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Asset Allocation
Chart of the Month

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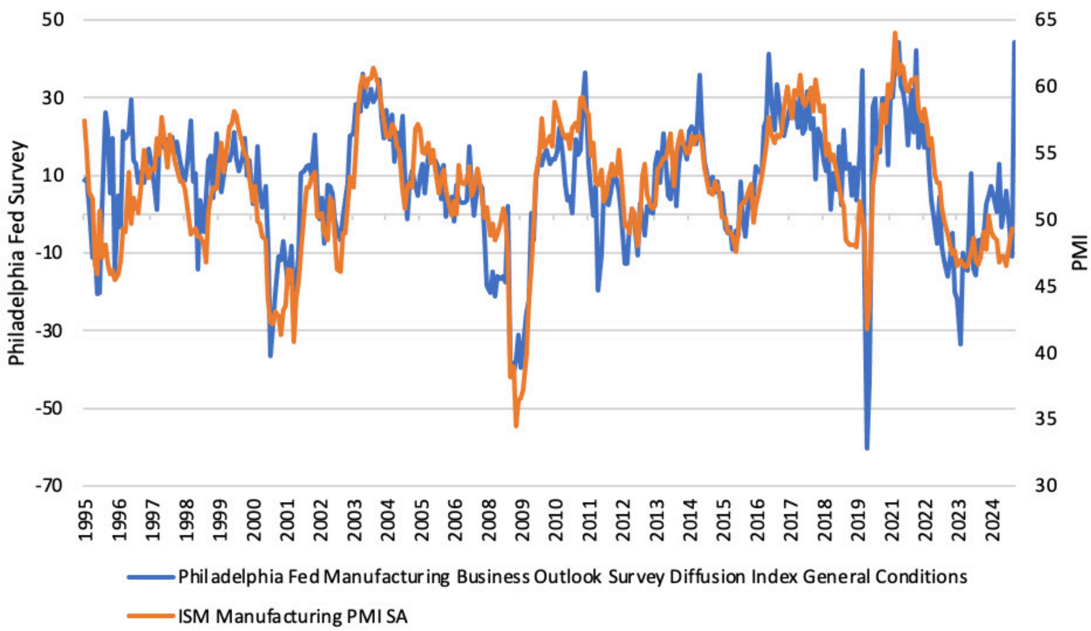
January 29, 2025

Interest Rates: Diverging

- We started 2025 with a U.S. biased, slightly risk-on posture. This stance reflects expectations for continued U.S. economic resilience, less restrictive monetary policy, and anticipated deregulation and tax cuts from the new administration. However, a huge leap in recent manufacturing survey data has prompted us to question whether we should increase our risk exposure further.
- In January, the Philadelphia Fed Manufacturers Business Outlook Survey surged to the second-highest monthly reading since 1995. While this is just one district, the survey has historically been a good proxy for the ISM Manufacturing PMI Survey. It also aligns with other indicators, including a notable surge in post-election CEO optimism - driven largely by expectations of deregulation and a more business-friendly policy environment.
- Other signs of renewed "animal spirits" in Corporate America include:
  - **Capital Expenditures:** A recent small business survey showed a sharp increase in capital expenditure plans. Small businesses would not be representative of AI spending, indicating a broadening of business spending.
  - **M&A** activity is expected to climb as antitrust scrutiny eases. Morgan Stanley's CEO highlighted that global M&A pipelines are at their highest level in seven years.
  - **IPOs:** Pitchbook forecasts a favorable outlook for IPOs, supported by improving financing conditions, tighter credit spreads, strong equity markets, and anticipated regulatory rollbacks for public companies.
  - **Foreign direct investment** into the U.S. is also likely to accelerate, driven by policies encouraging more domestic production. Additionally, some countries may seek to curry favor with the new administration by announcing large U.S. investments. Saudi Arabia, for example, recently unveiled plans to invest $600 billion in the U.S. over the next 4 years.
- While these developments appear positive for the economy and equities, we plan to wait for more definitive evidence (i.e. actual spending). Survey-based intentions don't always translate into action (let's hope they do), and we are already positioned to benefit from ongoing economic growth. Additionally, current market valuations are elevated, and although the Fed has cut interest rates, monetary policy remains restrictive. Finally, not all elements of the new administration's agenda are market-friendly, adding another layer of complexity to the outlook.

Manufacturing Surveys



Source: Bloomberg: Monthly data since 1995 through Dec 2024 for PMI and Jan 2025 for the Philadelphia Fed.

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