. With that uncertainty as a caveat, we attempt to provide a playbook for how some of the top market-relevant Washington fights could play out in 2025.

> A guiding principle for watching Trump 2.0 will be to 'expect the unexpected.'

> “We view his nominations to key posts (including Treasury, Commerce, and the US Trade Representative) as early indicators of his seriousness for aggressive trade and tariff actions.”

TARIFFS

Tariffs have formed the centrepiece of Trump’s fiscal and foreign policy agendas, and our base case is that tariffs (including those targeted at specific countries, as well as a global tariff), are coming—but the specifics remain up in the air. As an example, Trump has already vowed to impose sweeping Day 1 tariffs on China, Mexico, and Canada in response to fentanyl and immigration concerns. The pre-inauguration announcement of the tariffs underscores a key dynamic in Trump’s tariff strategy: his desire to negotiate and make deals. The timing should be viewed as an initial attempt to bring potentially impacted countries to the negotiating table early on. Trump will highlight in his negotiations that each country can avoid these tariffs by addressing his concerns, but his wish to negotiate does not mean he will not follow through on his tariff threats if a desired outcome is not secured. Trump has a range of authorities at his disposal to implement his suite of tariff proposals which also include the authority to impose a 10-20% global tariff. Several of those authorities would allow him to implement new tariffs almost immediately, and even for tariffs with longer procedural requirements, we would expect those to move relatively quickly.

Additionally, we view his nominations to key posts (including Treasury, Commerce, and the US Trade Representative) as early indicators of his seriousness regarding aggressive trade and tariff actions. Congress is also likely to support these actions and could provide new authority that would allow the president to address trade deficits and tariff barriers imposed by other countries against the US. These new powers could usher in trade deals that would be viewed as significantly beneficial to US companies and US exports. Ultimately, the timing and scope of these actions will dictate the economic and market impact.

PERSONNEL IS POLICY

Key to the policy specifics and implementation of priority agenda items will be the personnel appointed to manage those issues. While Trump announced his cabinet picks and other key appointees throughout November and December, the fate of many of his selections will lie with the Senate confirmation process. The Republican Senate majority and a push for deference to the president will mean that many will be confirmed, but some of the more controversial picks will face an uphill battle. Trump has indicated his willingness to use recess appointments if the Senate does not approve his nominees. Legal hurdles implemented by the Supreme Court in 2014, following the use of this power by President Obama, limits this authority. The 2014 ruling adds to the uncertainty surrounding the outcome.

DEBT LIMIT

Alongside personnel confirmations, the return of the debt limit will be a top priority in the early days of the new 119th Congress. While we expect the debt ceiling eventually to be raised, the narrow House GOP majority, the number of Republican members of Congress who have never and will never vote to raise the debt limit and the political drama previewed in the December 2024 government funding debate will likely introduce volatility to the process. The debt limit is subject to a 60-vote threshold in the Senate, requiring Democratic support for its passage. Using the last debt limit debate as a guide, we would expect the X-date (when the US government can no longer fulfil its debt obligations through the use of extraordinary measures) to fall roughly mid-year, and the debt limit debate will accordingly become a priority in the first half of 2025. On politically tough votes, additional measures are frequently added to provide incentive for members to vote in support; therefore, it is likely that measures to speed up infrastructure and energy-related projects are added to the increase in the debt limit. This would be viewed as adding to the economic growth of the US and positive for industrial projects.

DOGE & THE BUDGET

Trump's announcement of the 'Department of Government Efficiency' (DOGE), to be led by Elon Musk and Vivek Ramaswamy, has pushed the US budget and its process into the spotlight. We expect DOGE to have the most success in its push for deregulation, aided by a series of Supreme Court rulings that will make it easier to challenge existing regulations. Their effort to reduce government spending will be a more difficult challenge. A key challenge will be getting Congress to support their budget cut recommendations. The slim House Republican majority and the 60-vote threshold in the Senate are key hurdles here. A wildcard in this effort will be a court challenge to limits on the president's authority to withhold funds appropriated by Congress. We expect the Trump administration to challenge a 1974 law that restricts this authority. The outcome of that court case could determine the extent of the budget impact of DOGE. Separately, there are areas where increased near-term government spending may be suggested to increase longer-term government efficiency. Many government technologies are outdated and with the tech backgrounds of Musk and Ramaswamy, we could see an effort for upgrades that have better cybersecurity and position the US government for efficiency

> We expect DOGE to have the most success in its push for deregulation ... efforts to reduce government spending will be a more difficult challenge.

TAX CUTS

The individual portions of the 2017 Tax Cuts and Jobs Act (TCJA) are set to expire on 31 December 2025. The cost of a ten-year extension is estimated at $4.6 trillion, and President Trump has promised additional changes to the tax code as part of this extension. Most of the corporate tax changes, including the 21% corporate tax rate, were made permanent in 2017, while several important business provisions that incentivise investment in new equipment have expired and are part of the extension conversation. We expect Congress to use the budget reconciliation process to pass this tax law, as it only requires a simple majority in the House and Senate (no 60-vote Senate filibuster) for passage. As such, we expect the bill to pass on a party-line vote. The lower vote threshold does not guarantee smooth sailing, as the House majority is razor thin.

> The slim House Republican majority and the 60-vote threshold in the Senate (which requires Democratic support) are key hurdles.

Our base case for the tax bill is an extension of the expiring provisions, but the extension may be shortened to four or five years (versus the ten years allowed under congressional rules) to reduce the cost of the extension. A four or five-year extension would cost closer to $2 trillion. The tax bill is likely to include provisions such as the no tax on tips, overtime, and Social Security promoted by President-elect Trump during the campaign. However, those provisions are likely limited to lower-income households that are already excluded from paying federal income taxes.

The debate over the state and local tax (SALT) deduction cap will likely be a major battleground (and key example of the precariousness of such a slim House majority), especially for House Republicans in jurisdictions with high state and local taxes, such as New York, New Jersey, and California. There have been proposals to increase the current SALT limit from $10,000 to $20,000, while limiting the extra deductions for households with income less than $500,000. The expiration of the current estate tax limit is likely to be extended as part of the larger package, but we will be watching developments closely.

Offsetting the cost of these tax changes could have significant market and sector impacts. New tariff authority, the potential repeal of the Inflation Reduction Act (IRA), entitlement reform, cuts suggested by DOGE, and many other provisions are all on the list of potential offsets.

KEY TAKEAWAYS:

- We view the key market-relevant policies of the Trump administration as: tariffs; the debt limit; appointing key personnel; budget reduction; and tax cuts.
- Trump's appointments seem to indicate his seriousness about aggressive policies on tariffs and trade policy. Tariffs may also be used as a negotiating tool.
- The timing, magnitude, and tempo of these policies is still uncertain. We will be monitoring market reaction closely.

Bytes and Barrels: Energy Market Shifts Focus from Geopolitics to the Electric Grid

Pavel Molchanov, *Managing Director,* Energy Analyst, Equity Research

After a year of major wars in Europe and the Middle East, how is it that oil prices ended 2024 lower than where they started? As it turns out, geopolitics is not everything. Russia's war in Ukraine has faded into a depressing, seemingly endless backdrop. Israel's war with Hamas, Hezbollah, and—on two occasions—direct confrontation with Iran has been more headline-grabbing but without any direct effect on oil supply. The oil market has become numb to these headlines, and day-to-day volatility in oil prices is being driven by rather old-fashioned supply-side and demand-side factors. China's macroeconomic troubles, compounded by its fastest adoption of electric vehicles among the G20 major economies, helps explain the less than bullish sentiment vis-à-vis oil demand. Meanwhile, the long period of OPEC+ production discipline may be starting to unwind, with the group planning to boost production starting in April 2025. Balancing all of these considerations, we anticipate that oil prices will remain generally range-bound in 2025. This implies West Texas Intermediate (WTI) and Brent crude averaging in the $65 to $85 per barrel range.

AI AND POWER

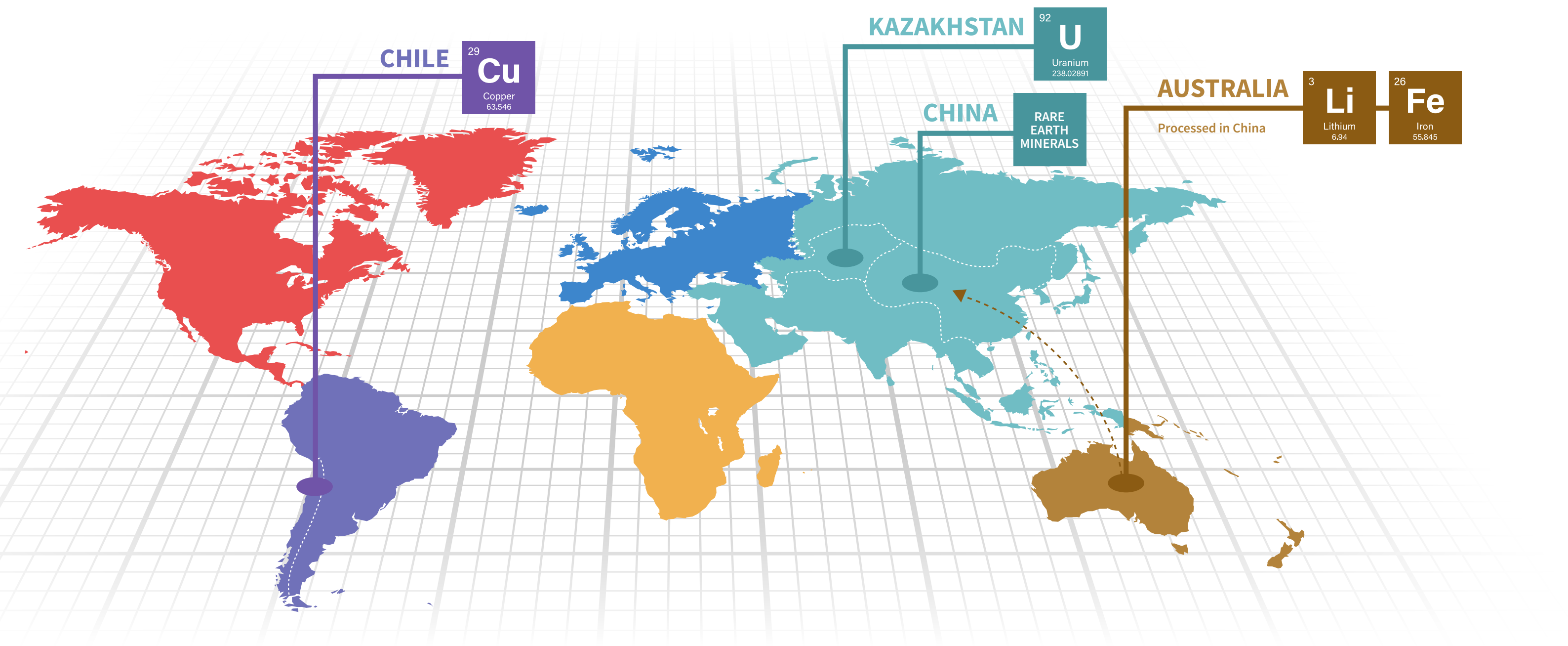
Insofar as one story in the energy sector truly stood out over the past year, it is entirely separate from the oil market.

> For the first time in two decades, US electricity demand is embarking on a period of sustained growth, mostly due to the highly energy-intensive data centres for the AI buildout.

We are referring to the interplay of artificial intelligence (AI) and the electric power industry. For the first time in two decades, US electricity demand is embarking on a period of sustained growth, mostly due to the highly energy-intensive data centres for the AI buildout. After increasing by an average of only 0.4% per year between 2000 and 2023, we forecast that US electricity demand will be growing 2% to 3% per year through 2030. In fact, there is no need to ask whether this growth is real—2024 was up more than 3%. Accommodating this growth will be a textbook case study of an all-of-the-above story: natural gas, wind, solar,

Strategic Materials Distribution

Materials like copper, lithium, and iron play key roles in supporting the electric power boom. Much of the processing occurs in China.



Source: US Geological Survey

nuclear, and let's also keep in mind the importance of modernising the electric grid. The US is leading the way in AI—Washington, DC has more data centres than any metro area in the world—but AI will also contribute to electricity demand in Europe and various emerging markets. In fact, the world's top 20 data centre markets can be found across 11 countries on four continents, with Beijing ranking #2 behind Washington. As this growth curve continues, there will be plenty of opportunities and challenges along the way. We always need to be mindful of delays: development of power plants and the associated grid infrastructure is a marathon rather than a sprint. This is especially true of anything nuclear-related, which for obvious reasons is closely scrutinised by regulators and takes a very long time to build.

STRATEGIC MATERIALS: WHERE OH WHERE?

Among the aspects of the electric power boom that are not always appreciated is the need for a wide range of strategic materials. Copper, for example, is a key input for electric cabling. Grid-scale power storage systems that incorporate lithium-ion batteries (the same type of batteries used in electric vehicles) require lithium, nickel, manganese, and cobalt. And, needless to say, practically all industrial construction uses steel in massive quantities. Unlike precious metals, the various industrial metals are not scarce in a geological sense, but their supply tends to be geographically concentrated. Nearly one-fourth of the world's copper comes from Chile. Lithium comes mostly from Australia, with the processing handled almost entirely in China. Likewise, Australia is the world's largest supplier of iron ore, which is shipped to China where more than half of the world's steel is produced. Kazakhstan produces nearly half of the world's uranium—which, of course, is vital for nuclear power plants—though there is more concern about the 5% that comes from Russia. As it relates to mining, China is most dominant in rare earths, providing two-thirds of global supply.

THE REGULATORY VIEW

The past year was uniquely full of elections in major economies around the world. For our US readers, it is hardly a secret that the incoming Trump 2.0 administration will be much less climate-focused than its predecessor. Environmental regulation will become weaker at the federal level, but there is a more complex landscape at the state level, which is where utilities are generally regulated. Turning to what's been happening internationally, in France there is parliamentary gridlock, which means that the status quo of high reliance on nuclear power is continuing.

The Labour Party in the UK is building on the environmental policies of the previous Conservative government—notably, the UK's

> “ What we like to call ‘electrification of everything’ is a megatrend that encompasses data centers, electric vehicles, and more. ”

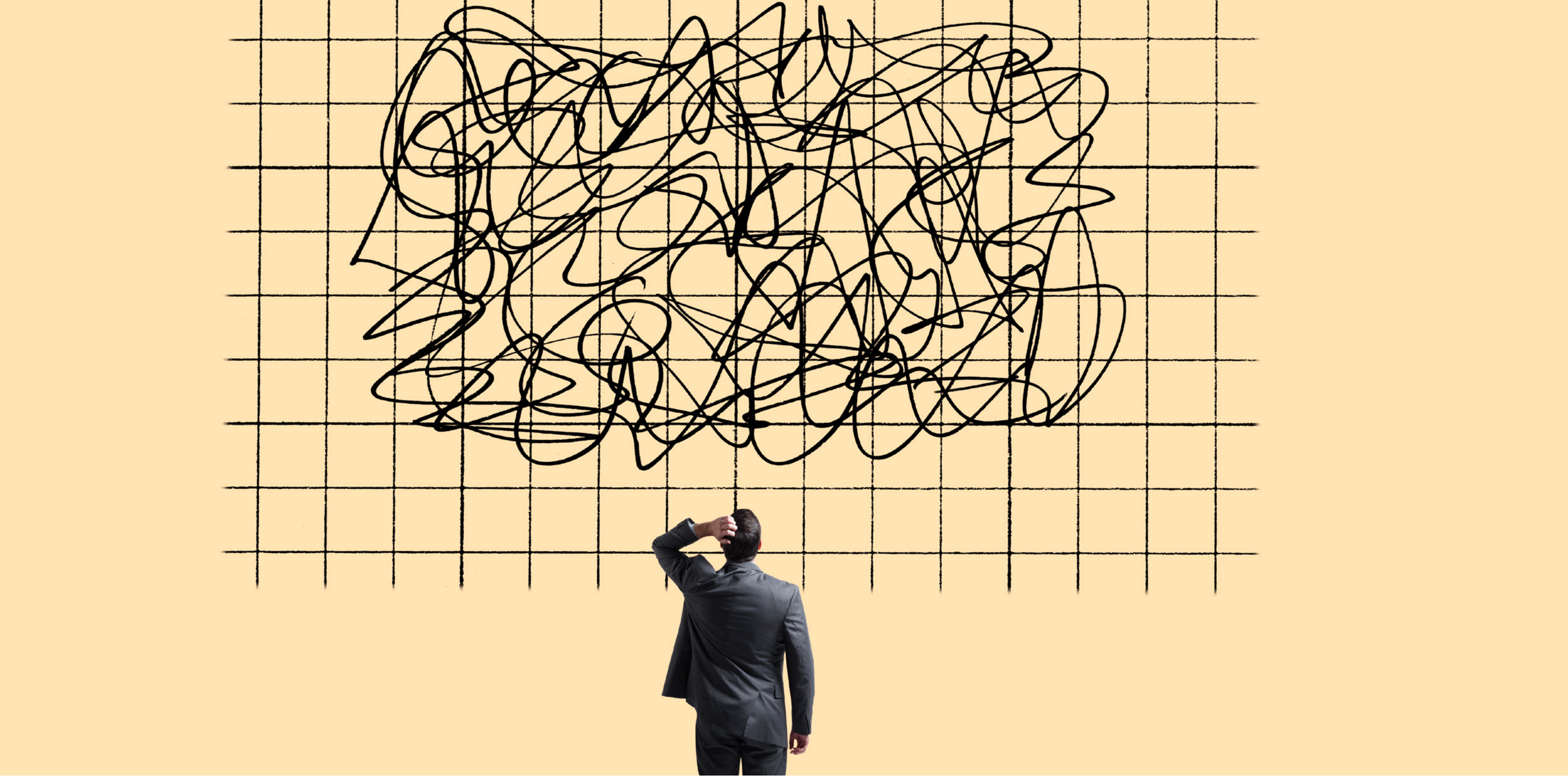
last coal-fired power plant was shut down in September 2024—and has started to provide more funding for offshore wind. South Africa's coalition government is talking about diversifying the country's electricity mix away from coal but needs to manage the political pressure from the mining industry. In 2025, there will be important elections in Canada and Germany, and we will be watching for any potential changes in energy and climate policy. On both sides of the Atlantic, one of the areas where parties on the left and right tend to find agreement these days is economic protectionism, which includes hefty import tariffs on Chinese solar panels and electric vehicles.

THE BOTTOM LINE

The key message here for investors is that it is not enough to consider the price dynamics of any given commodity—we also need to think about how volumes are growing. We anticipate that global electricity demand will grow 2% to 3% per year through 2030, whereas oil demand is set to grow less than 1% per year. Regardless of whether oil prices are green or red on your screen on a day-to-day basis, the underlying market for electric power is expanding more rapidly. What we like to call 'electrification of everything' is a megatrend that encompasses data centres, electric vehicles, and more. Likewise, mining output of the metal with which investors are most familiar—gold—is essentially static, whereas there is robust growth in key industrial metals such as copper and lithium. As useful as gold can be from an inflation hedging standpoint, underlying volumes have plateaued, and investors who want growth—without needing to make a bet on commodity prices—may want to consider other opportunities in the metals and mining sector.

KEY TAKEAWAYS

- Oil price volatility is being driven by old-fashioned supply-side and demand-side factors.
- We anticipate that oil prices will remain generally range-bound in 2025. This implies West Texas Intermediate (WTI) and Brent crude averaging in the $65 to $85 per barrel range.
- US electricity demand will grow 2-3% per year through 2030 largely on the back of AI data centres.
- There will be a growing need for strategic materials, most of which are found outside the US.



Uncertainty is Dead, Long Live Uncertainty

Eugenio J. Alemán, PhD, *Chief Economist,* Raymond James
Giampiero Fuentes, *Economist,* Raymond James

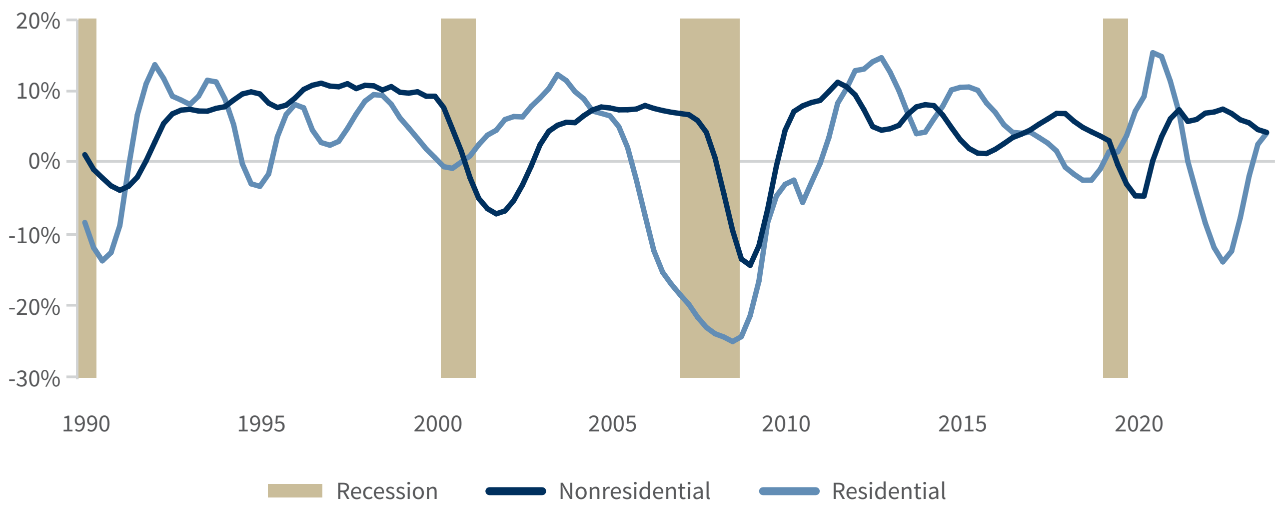
The results of the presidential election as well as those of the US Congress, with a Republican sweep, ended months of uncertainty regarding the next few years. Since then, markets have been salivating at the prospect of a more benevolent regulatory environment vis-à-vis the Democratic alternative. At the same time, markets seem to have become very positive on the prospects of a unified government that should, potentially, take some of the typical uncertainties off the table, i.e., a non-contested extension of the debt ceiling, etc. Having more certainty is great for markets. Still, the Republican sweep opens other uncertainty avenues that could affect the prospects for economic growth, inflation, and interest rates going forward.

ECONOMIC GROWTH

As has been the case for the last several years, economic growth continues to be on a strong footing, helped lately by very strong tailwinds created by the fiscal expansion provided by the CHIPS, IRA, and Infrastructure Acts as well as by a weakening but still relatively strong employment environment.

Furthermore, the last several years have shown that, while important, the manufacturing sector's weakness should not prevent the US economy from continuing to show economic strength. Perhaps the only caveat to our previous argument is that both the CHIPS and IRA legislation have kept nonresidential investment strong during a period when residential investment as well as current manufacturing production were very weak. Thus, investment in the nonresidential sector has remained positive even in the face of very high interest rates. As these new manufacturing plants continue to be built, the prospects for the US manufacturing sector will tend to improve. At the same time, the fiscal acts have also kept the US construction sector as well as construction employment in expansion, even as the residential investment sector plunged into recession. As long as the new administration's policies tend to keep this economic environment more or less unchanged, the US economy can continue to grow over the next several years. If that is not the case, then once we have the new policies implemented, we will assess the potential effects on economic growth.

Residential vs. Nonresidential Investment *(Four-Quarter Moving Average)*



Source: FactSet, data as of 31/12/2024

> Trusting energy prices to continue to behave in support of the Federal Reserve's monetary policy objectives is not a sustainable (or even recommended) strategy.

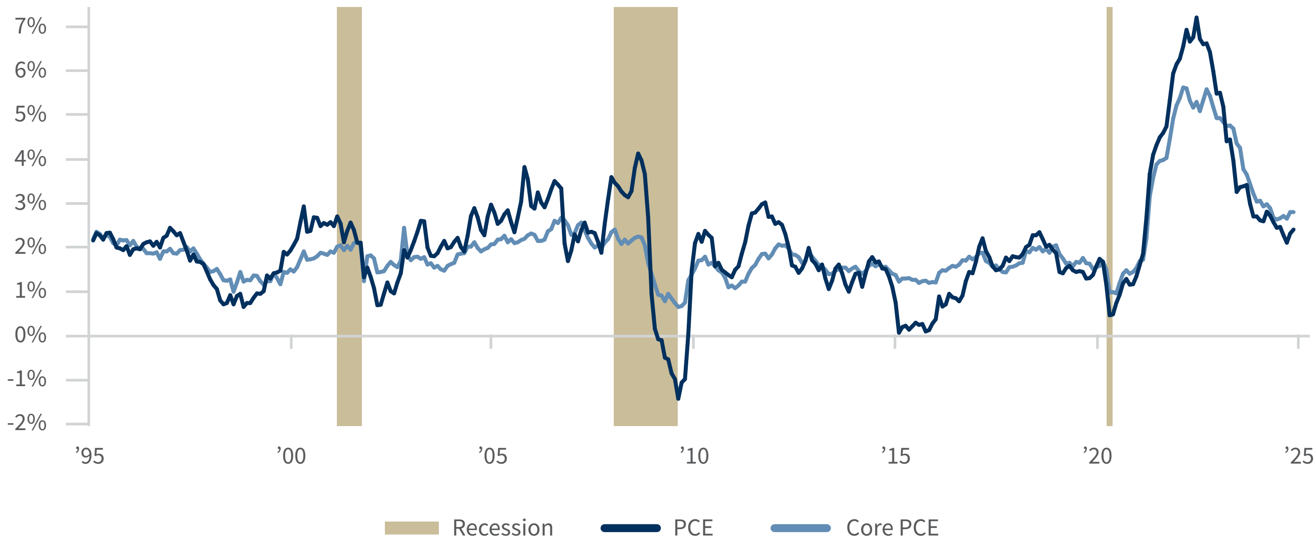
INFLATION

Strong growth during the last several years has not prevented inflation from decelerating after what happened in 2021 and 2022. The normalisation of supply chains, the drawdown of excess savings over time together with the 'revenge spending' triggered by the end of the pandemic, as well as the Federal Reserve's (Fed) high interest rate policies have allowed inflation, finally, to approach the Fed's target of 2.0%. However, the path to the 2.0% target rate has been slower than Fed officials would have liked as shelter costs have continued to remain uncharacteristically strong during this period compared to the past. At the same time, Fed officials have been very lucky as energy prices have continued to support lower inflation. However, trusting energy prices to continue to behave in support of the Fed's monetary policy objectives is not a sustainable (or even recommended) strategy.

Furthermore, although the headline PCE price index is the Fed's target inflation measure, Fed officials would like to see some further weakening of core inflation. That is, it prefers to see the core PCE, the personal consumption expenditures price index excluding food and energy prices, sustainably closer or even below the 2.0% target so it has some wiggle room to deal with the headline rate of inflation moving up or down temporarily without affecting the core PCE rate of inflation. This is the part of the inflation fight the Fed has not been able to win yet. This stability in the core PCE rate of inflation is a much longer-term objective, but one without which the Fed cannot be successful.

Today, the Fed has to deal with the potentially inflationary consequences of the incoming administration's policies, especially regarding tariffs as well as deportation of illegal aliens. Although there are still unknown details such as the depth, extent, and application of such policies, an analysis of the economic consequences points to potentially higher inflation going forward. As we have said in the past, it is not that we believe we will have higher inflation going forward—however, if there is the potential for inflation to move higher in the future, this will trigger a change in Fed monetary policy, which could include interest rates staying high for longer or even pushing the Fed to increase rates if the inflationary consequences of these new policies merit such a move.

PCE and Core PCE Price Indicies (YoY Change)



Source: FactSet, as of 31/12/2024

INTEREST RATES

We have left interest rates for last because economic growth as well as inflation will determine the path of interest rates. This has been confirmed by markets, which are now expecting high interest rates to stay with us for a longer period of time. And we agree with markets at this junction. For now, elevated interest rates have not been a constraint on economic growth. High interest rates have not been binding for real nonresidential investment while they have been binding for real residential investment. However, as the effects of the fiscal expansion created by the CHIPS and IRA, and to a lesser extent, the Infrastructure Act, continue to fade away, interest rates are going to become a constraint on economic growth.

But perhaps the biggest risks for the US economy are higher interest rates from potentially higher inflation due to tariffs and the proposed deportation of millions of illegal migrants. While the impact on inflation from the curtailment of illegal immigration is going to take some time to feed into wages across the different industries affected, i.e., construction, agriculture, hospitality, etc. (see infographic on next page), and then into inflation, the effects of the imposition of tariffs on imports from the rest of the world is going to have an almost immediate impact.

We could even start seeing some of the impacts from tariffs during the fourth quarter of last year and the first quarter of this year, not through higher inflation but through higher imports as firms try to

The biggest risks for the US economy are higher interest rates from potentially higher inflation due to tariffs and the proposed deportation of millions of illegal migrants.

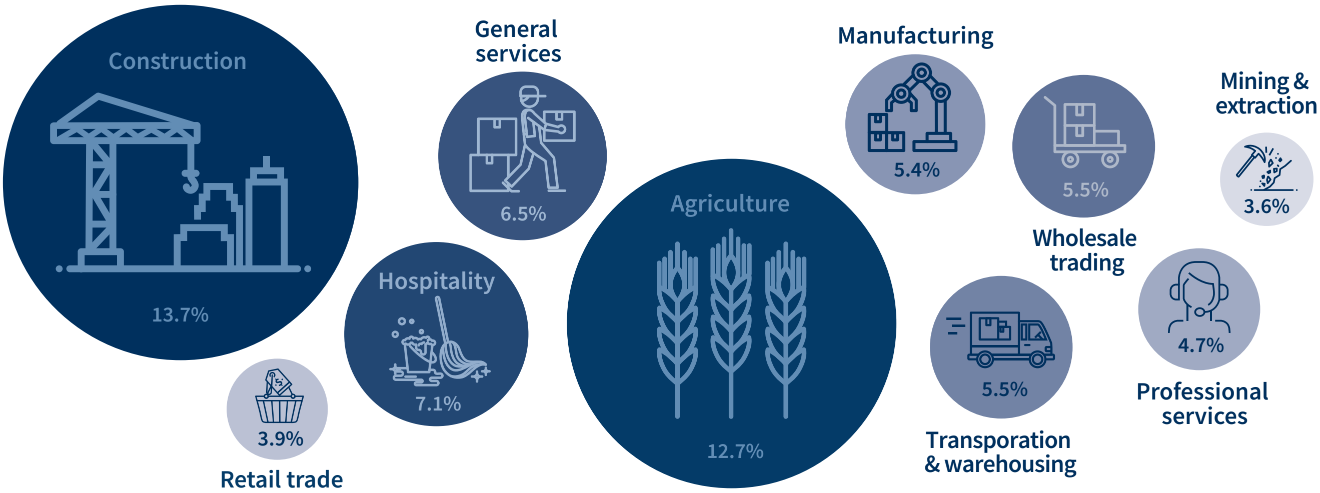
front load any increase in future tariffs by replenishing inventories ahead of the increase in price. These added imports could weaken economic growth somewhat in Q4 2024 and Q1 2025 compared to a no-tariff environment.

Once again, we want to be mindful of the few details available regarding the implementation, breadth, and scope of the potential tariffs—our analysis is just an interpretation of publicly available information. You can also read our fourth quarter 2024 Investment Strategy Quarterly article in which we covered this topic in some more detail.

But the fact of the matter is that the imposition of tariffs on imports will increase the price of those goods that are covered by the tariffs as well as generate an increase in the prices of domestically produced goods that compete with the imported goods that are covered by tariffs. At the same time, tariffs will increase the price of inputs used in production and these increases in the cost

Share of Undocumented Workers by Industry

The impact on inflation from the curtailment of illegal immigration is going to take some time to feed into wages across the different industries affected.



Source: American Immigration Council, as of 2022

of production will find their way into the final price to consumers. Higher inflation will push the Fed to keep interest rates higher for longer and/or increase interest rates further.

All this means that today's interest rate path is higher than it was before the results of the presidential election. Fundamentally, this is because the prospects for economic growth today have improved marginally but primarily because the prospects for higher inflation have changed materially, which will keep the Fed in a defensive position. At the same time, this new interest rate path may increase the risks of a recession down the road, especially if the effects of the new policies increase the rate of inflation more than markets expect.

Once again, and going back to the title of this article, while the November 5th presidential and congressional elections cleared the path of one set of uncertainties, it also added another completely different set of uncertainties that markets, investors, and economists, will have to deal with going forward to figure out the path for economic growth, inflation, and interest rates during the next several years.

KEY TAKEAWAYS

- While the results of the election in November resolved some uncertainties, it opened the door to others which could affect the prospects for economic growth, inflation, and interest rates going forward.
- Economic growth continues to be on a strong footing, helped by the very strong tailwinds created by the fiscal expansion provided by the CHIPS, IRA, and Infrastructure Acts as well as by a weakening but still relatively strong employment environment.
- Inflation has, finally, approached the Fed's target of 2.0%.
- Economic growth as well as inflation will determine the path of interest rates going forward.

Uneven Growth in an Uncertain World

Professor Jeremy Batstone-Carr, *European Strategist,* Raymond James Investment Services Ltd.

The global economy will grow in 2025—a high degree of conviction in a world mired in uncertainty following President-elect Donald Trump's victory, but outcomes will vary and become more dispersed. Outside the US the biggest improvement to global real GDP prospects will be in Japan and to a lesser extent the UK. In contrast, persistent structural headwinds will hamper the euro zone and growth will be lacklustre at best. Of the emerging markets, the Chinese economy will grow again but the pace will slacken as Beijing adjusts its focus away from the export sector and towards stimulating domestic demand. India has enjoyed a strong start to the decade and will remain the fastest growing major economy next year. Inflationary pressure, the focus of central bank policy measures over the past few years, will slowly normalise but with variance across differing geographical locations. This variance will manifest in a divergent approach to monetary policy between systemic central banks, with the Bank of Japan cautiously raising interest rates while restrictive policy is loosened gradually elsewhere. For markets, the combination of moderate but still positive growth, subdued inflationary pressures, and supportive monetary policy is constructive for positive returns over the year ahead. Investors will, however, be mindful of the risks associated with a wide range of potential policy initiatives, market sensitivity driven by the substance, weight, and timing of measures which could deliver notably divergent investing outcomes.

GLOBAL GROWTH WILL MATCH THAT OF 2024

Prospects for the global economy and markets outside the US are highly uncertain. Initially at least, President-elect Trump's provocative rhetoric, particularly in relation to the imposition of trade tariffs on imported goods from 'Day One' following his inauguration, will garner most attention but the immediate impact could be fairly small. The global economy is expected to deliver real GDP growth of 2.7%, likely close to that achieved in 2024.

> The combination of moderate but still positive growth, subdued inflationary pressures, and supportive monetary policy is constructive for positive returns over the year ahead.

> “ The global economy is expected to deliver real GDP growth of 2.7%, likely close to that achieved in 2024. ”

FOR CHINA THE DOMESTIC CHALLENGES TRUMP THE TARIFF IMPACT

The imposition of large tariffs on Chinese exports would damage the country’s export sector—but goods exports to the US amount to less than 3% of China’s GDP. Taking account of possible exchange rate weakness, some possible attempts at evasion (perhaps through re-routing exports via a third country subject to a lower tariff, such as Vietnam) and the redirection of manufacturing output to other destinations, the overall impact of even a 60% tariff could drop to less than 1% of GDP. The impact may likely be offset by lower interest rates and particularly fiscal policy expansion in part aimed at heading off the threat of insolvency in the Real Estate and Financial sectors.

EURO ZONE FACES PERSISTENT STRUCTURAL HEADWINDS

The direct impact of the threatened 10% tariff on all US imports, although an additional cost for exporters, would only amount to a fraction of a percent of euro zone GDP. However, the impact would be greater on Germany as the US is one of its key export markets. The extent to which the region is impacted will depend on the extent to which tariff imposition might be diluted through negotiated concessions from the European Union as was the case in the automotive sector in 2018. Furthermore, exports to the United States account for only a small proportion of regional economic activity and the overall impact might be further diminished were the threatened 10% universal tariff applied to all countries, thus not placing the euro zone at a competitive disadvantage elsewhere.

That being said, indirect knock-on developments could impose a greater cost to the euro zone, notably a broader shift towards protectionism. Were Mr. Trump to press ahead with the threatened 60% tariff on China, European firms could experience even greater competition from Chinese manufacturers seeking to redirect exports away from the US. More generally, adjustments made in response to altered US trade policy come on top of structural challenges for Brussels including the need to spend more on defence at a time when national public finances are already stretched. The European Central Bank, already pivoting away from residual inflation concerns and towards propping up lacklustre growth will loosen monetary policy further. On top of that, President Christine Lagarde has revived the long-standing debate regarding the creation of a new Eurobond market which would, if it came to fruition, provide investors with a new, stable, and likely sizeable asset.

In the context of the uncertainty surrounding President-elect Trump’s trade policies, political turmoil in the euro area’s economic powerhouses, Germany and France, is the last thing an already embattled Brussels needs. Incumbent administrations have lost confidence votes, in no small measure associated with pre-existing domestic economic pressures and in the case of the latter a burgeoning fiscal deficit. Elections in Germany have been brought forward to February, while in France President M. Emmanuel Macron has been forced into appointing the country’s fourth Prime Minister in under a year. With no major grouping in the National Assembly holding a majority and politicians in no mood to compromise there is little chance that France will achieve the fiscal consolidation necessary to put a deficit/GDP ratio of 6% on a sustainable footing.

> The direct impact of the threatened 10% tariff on all US imports, although an additional cost for exporters, would only amount to a fraction of a percent of euro zone GDP.

The uncertain outlook has caused credit agency Standard & Poor's to cut its rating, an additional worry for investors already perturbed by a widening spread between French and German bond yields.

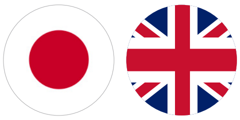
Although the political situation in Germany is less fraught, the election will not turn the ailing economy's fortunes around. Having broadly stagnated since the pandemic, a worse outcome than that experienced by its regional peers, the outlook remains poor. A weak labour market is depressing consumption, employment growth has stalled and will likely go into reverse in part the consequence of automotive giant VW's plans to shutter three manufacturing plants for the first time in its long history. Meanwhile industrial output has slumped and with order books at depressed levels a near-term turnaround is unlikely. The export sector on which the German economy has come to rely is under pressure, producers are already reporting a loss of international competitiveness and that's without the US tariff threat. A turnaround could be achieved through a loosening in the country's strict fiscal rule , the so-called 'debt brake', but political parties are keeping their cards close to their chest as potential bargaining chips in likely post-election coalition talks.

DIVERGENT PROSPECTS FOR EMERGING MARKETS

Turning to emerging economies and potentially very divergent prospects for the two economies thought likely to bear the brunt of a more isolationist USA: the Mexican economy appears most vulnerable. Not only are the country's public finances in poor shape already, but a stronger dollar would also likely limit the scope for policymakers to counter the impact of tariff implementation through fiscal or monetary policy support. In contrast, South Asia might prove a net beneficiary. Certainly, the imposition of a universal 10% tariff would not be consequence free but if accompanied by a 60% tariff on Chinese goods export it could allow regional producers to gain market share and encourage inward investment. Such a development would be beneficial to Vietnam. The Indian stock market has given up some ground after a stellar start to the decade. Despite a still favourable macro backdrop, equity valuation fully reflects this, and a Trump presidency (strong dollar) would tighten financial conditions imparting a headwind to upside progress in so doing.

SUPPLY CHAINS

In a world in which supply chains can be long, complex and where component parts often cross borders numerous times during their assembly, the impact of tariff imposition broadens potentially engulfing US manufacturing firms too. Businesses thought protected by the introduction of tariffs on competitive imports would still be forced to pay higher imported input costs. Additionally, any drop in US imports could trigger a drop in exports of US-produced parts used in the manufacture of goods overseas.



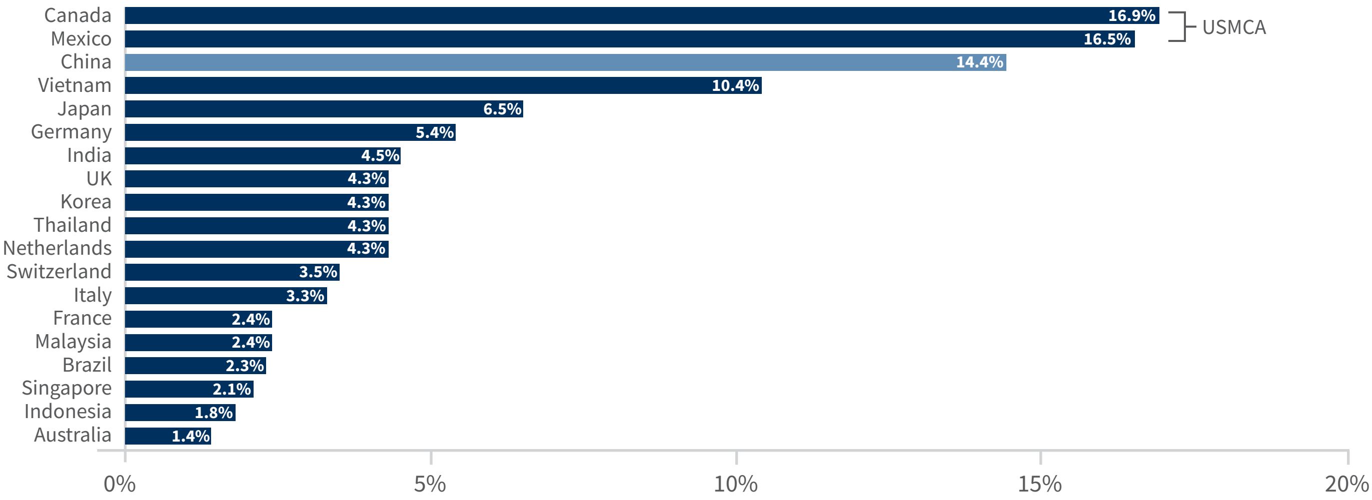
JAPAN AND THE UK

If China is no longer to be the United States' 'Most Favoured Nation,' might that mantle shift to Japan? Whilst standing ready for tariff imposition, Japan's free trade agreement with the US may mean its economy gets off lightly. Note that Japan sees itself as a good partner to the US, with total investment hitting $783 billion (15% of total cumulative foreign direct investment into the US in 2023). This may not be good enough for the Trump administration given Japan's economic relationship with China. Facing long-term structural headwinds of its own, a contrite (and unstable) minority ruling coalition has agreed to a JPY 13.9 trillion ($92.4bn) supplementary budget containing stimulus measures aimed at reflating the economy through increased consumption. This would add 0.6% to real GDP growth in 2025 alone, through increased consumption and public works spending and further expansionary fiscal policy measures cannot be ruled out.

Other than pharmaceutical products and automotive exports, the UK economy is not generally exposed to the imposition of US import tariffs. Goods trade between the two economies is broadly in balance and although the UK runs a trade surplus with the US in services of £69bn (2.5% of UK GDP, 2023) Mr Trump's desire to improve the fortunes of US manufacturing above all else implies that the UK should escape fairly lightly (+/- 0.1% GDP in 2025). More pertinently, Finance Minister Rachel Reeves' budget focuses on investment to boost the UK economy's longer term productive potential. The policy may work, but only over time and likely with the support of the Bank of England which, in common with the Federal Reserve, is expected to cut interest rates only very gradually over 2025.

US Goods Imports by Country

Proposed tariffs may have uneven impacts on US trading partners.



Source: FactSet, data as of 31/10/24

Governments around the world are adjusting to prepare for a more isolationist US administration.

CONCLUSION

From Brussels to Tokyo and Taipei to Kyiv, governments around the world are adjusting to prepare for a more isolationist US administration led by a president who sees diplomacy in purely transactional terms. The challenges confronting the world are that much greater in an economic system being reshaped by the fracturing relationship between the US and China, a process Mr. Trump did so much to accelerate during his first term of office. Most of all, the return of President Trump and his newly forged cabinet will result in a more uncertain global policymaking environment. The shift in attitudes both towards Beijing and Washington will be the defining legacy of 2025, initiating a potentially profound adjustment in the global economic order.

KEY TAKEAWAYS:

- The global economy will grow at a pace close to that achieved in 2024.
- The direct impact of tariff implementation will be quite small but the indirect impact will be greater and more persistent.
- Inflationary pressures will slowly subside to target allowing room for central bank policy loosening.
- Beijing faces two challenges, to offset aggressive tariffs on exported goods to the US and address the growing solvency crisis in its real estate and financial sectors.
- Tokyo's efforts to reflate the Japanese economy will deliver a cyclical revival. The Bank of Japan will deliver limited rate hikes.
- Goods trade with the UK is broadly in balance. The focus for the UK economy will be on Finance Minister Reeves' ability to raise productivity and growth. Bank of England policy will be broadly supportive.
- The macro backdrop is consistent with positive returns from financial market assets, but prospects will vary across differing geographic locations.

Disclosure

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Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

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While interest on municipal bonds is generally exempt from federal income tax, they may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

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Beta compares volatility of a security with an index. Alpha is a measure of performance on a risk-adjusted basis.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

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The indexes are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities. The Shanghai Composite Index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

The VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

The MSCI Emerging Markets Index is used to measure the financial performance of companies in fast-growing economies around the world. The MSCI China A Index measures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The MSCI Pacific Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region. The MSCI USA Index is designed to measure the performance of the large- and mid-cap segments of the US market. The MSCI Europe index is a European equity index which tracks the return of stocks within 15 European developed markets.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

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