Citizens
PRIVATE WEALTH™

2025 Investment Outlook

Opportunities amidst a changing landscape

Looking ahead to 2025, we believe that the world's major economies can sustain economic growth as inflation moderates. Ongoing geopolitical tensions and a new administration in the U.S. introduce questions about the path ahead, yet consensus is emerging that, on balance, policies from the second Trump administration will positively impact the domestic economy and markets.

Overall, we anticipate that lower monetary policy rates in 2025 will create an attractive environment for risk assets with potential opportunities in both public and private markets. We believe that flexibility around asset allocation and portfolio positioning will be key to a successful 2025, where active management is poised to add value in a dynamic investment landscape. In our 2025 outlook, we share our forward-looking views on the global economy, its impact on equity and fixed income markets, and highlight a growing set of opportunities in the private market space.

—**Michael Hans,** Chief Investment Officer
Citizens Private Wealth

Key Takeaways

- Changes in economic policy, regulations and tax code emanating from a new administration in Washington should positively impact U.S. economic growth and support risk assets as 2025 evolves. Broader policy implementation can be a catalyst for an uptick in market volatility.
- Global policy and economic divergence will offer investment opportunities for diversified portfolios in a more desynchronized world.
- We see the Federal Reserve continuing to lower rates, albeit at a slower pace than initially expected. We ascribe to a higher-for-longer narrative and foresee the neutral federal funds rate remaining elevated. We anticipate that markets will negatively react to headline risk around unsustainable increases in fiscal deficits.
- We are cognizant of high valuations and concentration across large-cap U.S. equities but continue to see the U.S. equity market valuation premium persisting. We anticipate increased levels of sector and company dispersion, which should favor an active approach to portfolio construction. The market is poised to continue broadening with select opportunities in value as well as across small- and mid-capitalization equities.
- International equities are trading at significantly lower valuations relative to U.S. counterparts and closer to their historical averages. Continued sluggish growth and political headwinds give us caution in the near term; however, long-term prospects are attractive. We adhere to using selective and nimble strategies as regional and sector positioning will be important. We continue to favor growth over value when investing overseas.
- Select alternative asset classes present compelling opportunities, particularly in private credit and private equity secondaries while we assess other segments.

Global Economic Outlook

United States

The post-election environment offers a wider range of potential outcomes dependent upon the numerous policies and initiatives from the Trump administration. While a variety of narratives emanate from strategists, we see the U.S. economy exhibiting considerable momentum as we move into the new year.

Uncertainty around policy from the new Trump administration increases the potential for higher market volatility, although we lean toward more upside on balance and expect the first 100 days post-inauguration to be critical for assessing policy prioritization and implementation.

Catalysts for U.S. growth will likely include policy change around deregulation, tax cuts, increased production of oil and natural gas as well as incentives for domestic manufacturing, while potential downside risks stem from tariffs, immigration and general policy uncertainty.

An extension of tax cuts passed during the first Trump administration has the potential to create larger than expected fiscal deficits, placing upward pressure on interest rates on the longer end of the yield curve, yet the upside to consumers and corporations of status quo or better on the tax front outweigh these concerns.

We see the appointment of Scott Bessent as Secretary of the Treasury as a positive influence in combating these scenarios. The focus on long-term economic growth to combat excessive deficits and overall debt burden must be a centerpiece of the administration's strategy to keep bond vigilantes at bay.

Coupled with change in Washington, it is fair to expect above-trend economic activity to continue as the Fed has demonstrated a considerable degree of support for the labor market, recently shifting attention away from inflation concerns. While prices should continue to moderate, the path to lower inflation will not be as easy as the improvement seen during the first half of 2024. Recent data remain choppy as embedded inflation appears likely to stay above the Fed's 2% target for some time.

Barring a surprise demand shock, the Fed's dual mandate of price stability and full employment seems somewhat achievable, leaving only modest room for rate cuts and monetary accommodation. This creates a scenario where a higher neutral federal funds rate anchors the front end of the yield curve and supports a higher-for-longer view. This environment offers an opportunity for yield-focused investors to deploy capital at attractive rates without taking significant duration risk.

International

Our view on global growth is less sanguine as we anticipate other major developed economies will lag the U.S. We continue to see the lack of synchronization of monetary policy across global central banks, impacting the pace of growth and business cycle. Weakness in broader European economies is poised to persist, particularly in manufacturing, which may also be impacted by U.S. tariff policy.

However, European manufacturers may be a potential beneficiary from Chinese economic stimulus and a rise in consumer demand, particularly around luxury goods and related industries. Europe will also continue to be negatively impacted by sustained higher energy prices, uncertainty stemming from the war in Ukraine and changing political crosswinds in France, creating a backdrop where the European Central Bank will likely ease rates as it tries to restimulate growth.

In developed Asia, we see a continued economic revival in Japan as the country appears to have broken out of its low-inflation regime, likely serving as a tailwind to economic expansion.

Emerging Markets

China unleashed significant stimulus during the second half of 2024 and is indicating a willingness to further support its economy, which has been in a state of malaise for the last few years. Continued stimulus should be broadly supportive of economic growth and positively impact neighboring emerging countries and select industries; however, U.S. tariffs on Chinese exports are expected to rise meaningfully, leading to slowing exports. Although it is too early to discern if overall steps will slow downward economic pressure, investors should note that historically it is important to highlight that China's economic performance and its equity market have generally not been strongly correlated.

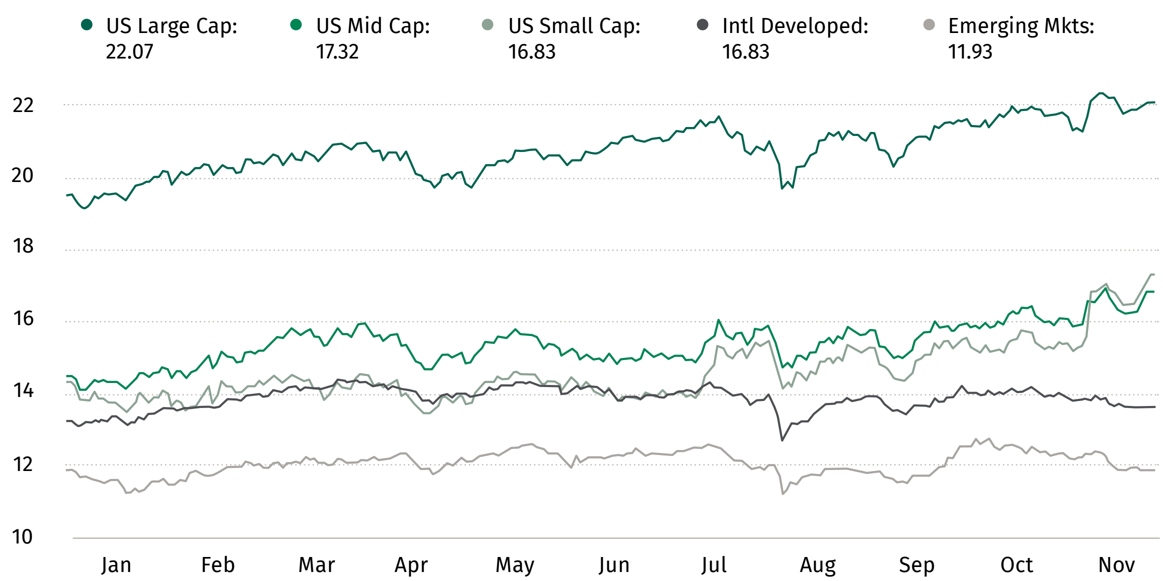
India has exhibited strong growth and stands to continue to benefit from favorable demographics, while other countries, such as Taiwan and South Korea, should benefit from semiconductor manufacturing prowess fueled by AI development.

Global Equity Outlook

Equity valuations and future earnings potential frame our 2025 equity outlook. Broadly speaking, the U.S. economy has consistently demonstrated its resilience, driven by innovation, robust consumer spending and policy flexibility. This has sustained U.S. equity market leadership relative to other regions for over a decade, and there is little evidence to suggest that this trend will reverse in the near term.

Although U.S. forward equity multiples remain elevated compared to both historical averages and international markets, we believe the willingness of investors to pay for the potential growth amidst high valuations of U.S. equities earnings remains warranted and should not reverse course without the fears of a recession unfolding.

Equity Valuations: Forward Price/ Earnings Multiple as of November 2024



(source: FactSet, proxy ETFs used IVV/IJH/IJR/EFA/EEM)

In the U.S., high-quality and strong cash flow mega-cap technology companies offer financial stability, exposure to strong secular growth trends, as well as represent cutting-edge new technologies and even provide some dividend income — a tough combination to compete against and arguably one that we believe deserves a higher-than-average price multiple.

On the other hand, international equities are more exposed to lower economic growth trends and on aggregate subject to a higher level of cyclicality. In our view, this warrants a valuation disparity — all else equal — purely based on market differences in company, industry, sector and style exposures across geographies.

2025 Earnings and Sales Growth Forecasts

	2025 CONSENSUS GROWTH FORECASTS	
	EARNINGS	*SALES*
U.S. LARGE CAP	14.70%	5.58%
U.S. MID CAP	13.21%	4.79%
U.S. SMALL CAP	17.81%	4.25%
INTERNATIONAL DEVELOPED	7.73%	2.56%
EMERGING MARKETS	13.94%	8.63%
WORLD	12.43%	4.98%

(source: FactSet, S&P 500/400/600 & ETF Proxy EFA/EEM/ACWI)

We acknowledge that discounted valuations can remain intact for extended periods of time, and investor sentiment toward international markets remains mixed at best. Although valuations on the surface are compelling, we do not believe we are in an environment where international equities are poised to generate a cyclical uplift and generate durable outperformance relative to the U.S.

Furthermore, the protectionist trade stance by the Trump administration could introduce headwinds for global growth, amplifying challenges for international equities. Successful portfolio positioning in 2025 will require a balance of global diversification and select exposure to U.S. centric opportunities, which stand to benefit from ongoing policy changes. We favor an active approach in this environment where sector and issue selection are important, especially within less efficient market segments.

	CITIZENS PRIVATE WEALTH 2025 EQUITY POSITIONING
GLOBAL EQUITIES	U.S. over International
WITHIN U.S. EQUITIES	• Overweight Small & Mid Cap • Maintain Large-Cap Exposure • Overweight: Information Technology, Financials, Communication Services • Underweight: Consumer Staples, Health Care
WITHIN INTERNATIONAL EQUITIES	Developed over Emerging Markets

Equity Positioning

United States

Within the U.S., we aim to maintain a neutral exposure to the admittedly expensive large-cap growth segment as the combination of high-quality names and robust growth outlook demands long-term investor allocation.

On a sector basis, we prefer employing a barbell strategy of exposure to secular growth and cyclical value, with higher returns likely stemming from information technology, communication services and the financials sectors.

- We seek to maintain exposure to the Magnificent Seven and the AI megatrend as accelerating innovation will present market opportunities to shape the future landscape.
- In Financials, deregulation will boost investor sentiment and capital markets activity, while an expected normalizing yield curve should boost profits for this cyclical value sector.
- We recommend an underweight to Consumer Staples, especially the higher-priced multinationals most exposed to volatile trade policy and tariffs as well as a strong U.S. dollar.
- We remain cautious on Health Care as any deregulation benefits could be overwhelmed by shifting policy and federal spending reductions. Moving down the market cap spectrum in the U.S., valuations become more reasonable in our view and present opportunities to deploy fresh capital.

Mid- and small-capitalization securities are poised to benefit from a stronger U.S. dollar and greater exposure to U.S economic tailwinds, in addition to competitive positioning created by trade policy and tariffs. We recommend employing an active approach to this space to avoid the lowest-of-quality and most-indebted companies that may be most impacted by a higher-for-longer rate environment.

International

We remain cautiously optimistic about international equity markets and recommend maintaining an allocation to non-U.S. markets within a diversified equity portfolio, despite the aforementioned headwinds. The segment should be supported by global disinflationary trends, easing monetary policy, attractive valuations and some positive earnings growth.

Selective and nimble managers can add value on a regional and sector basis, and we continue to favor growth over value when investing overseas. In addition, we believe there is a stronger case for developed markets relative to emerging markets, which are seen to bear the brunt of Trump's tariff policy.
U.S. protectionist rhetoric could disrupt investor sentiment, affect capital flows and dampen global trade activity. The resurgence of U.S. dollar strength poses additional headwinds for emerging markets, producing lower trade volumes and higher borrowing costs. We believe that developed equity markets are better equipped to handle these challenges due to their stronger economic fundamentals and reduced reliance on external funding in U.S. dollars.

Fixed Income Outlook

We expect the U.S. economy to continue to expand in 2025 at a pace relatively in line with current street consensus, remaining at or above trend in the coming quarters. We believe the policies of the new administration will ultimately result in the continued growth of the U.S. economy, with fears of a hard landing or recession dissipating.

Inflation data points have come down sharply as supply chain issues have been resolved and consumers have exhausted their savings, yet prices remain higher than initially anticipated. The core consumer price index (Core CPI) — which excludes food and energy — has experienced a recent uptick as shelter costs continue to rise. U.S. housing, for both buyers and renters, remains elevated due to increased immigration, scarcity of supply and higher borrowing costs.

The U.S. labor market remains strong overall and has started to show signs of normalization, with job growth slowing in the latter half of 2024. We are closely watching weekly initial jobless claims along with job openings and the monthly Bureau of Labor Statistics report to glean insight as to any signs of material weakness emerging.

Slowing wage growth, however, is a positive for the Fed's fight against inflation as is an increase in the measure of labor productivity. Accordingly, we believe this environment of above-trend growth, a strong but softening labor market and moderating inflation creates a scenario where the Fed will continue to reduce the federal funds rate, but at a slower pace than markets initially anticipated.

There are, however, risks to our outlook that are based on the same pro-growth policies by the new administration. An uncontrollable increase to the U.S. federal deficit and an upside surprise to inflation would not be welcome data points by the market. Both issues will need to be thoughtfully addressed by the incoming administration.

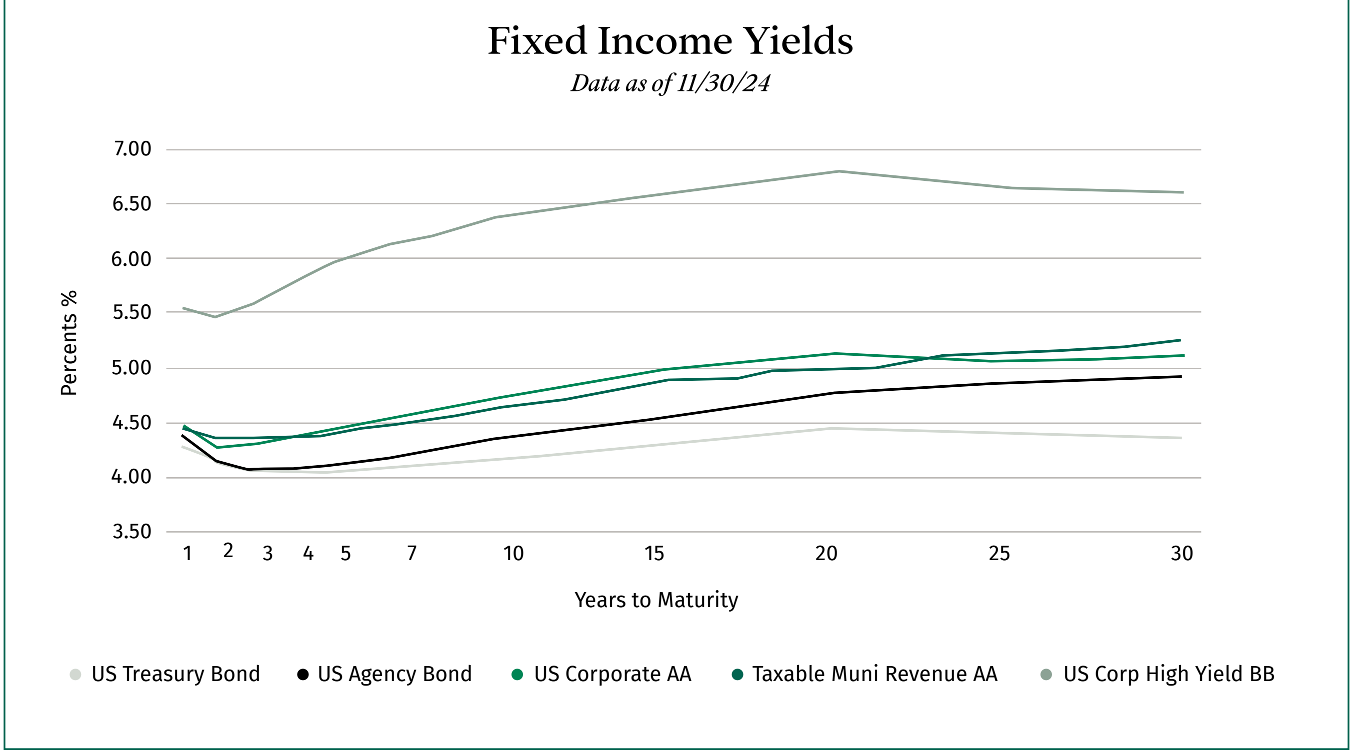
We will closely monitor the longer end of the Treasury yield curve as it will serve as a barometer for how the market interprets policy action prior to implementation. Currently, having recently dis-inverted, the yield curve portends a view of higher economic growth outlook with limited room for Fed easing. If long rates move higher in conjunction with continued increases in economic activity, our view is that this should be positive for the markets. However, should long rates rise without signs of increased growth, it would be an indication of market dissatisfaction with policy and a signal that market participants are losing confidence in their ability for the economy to generate sufficient growth to bring down the deficit and will put the Fed in a difficult position.

Fixed Income Positioning

Actively managed, noncore, fixed-income investment strategies have added considerable performance benefits during the last several years, and we retain conviction that they are poised to perform well in 2025.

While U.S. government bond yields are more attractive than they were in years prior, we see compelling opportunities in the credit and municipal markets. We believe well-constructed, flexible fixed-income strategies, which balance duration and credit risks, will positively impact performance.

We will continue to utilize fixed-income investment strategies that employ a flexible mandate with the ability to allocate across sectors and sub-asset classes along the yield curve. We remain cautious of taking long duration exposure as we carefully monitor the market response to ongoing policy changes coming from Washington.



(source: Bloomberg)

As the yield curve remains relatively flat, we believe the short to intermediate part of the curve offers the best value, allowing investors to take advantage of high absolute yields without having to meaningfully extend duration or take undue credit risk. Opportunities in the credit space, including investment grade, select high-yield and foreign bonds, municipals and private credit will be compelling in a well-constructed fixed income asset allocation that complements our equity outlook.

Credit

With yields sitting at relatively high levels, we believe credit markets offer attractive income for investors. Our outlook for U.S. corporate debt is generally optimistic, supported by positive macroeconomic factors and strong corporate fundamentals.

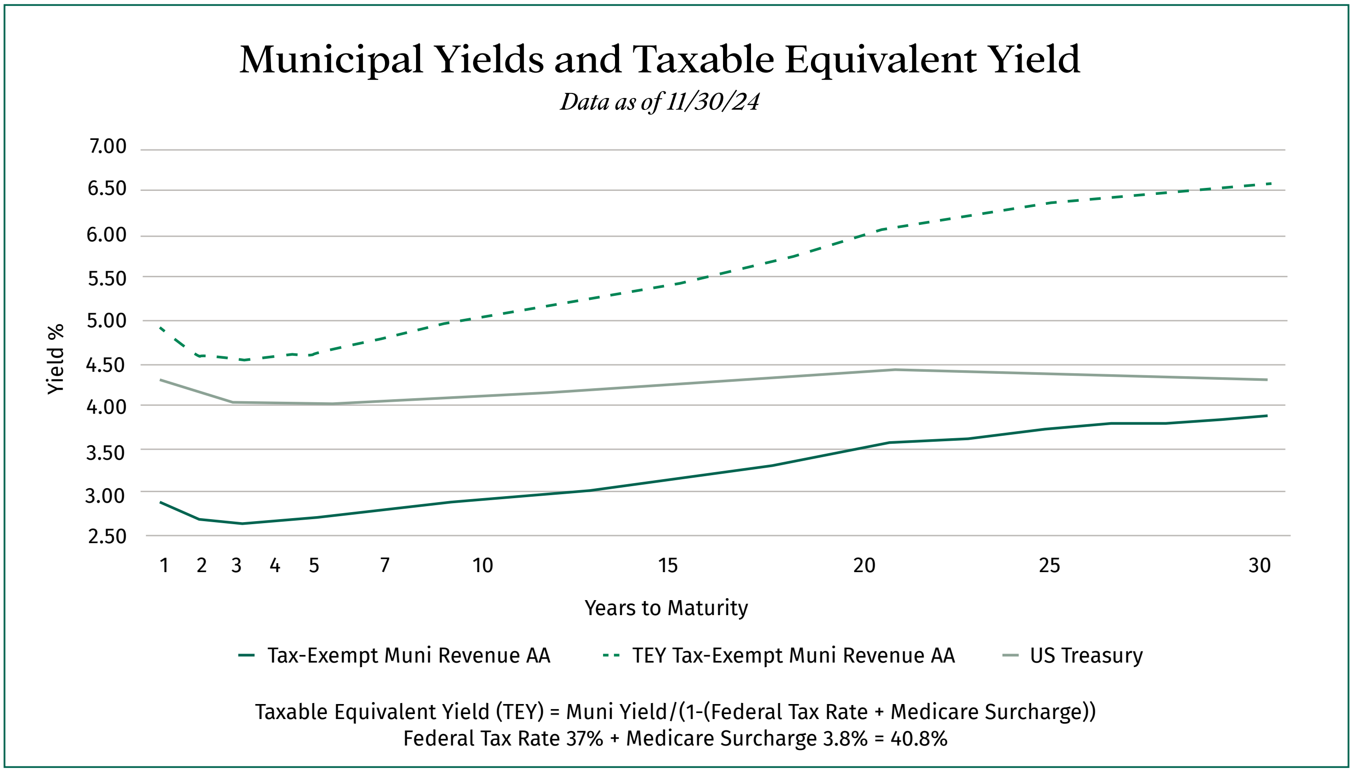
Pro-growth policies, including tax cuts and deregulation, can potentially boost corporate earnings, creating a favorable dynamic for U.S. corporate credit. However, as of this writing, spreads (defined as the incremental yield earned for holding credit relative to U.S. Treasuries of similar duration) for investment grade and high-yield bonds are at the lowest levels since 1998 and 2007, respectively. This underscores the optimism among investors over the potential for a favorable regulatory regime as well as a testament to the current health of the corporate credit market. We also acknowledge that this prices the market close to perfection, which makes sector and issue selection important within the broader allocation.

Regulatory changes will have sector-specific impact, highlighting the importance of active management and a well-balanced sector allocation. Counter-cyclical companies, such as health care and utilities, are poised to perform should growth slow. Sectors with strong growth potential and a stable customer base, such as technology and communication services, are potentially appealing should growth reaccelerate amidst a backdrop of increased demand for AI. Finally we retain a more positive view of financials, as they should benefit from operating with less regulation and within a more normalized yield curve environment amidst the positive economic cycle.

Municipals

The outlook for the municipal bond market remains favorable in 2025. The added diversification, tax favorability and resilience that municipals offer will continue to attract a mix of both conservative and opportunistic investors. Our forward-looking guidance favors a relative value focus and a duration-neutral stance.

Although the fundamentals for municipal issuers remain strong, we anticipate two opportunities that may compel investors to enter the market. First, new issue supply increases, most likely during the second half of the year, will create attractive entry points if demand isn't strong enough to match supply. Second, policy change in Washington may lead to increased volatility as yields respond to the expected impact on inflation, the deficit and economic growth.



(source: Bloomberg)

Our investment process favors issues with dedicated revenue streams to pay debt service. In addition, we believe the health of state and local government debt has been aided by improved fiscal positioning post-pandemic as they benefited from federal stimulus funds and a robust economic environment.

In addition, strong equity returns have decreased public pension liabilities, providing increased budgetary flexibility. Sectors like health care and education-dependent issuers are viewed less favorably as they may face heightened credit risks due to cost inflation and changing demographics. We also remain watchful of potential changes in federal funding commitment levels to states and municipalities, which could alter borrowing needs.

Alternatives

In a world where public markets are at or near all-time highs, alternative investments are an important component of a well-constructed asset allocation. We hold a positive outlook for opportunities within private market strategies as investors can benefit from similar economic tailwinds driving public markets while earning additional compensation for accepting illiquidity.

Within private credit, we believe direct lending offers an exceptional risk-reward opportunity, as its low volatility and correlation to public debt markets make it an ideal part of a fixed income asset allocation. As public credit spreads remain tight, direct lending offers higher current yields with a similar credit risk profiles, attractive to income-focused investors. We are not as favorable of distressed credit strategies and believe valuations are less compelling on a risk-reward basis and should be viewed selectively.

Within private equity, we find the most attractive area to be within secondaries. This segment of the private equity landscape is extremely viable as key advantages include investing in diversified portfolios of mature multi-vintage assets that are past the J-curve. They possess a shorter investment time horizon and have been acquired at a discount from motivated sellers. In addition, we find the sector attractive as there is pent-up demand for liquidity in the wake of a muted IPO environment and a relatively low level of recent capital markets activity. Outside of secondaries, we are increasingly positive on private equity investment and expect to find opportunities in growth/buyout as well as later-stage venture.

We retain a cautious outlook on real estate assets. Specifically, real estate and infrastructure should be closely monitored in 2025, as governmental policy shifts at the federal level will likely have large investment implications. We recognize that interest rates directly impact financing costs, so both activity and valuations may face downward pressure in a higher-for-longer rate environment.

Commercial real estate has been severely challenged due to the devaluation of office space post-COVID-19, and we see potential for further price erosion. We are more positive on residential real estate, given the supply-demand imbalance from a long-term undersupply of new homes.

Finally, we maintain a neutral outlook for hedge funds. As a group, we believe hedge strategies may generate higher absolute returns in 2025 than in recent years; however, on a relative basis, the risk-reward does not appear exceptional relative to the opportunity across private markets. Within the hedge fund universe, we believe that multi-strategy funds are a potential bright spot, leveraging structural and operational advantages by investing in spread trading businesses; however, each manager must be reviewed independently as returns will likely be disparate across the asset class.

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