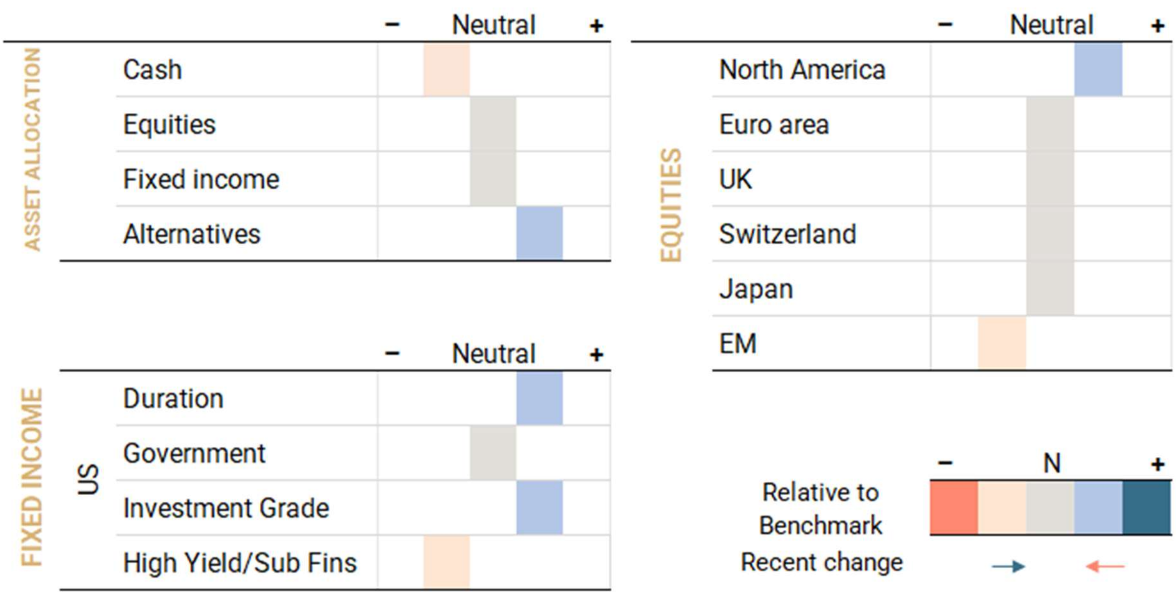
MACRO STRATEGY – Q3 2024

APRIL 03, 2025

Executive Summary

- The US stock market has diverged from the trend in global equities, with a sharp correction driven by multiples, affected by political uncertainty and tariff policies. Despite this, the correction appears to be part of a broader bullish trend rather than a structural downsizing;
- On the positive side, US policies are forcing stimulative fiscal measures in Europe and China, making previously ‘uninvestable’ markets attractive again. Investors are beginning to explore new geographic opportunities;
- Tariffs have contributed to market uncertainty, with some risks of stagflation. However, the economy remains supported by strong consumer conditions, fiscal consolidation, ongoing deregulation, and a cooperative Federal Reserve with room for policy adjustments if necessary;
- Overall earnings expectations for the S&P 500 have barely adjusted in the surface. Some sectors (financials, utilities) have improved while others (consumer discretionary, industrials) have declined. We updated our “S&P 500 inc.” model for the impact of tariffs, and it shows a reduction in earnings growth from 10% (expected at end 2024) to 4.3% YoY growth today. It is entirely possible that the market, at current prices, has already incorporated the lower estimate via a reduction of multiples, as they typically adjust earlier.

Novum Portfolio Allocation



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2025 started with the US stock market diverging from the rest of the world. The turnaround has been abrupt, after we had become accustomed to a very strong trend, with the leadership of the technology. But, as can be seen from the table below (1), the divergence is huge, and many investors are wondering whether Trump's isolationist policies impose a structural downsizing of the US capital market, or whether we are just witnessing a healthy correction (led by multiples, as we see below) within the bullish trend. **In our view, we are in the midst of a correction, so we have not considered reducing US equities or buying other markets, except for both a geographic and sector rotation within the equity book.**

	YTD % TR USD	YTD % TR Local
MSCI World	-1.11%	-1.11%
S&P 500	-3.91%	-3.91%
S&P 500 Equal Weighted	-0.49%	-0.49%
Mag 7 Index	-14.62%	-14.62%
Russell 2000	-9.46%	-9.46%
Euro Stoxx 50	13.13%	8.17%
SMI Index	12.33%	9.51%
CSI 300 Index	-0.64%	-1.05%
Hang Seng Index	16.29%	16.51%
Nikkei 225	-4.87%	-9.67%
MSCI EM	3.84%	3.84%

	YTD % TR USD
S&P 500 Info Tech	-11.83%
S&P 500 Comm. Serv	-5.25%
S&P 500 Health Care	4.69%
S&P 500 Financials	3.32%
S&P 500 Cons Discr.	-12.83%
S&P 500 Energy	10.85%
S&P 500 Real Estate	3.70%
S&P 500 Materials	3.19%
S&P 500 Industrials	0.41%
S&P 500 Cons Staples	5.53%
S&P 500 Utilities	5.26%

	YTD % TR USD
US Dollar Index	-3.87%
Bitcoin	-10.60%
BBG Precious Metals	17.46%
BBG Energy	4.34%

	YTD % TR USD
LQD (High Grade)	2.85%
HYG (High Yield)	1.47%
US Treasuries Index	3.19%
TSY 2 year (bps)	-35
TSY 10 year (bps)	-39
Bund 10 year (bps)	31
SOFR March 27 rate (bps)	-56

Table 1 : Y-t-Date returns for selected assets

What is happening in the 'rest of the world' however is positive, as US policies are pushing both Europe and China to stimulative (albeit partly rearmament-oriented - hence less positive, but still counter-cyclical) fiscal policies. As a result, we recognise that markets that were previously deemed 'uninvestable' are coming back under investors' radars, and thus also represent an opportunity for us to broaden our geographic horizons.

Most commentators attribute the correction in US equities solely to tariffs; it is clear that tariffs play an important, and negative, role, but we believe there are other equally important factors as well. In fact, markets (we use Europe and China as proxies) that should be hurt the most, as they suffer from tariffs and risk losing exports, are outperforming, with healthy Year-to-Date gains in many cases (all Europe and technology in China).

The origins of the selloff

First of all, we have to consider the starting point. At the end of 2024, positive sentiment was extreme, both in equities and currencies. The mantra had become that China and Europe were uninvestable, and the “trade” of the last two years, long US stocks and the US Dollar was inflated. Positioning (we use the American Association of Individual Investors Bull-Bear ratio as a proxy, picture 1) was quite elevated, multiples generous (between 21 and 22 for the forward PE of the S&P 500, above 32 for the Mag 7), and expectations for the future (in US at least) rosy. The market was expecting GDP growth of 2.5% in real terms, 6% nominal, and earnings growth between 10% and 12% over the next two years. Against this backdrop, the political change and the explosion of uncertainty triggered the correction, which has shaved 10% off the highs for the S&P 500 and 20% for the Mag 7.

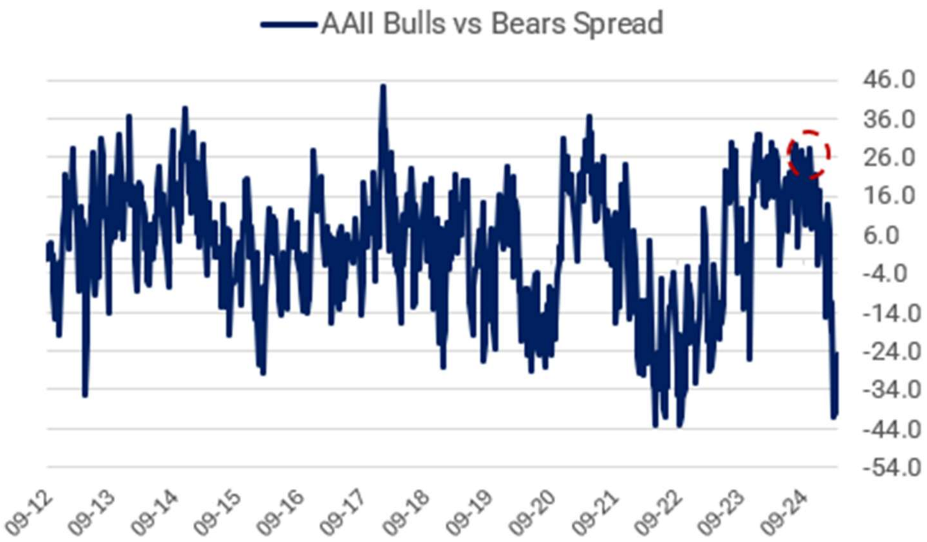

Chart 1: AAII Bulls/Bears, from extreme long in Jan, to very subdued levels today

The second aspect that is weighing on markets is the implementation of Trump's policies, relative to expectations. During the summer of 2024, equities started a rally in anticipation of Trump's victory, and continuing to rise until mid-January for a total move of more than 10% for the S&P 500. This was based on expectations of a repeat of Trump -1 Presidency. But during the past weeks Trump (and Bessent), have stated that they are not worried about market trends in the short term, while, on tariffs, it seems clear that they are not just a negotiating tool. Tariffs must be intended as an instrument to collect taxes (which will largely be ‘returned’ to extend or increase the tax cuts introduced in Trump-1).

On the issue of tariffs, communication also counts, and by now the market is getting used to aggressive announcements or changes of direction to sweeten the pill. This is probably a consequence of continuous negotiations between Hawks and Doves within the administration. Fortunately, we are approaching the fateful date of 2nd of April (“liberation day”), but the uncertainty does not help decision makers in companies, and probably consumers as well, as we’re seeing from sentiment polls published during last weeks.

The H2 ’24 rally was based on expectations of tax cuts and more deregulation; instead we find ourselves with tax increases (tariffs), cuts in public spending (DOGE), the fight against immigration (thus reducing the labour supply and possible pressure on wages).

Basically we can say that the “Trump put” does not exist for the moment, or that its strike is lower than expected.

Despite challenges, our long-term outlook remains constructive. Our message remains constructive for the long term. Our constructive view rests on four pillars: 1) consumers' conditions (pillar of the economy, 70% of GDP) remain solid. As we have shown in many presentations with our clients, households balance sheet has been restored over the last 15 years, while the labour market shows no signs of crisis, outside the cuts in the government sector. 2) Bessent's actions to bring the government deficit down from 6% to 3% is healthy and positive, addressing the problem that all critics have been indicating, i.e., excessive government debt and out-of-control interest spending. 3) Let's not forget deregulation, which is not off the administration's agenda, but has a longer time frame for implementation. 4) The direction of inflation has started to fall again, after a couple of worrying readings in January and February. The Fed for its part seems cooperative, letting politics take centre stage these months, but there have been no signs of concern or hostility from Powell or other governors. Moreover, Fed Funds are still at 4.5%, so there is plenty of room to cut should there be a financial accident (the Fed has a triple mandate, not only on inflation, but also on the labour market and long-term rates stability).

Some economists are quite concerned by the risk of stagflation due to the impact of tariffs on prices and activity. In the two graphs below (2 and 3) we propose the same data series, over 2 years (left) and 10 years (right). The grey line represents the breakeven rate, i.e. the inflation premium implied by the market; the blue line is the real yield prevailing. The message of the two graphs is quite different: for the short/medium term, the market fears stagflation, given the collapse of the real rate (which is accompanied by low growth). The 2 years real yield has collapsed from above 2% to 0.75% today. To the opposite, the inflation premium has climbed above 3%. For the long term, on the other hand, chart 3 to the right, the situation is under control: real rates and inflation are expected to be close to 2% for the next 10 years, without major fluctuations. At Novum, we believe in long-term expectations, and think that if the economy slows down more than expected, inflation will also fall, as it typically does following an economic slowdown.

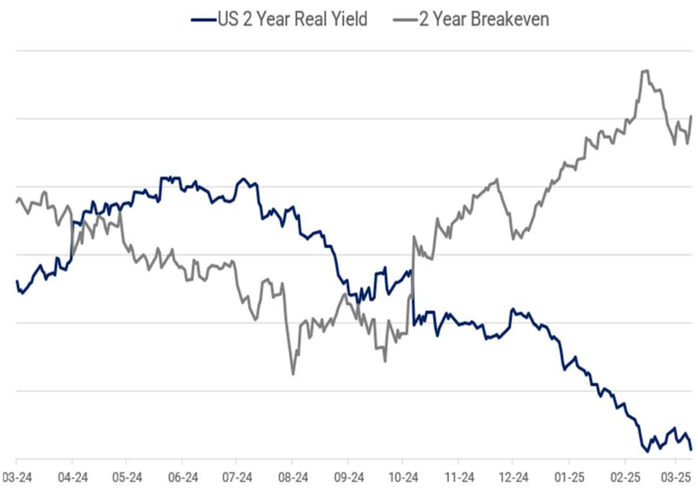

Chart 2: 2 Year real yields vs breakevens

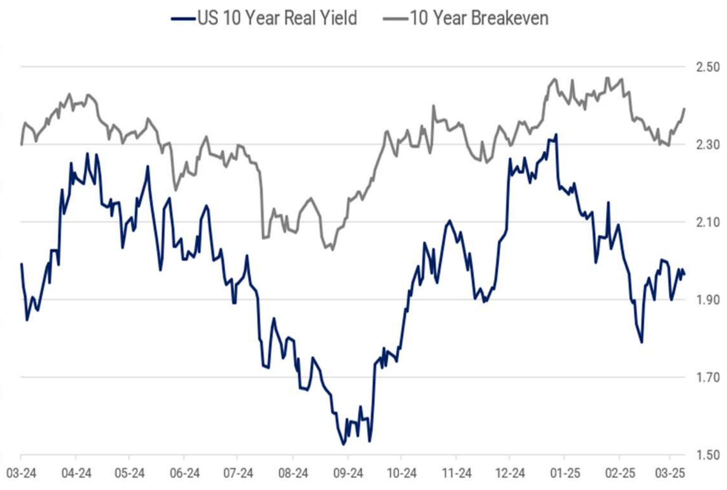

Chart 3: 10 Year real yields vs breakevens

The impact on corporate earnings

Within the CIO team there is a lively debate on short-term direction for markets. The most optimistic believe that the economy and earnings in 2025 will not be affected by the aforementioned issues, believing that as is often the case, soft data (which has already come on the weak side) will not translate into weak hard data. Conversely, other members fear that earnings will also suffer and expectations will have to adjust.

But let us take a quick look at the numbers with the support of some charts. Expectations for earnings in the S&P 500 stand at 270 at the end of 2025, up 10% from the level at the end of 2024. Expectations have fallen by 2.5% since mid-2024, but only by 1% since early 2025.

It is interesting to look at movements within a few key sectors: looking at the last 6 months, there are two sectors that have seen improvements, financials and utilities. The others (consumer discretionary, which includes autos, industrials and materials) have deteriorated, in some cases sharply. It is evident how, even if at the index level there are no major deviations, the market is already incorporating the impact of tariffs in the right direction (financials for example should do well in a closed and protected system, with higher interest rates and a steep curve). Table 2 shows the change in earnings expectations at sector level since the beginning of the year.

Materials	Financials	Utilities	Cons Discr	Health Care	Staples	Industrials	S&P 500
-10.4%	3.3%	-0.5%	-2.8%	-1.1%	-3.0%	-3.3%	-0.9%

Table 2: Year-to-Date changes in earnings expectations

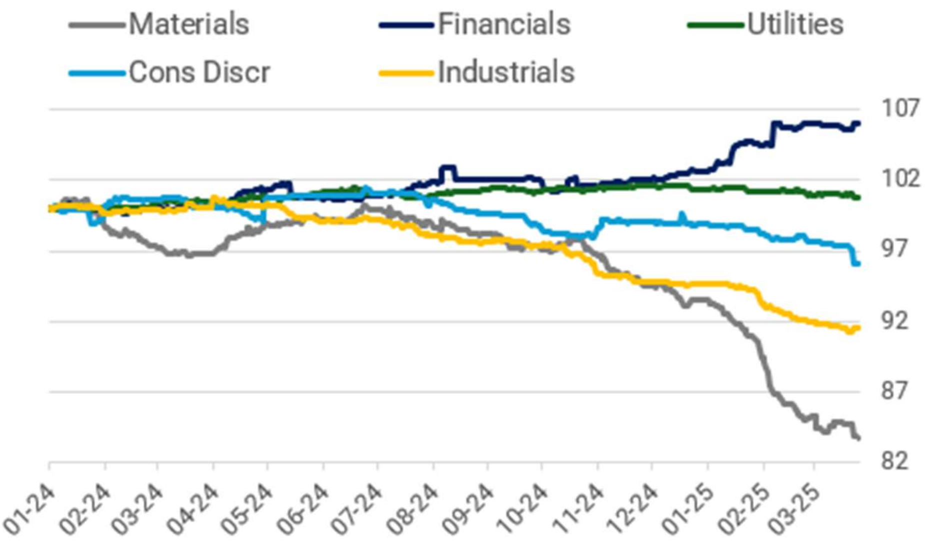

Chart 4: normalised earnings expectations over the past year

At the end of 2024, when preparing our Outlook for last year, you will recall that we drew up a simulation of an “S&P 500 inc.” income statement to show how earnings growth targets and index levels could be achieved. The assumptions of the exercise were based on the market consensus, which was favourable at the time but made sense. It was assumed that the economy (and thus corporate sales) could grow by 5% (equivalent to nominal GDP growth, including inflation), and that COGS would grow by 4% YoY, and operating costs by 3% (both above the level of inflation to be conservative).

We have now retrieved key data to estimate the impact of tariffs on 2025 earnings. Fortunately, the US economy is closer than commonly perceived, and we know that total imports (about 325 bln/month) amount to about 14% of GDP. Similarly, imports account for about 17% of total corporate sales (23 trn annual). Assuming an average weighted tariff of 25% on all American imports (we updated our tables for the worse after Wednesday's announcement), the impact on COGS hurts profitability and **thus EPS, which could rise by 4.3% in 2025 instead of the 10.5% assumed at the end of 2024.**

On multiples, we started the year with a forward PE at 22, and it stands at 20.3 now. A small rebound to 21, with a 4.3% earnings growth, would translate into a S&P 500 level of 5'367, 2.4% below current levels. This would imply a loss for the year 2025 (-8.7%), while a stabilisation in prices would, in our scenario, anticipate higher S&P 500 levels in 2026 (towards 6'000 area). In summary, our positive and higher targets for the S&P 500 are postponed.

However, these calculations do not take into account the impact of possible retaliation on US exports, as for the possible drop in consumption (and thus sales growth) due to the climate of uncertainty and the direct effects of the DOGE cuts on people and contractors.

	2024	2025	2026
SALES	1'882	1'967	2'065
(yoy change)		*4.5%*	*5.0%*
COGS	1'244	1'306	1'358
(yoy change)		*5.0%*	*4.0%*
GROSS MARGIN % *	33.9%	33.6%	34.2%
OPERATING COSTS	238	245	252
(yoy change)		*3.0%*	*3.0%*
EBITDA*	400	415	454
INTERESTS COSTS	27	28	29
TAXES	80	83	91
DEPRECIATION	47	49	51
EPS*	245	256	284
(yoy change)	*9.9%*	*4.3%*	*11.0%*
EPS MARGINS	**13.0%**	**13.0%**	**13.7%**
S&P 500 level	**5'880**	**5'367**	**5'960**
(yoy change)		*-8.7%*	*11.0%*

S&P 500 change from current level :	*-2.4%*

Table 3: "S&P 500 inc." income statement model

On the other hand, multiples have already retraced, especially in the Mag 7 segment, anticipating the normalisation of earnings growth. This is why in our model, *despite less growth* in earnings we did not adjust lower the PE estimate at year end. As can be seen from the two graphs below, Mag 7 multiples have gone from 33 to 26, while their earnings expectations have risen slightly in recent weeks. It is clear that lower and more reasonable valuations should offer support to equities in the next quarters.

Chart 5: forward P/E ratio for the Mag 7 Index

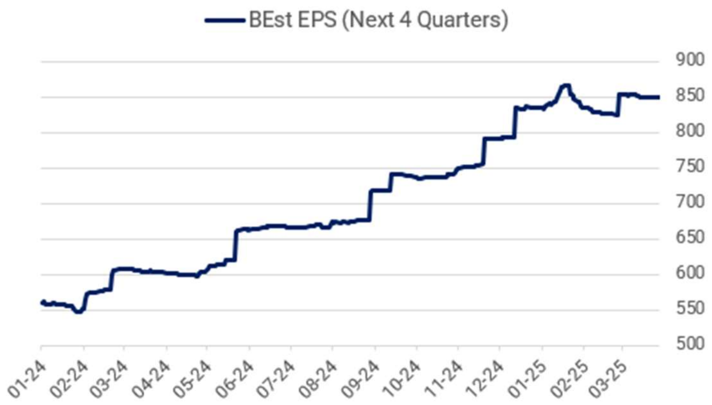

Chart 6: forward EPS for the Mag 7 Index

In conclusion, while maintaining our constructive tone, it is important to identify the key risks, i.e. the scenarios in which our model could be wrong. In fact, even if we forecast lower than previously expected earnings growth (+4.3% in 2025), this is still a respectable pace.

- Our assumptions on tariffs could be too mild and their cost fully absorbed by corporates;
- Inflation spikes and the Fed proves not willing to cooperate even if growth decelerates. This would affect equity multiples negatively;
- Uncertainty remains and soft data translates into hard economic data, so our assumptions on sales growth prove too high.