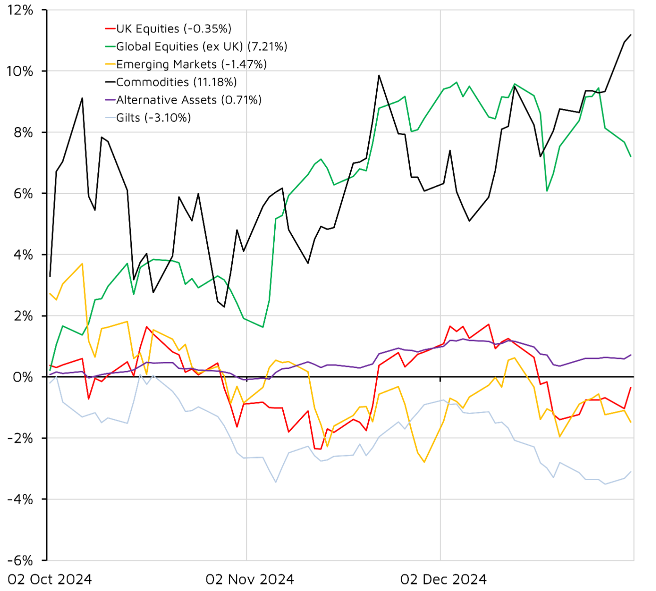
WINTER OUTLOOK

REVIEW OF THE PAST QUARTER:

US and global equity indices gained as big tech companies backed up aggressive valuations with further revenue growth and higher profits. Other sectors of the US equity market increased as robust consumer spending helped increase profits, and slowing inflation allowed the Federal Reserve to cut rates further. The re-election of Donald Trump as US president also provided a boost. UK equities faded during December as economic growth remained weak, businesses turned more cautious about hiring and manufacturing slowed. There was further volatility in Japan, partly due to uncertainty in Japanese politics; however, Japanese equities markets made a gain for UK investors. European equities continue to struggle in the face of weak economic growth and lower demand for manufactured goods from the US and China.

Emerging market equities declined as a stronger US dollar weighed on sentiment and concerns about high valuations saw Indian markets fall slightly. Chinese government stimulus triggered a big rally at the end of September but they have reversed much of their gains due to weak economic data and a combative US stance on trade. Bonds have lagged as markets revised rate cut expectations in the US and UK. US economic strength and concerns over inflation from the UK Budget and the US election have also pushed down bond prices. Corporate bond markets gave back some gains to end close to their starting point as well.



Performance Data Calculated on a Total Return Basis

ASSET CLASS RETURNS

Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Property
+1.05%	+2.32%	+1.42%	+2.28%	+2.26%	+0.18%	+2.46%	+1.61%

THE ACTUARIAL VIEW:

The outlook for equities is better than fixed income; however, the short- and medium-term outlook has been complicated by the US presidential election. A general outlook for above-trend growth and slowing inflation should be supportive of risk assets. Quality global companies are well placed for the current forecast and global small caps offer attractive valuations. The return of Donald Trump to the White House has improved the growth outlook for the US, compared to the EU and UK, but has also brought potential inflation over the medium term. The outlook for Japan remains positive as ongoing corporate reforms and stronger economic growth are likely to be supportive. Recent monetary and fiscal stimulus in China is unlikely to turn around Chinese economic growth, but it is unlikely to get any worse.

The outlook for global corporate bonds is balanced. The spread over government bonds is relatively narrow, implying they are carrying high valuations, but default rates remain low. UK government bonds appear more attractive than the US, but the Bank of England has indicated the pace of interest rates cuts would slow, and resilient inflation and above average wage growth add to this argument.

WHAT TO LOOK FOR:

- **UK**: The Monetary Policy Committee (MPC) announcements and minutes are set to be released on 6 February. Preliminary GDP growth for Q4 2024 will be available on 13 February. Average wage growth and employment data to be published on 21 January. December retail sales are due on 7 January.
- **US**: There will be interest rate decisions from the Federal Open Market Committee (FOMC) on 29 January. Minutes will be published three weeks after each decision. GDP growth for Q4 2024 and full year 2024 is to be released on 30 January. Change in Nonfarm Payrolls is expected to be available on 10 January. The December inflation rate is due on 15 January.
- **Eurozone**: Quarterly GDP flash data is set to published on 30 January. A European Central Bank monetary policy meeting is scheduled for 30 January. December inflation for the eurozone is published on 7 January.
- **Other data**: Chinese inflation for December is due on 12 January. Chinese retail sales and house price index data is due on 17 January.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: Inflation remains near target as the Bank of England slowly cuts interest rates. Economic growth shows signs of improvement, but consumer sentiment and business activity stay weak. There will be less of a gap between small and large companies due to the recent underperformace of smaller companies.. Housebuilders, technology and other rate-sensitive sectors should benefit from falling rates.

Worst Case: Wars in Ukraine and the Middle East drag on and keep commodity prices high, leading to higher inflation. The incoming Trump presidency leads to the US dollar's devaluation as inflationary pressures from trade tariffs drag down global markets. Monetary tightening contributes to a sharp correction for equities and bonds but the UK may do better than other markets due to lower relative valuations.

Best Case: Central banks cut rates as inflation falls without harming unemployment and growth. From its low valuation base, the UK outperforms other markets as high and sustained growth returns. Peace returns to Ukraine and the Middle East, keeping inflation subdued. With more bullish sentiment, money flows into UK equities. Such a sustained bull run will benefit smaller companies the most.

CASH

Most Likely: Money market yields are kept steady, with the Bank of England taking a cautious approach, with moderate rate cuts as inflation gradually eases and the economic environment remains stable.

Worst Case: If economic indicators signal a significant growth slowdown, the Bank of England may aggressively cut interest rates, lowering yields on money market funds and making government bonds more attractive, thus reducing the appeal of cash instruments for investors.

Best Case: Money market instruments continue to provide attractive yields as the Bank of England holds rates steady as inflation proved to be stubborn and above its target. Returns adjusted for inflation improve as inflation falls.

GLOBAL EQUITY

Most likely: A reduction in inflation helps the Federal Reserve cut rates. This benefits smaller companies and the dominance of US technology stocks diminishes. Energy markets remain changeable due to geopolitical tensions and mixed demand. European inflation falls and the European Central Bank cuts rates to drive up economic activity but political uncertainty undermines business confidence.

Worst case: War in the Middle East and Ukraine escalates. Geopolitics and bad weather cause supply shortages as energy and food prices soar. Central banks hike rates as they fight stagflation and bank lending falls. Energy and defensive sectors are likely to act as safe havens due to Europe's dependence on food and energy imports.

Best case: Peace in Ukraine and the Middle East eases inflationary pressures and China's economy rebounds. Disinflation continues and central banks cut rates further and this lifts markets. A rise in cyclical sectors like industrials and consumer discretionary leads US and European markets higher. Tech stocks rise as the application of artificial intelligence improves productivity and earnings.

FIXED INCOME

Most Likely: Less aggressive US interest rate cuts given the implications of Trumpian policy as US protectionism risks inflation. There are risks of mild recession if weaker global growth impacts labour markets elsewhere. The Bank of England faces pressure to cut rates, given weak growth. Providing no there are major shocks, quality credit should do well. However, government bonds are likely to be volatile.

Worst Case: Developed markets experience unexpected reflation and negative growth surprises. New US trade policies pose a 'stagflationary' risk. Central banks begin 2025 with a slower rate of cuts than expected and this hits bond issuers struggling to refinance, and consumer spending flags. Government bond prices decline. Defaults may pick up, and investors may suffer capital losses in riskier and emerging markets.

Best Case: Inflation slows to target as government bond yields fall further at the shorter end. Defaults in credit show no significant uptick. Global profit margins remain stable, and a 'soft landing' in 2025 is all but declared. The incoming US government is less severe than expected for global growth, and returns in credit markets stay strong.

EMERGING MARKET EQUITY

Most Likely: Chinese government stimulus has a modest but beneficial impact on China's growth as more substantial intervention is likely needed to stabilise the weak property market and boost domestic demand. US-China tensions will escalate. The return of Donald Trump to the White House brings more trade tensions, particularly with China, and the potential for a higher dollar.

Worst Case: China's stimulus fails to achieve its objectives and deteriorating US-China relations adds to weak economic growth. Rising US inflation forced the Federal Reserve to hold rates, which would be unfavourable for emerging markets. Further volatility in tech stocks hurting markets such as Taiwan and South Korea.

Best case: Chinese equities receive a boost as government stimulus stabilises economic growth. Slowing inflation in the US allows the Fed to cut rate further and this helps emerging markets. Indian growth accelerates, fuelled by foreign direct investment. The tech-focused markets of Taiwan and South Korea attract further inflows on the back of AI-related optimism.

ALTERNATIVES

Most Likely: Economic growth moderates with stable inflation, creating an environment where liquid alternatives can yield consistent returns. Liquid real assets are attractive as an inflation hedge, while hedge-fund strategies excel by capitalizing on increased market dispersion and effectively managing risks during periods of market volatility.

Worst Case: In scenarios where equity markets experience an upswing, predominantly driven by major US technology stocks, it is likely that liquid real assets and most hedge-fund strategies will underperform.

Best Case: Solid economic fundamentals support real asset sectors, and market volatility offers profitable opportunities for hedge fund managers.

Data Sourced from FE Analytics and MSCI