Macro Outlook Summary

February 2025

Some items on Donald Trump's action list are understandable and even make sense. Reduce inflation to enable lower interest rates and thereby reduce the massive interest bill on US Government debt is one. Others are to reduce energy costs through more supply, cut the dead hand of bureaucracy and government spending and finally engineer a weaker dollar. These objectives fit together and are all possible but how to achieve them is not so straightforward as it becomes increasingly evident that Trump doesn't care about the consequences for other economies and indeed global trade.

One of the upshots will almost certainly be a reversal of the inward capital flows of recent years into the US both because the USD no longer stays dominant but also because US growth prospects will be weakened so undermining equity valuations which are very extended. So, if capital is reallocated from the US, then where will it go to? Probably not just to one other country or even region as markets have already begun to indicate but flowing to multiple stories of change and awakening some sleeping giants. China, Japan, Emerging Markets all spring to mind as offering highly attractive investment stories which until now have been sidelined in favour of investing with the crowd into US Exceptionalism.

Usually, a weakening dollar goes hand in hand with Emerging Markets (EM) outperforming DM. The outperformance, enhanced by the currency effect, quickly triggers a positive feedback loop forcing investors with an EM underweight to follow this re-allocation as quickly as possible and at least get neutral or face the consequences of underperformance versus their index.

Such a transition from managers being overweight the US justified by the US Exceptionalism story to an EM re-allocation justified by attractive demographics, rising wealth and consumption, better fiscal profiles and a currency tailwind does not happen in a month but maybe a year. The shift to overweight is a bigger step lasting a decade and would bring with it a meaningful diversification benefit.

The correlation of MSCI EM to SP500 is currently 0.26 which is near to historical lows. MSCI China is even lower at 0.1. As the world reorganises into economic super-regions as a result of nationalism and a trade war with the US, then decoupling of economic performance between these different regions is easy to picture. We think this process is already under way and will pose an enduring challenge to recent consensus asset allocation thinking.