

THE “GOLDEN AGE”

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INVESTMENT VIEWS
FROM OUR PARTNERS
AT WALTER SCOTT

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KEY POINTS

1 The US economy is broadly in good shape, but the complexion of the equity market may change.

2 For a “museum,” Europe has some great companies, while Japan still offers opportunities amidst economic uncertainty.

3 We don’t share the overly pessimistic consensus view on China.

At his recent inauguration, President Trump forecast a golden age of prosperity for America, founded on smaller government, tax cuts, and the promise of trade and security policies squarely aimed at putting the interests of the nation first.

What to expect from Trump 2.0 has been a focus of attention for global investors over the last few quarters as they mull the prospect of a reset in US security and trade relations among its allies, trading partners and “frenemies” alike. Wall Street has welcomed the growth-positive aspects of fiscal laxity and a looser regulatory grip.

Good, but with a few blemishes

Not that the US economy has been performing poorly. Gross domestic product (GDP) rose at an annualized 3.1% rate in the third quarter, with Main Street continuing to open its wallet, albeit selectively. Several US retailers are continuing to report price sensitivity among their customers, as the lingering effect of inflation weighs on certain areas of spending.

Additionally, as indicated by the ISM Purchasing Managers’ Index, manufacturing activity remains in contraction territory. That said, the rate at which it is declining has moderated. However, notwithstanding the uncertainty over

the impact of tariffs on US inflation and supply chains, President Trump’s fiscal adrenaline shot may assist the long-awaited turn in the industrial cycle as well as underpin personal spending. Consumer penny-pinching seems selective, with recent trends showing rising demand for luxury goods, which has offset some of the overly negative sentiment towards the sector’s prospects in China.

In light of US economic vigor, and with a nod to the potential inflationary effect of tariffs, we believe the Federal Reserve’s (Fed) caution over the pace and scale of interest rate cuts makes sense.

The market’s broadening gaze

Although the market is now musing over the Fed’s next monetary steps, the shift towards cheaper money has helped provide a solid backdrop for equities over the last two years, although market performance has been skewed by the narrowness of returns. In 2024, the Magnificent Seven accounted for 47% of the MSCI World Index return.¹ To a large extent, this reflects the market’s pursuit of the artificial intelligence (AI) theme, but over time we would expect this interest in AI to broaden. Notwithstanding any policy-induced volatility as the president pursues his economic agenda, the near-term tailwinds for US equities are likely to persist.

A museum?

Ana Botin, the chair of Santander Bank, recently stated that “[Europe is] at risk of becoming a museum.” This was a clarion call for the region to give itself a shake economically and politically in view of external and internal challenges. The European Commission downgraded its forecast for 2025 in November, now expecting the region’s GDP to grow a modest 1.3% year on year. Lower inflation and further European Central Bank interest rate cuts are expected to bolster personal spending, but industrial production across most of the region remains sluggish.

This is particularly the case in Germany, where energy costs, slow demand, and competition from China has blighted the industrial environment. Not that this has inhibited the equity market, with the Dax index rising 19% in local currency terms in 2024. Perhaps not quite a case of “Die glorreichen Sieben” (the Magnificent Seven), but a select number of leading companies led the charge, including enterprise software giant SAP.

Political leadership in Europe, or lack of it, has periodically caused some market jitters. The fracas in France over how to contain the burgeoning budget deficit has continued, dampening the stock market last quarter and inducing a temporary spike in bond yields. This is perhaps indicative of the fact that investors have not forgotten that even in the face of lower interest rates, there is a cost to be paid for fiscal abandon in the form of higher bond yields and, consequently, the cost of credit. The US enjoys the privilege of being the world’s reserve currency and, thus far, has been able to run huge deficits without bond vigilantes making a disruptive appearance.

But if Europe is a museum, it contains more than a few active and enterprising exhibits. Despite the macro headwinds, it remains a repository for leading, globally competitive companies with high barriers to entry in fields such as healthcare, specialized information technology, key industrial processes, and luxury. We have never defined an investment opportunity by the macro vagaries of its place of listing. This holds true of Japan, which has endured its fair share of economic false dawns in the forty years we have been investing in the country.

Focusing on companies

Japanese equities were robust last year, with the market reflecting the competitive benefits of the weak yen and signs of better corporate governance. However, the extent of the fall in the currency not only undermined market returns in US dollar terms, but also sustained unwanted cost-push inflation. Demand-led inflation has long been a goal of the Bank of Japan (BoJ).

The bank still hopes that real wage growth will pick up and invigorate personal spending, and it has a cautiously optimistic view of the economic outlook, albeit some of that is based on expectations of improving overseas trade. Interest rates look set to increase, but the BoJ will tread carefully given the still-fragile state of the economy. We remain broadly agnostic on the “macro” prospects for Japan. Rather, we are more encouraged by the opportunities afforded by some of its leading companies. These include areas such as technology, where many are lynchpins in key processes, or in factory automation, where global and domestic demographic trends offer long growth runways.

¹ Walter Scott, Factset and MSCI in US\$ terms, as of 12/31/24.

The Middle Kingdom

Investor and media sentiment towards China has remained broadly negative in view of the economic slowdown and the lengthy downturn in parts of the property market. Compounding this are the additional tariffs on Chinese export goods at a time when the Xi administration is promoting the development of a value-added, globally competitive industrial sector.

However, while we don't underestimate these challenges, as regular visitors to the country we don't share the consensus pessimism about China. The trend of global companies moving production from China to other countries is ongoing, but there are limitations. China remains an integral part of both the global economy and hard-to-unravel supply chains. It also still represents a vast market opportunity for companies across the world.

The days of extremely rapid economic growth may be behind it, but the Chinese economy is still growing faster than the majority of developed markets. The Middle Kingdom is moving up the value chain and taking advantage of powerful growth trends in emerging markets. China's penetration into the electric vehicle market, and its growing dominance in solar energy, speak to success in its industrial evolution and the emergence of globally competitive corporate champions.

The immediate fixation of global markets in coming months will be on tariffs.

Tariffs are not new. Global trade has had a more protectionist bent for nearly a decade, stretching back to President Trump's first term in office. Many of the tariffs imposed at that time were retained by his successor Joe Biden, with some levies on Chinese goods actually increasing during his tenure. Companies have therefore had several years to adapt to a more protectionist world and to implement strategies to mitigate its impact, through diversifying supply chains or relocating manufacturing.

Long-term optimism amid uncertainty

As bottom-up stock pickers with a multiyear investment horizon, we have a positive view of the future. Core to our long-held investment philosophy is the belief that it is company fundamentals, not political or macroeconomic factors, that ultimately determine investment returns over time. Many of the world's market-leading, globally diverse businesses are well-versed in navigating changes in political and economic landscapes, while retaining the ability to take advantage of growth trends that will outlast near-term headwinds.

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About Walter Scott

Walter Scott is the global equities-focused investment firm within BNY Investments.

Artificial intelligence (AI) refers to computer systems that can perform tasks typically requiring human intelligence, such as visual perception, speech recognition, decision-making, and language translation.

DAX (Deutscher Aktienindex) is a stock market index that represents the 40 major German blue-chip companies trading on the Frankfurt Stock Exchange.

European Commission is the primary executive arm of the European Union.

Golden Age refers to a period in a civilization or society characterized by significant achievements.

Gross domestic product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.

ISM Manufacturing Index is a composite index that measures the change in production levels across the US economy from month to month

Magnificent Seven is an acronym to describe megacap tech growth stocks Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla.

Main Street is a colloquial term used by economists to refer collectively to America's independent small businesses

MSCI World Index captures large and mid cap representation across Developed Markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country. Investors cannot invest directly in an index.

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