GENERALI INVESTMENTS

COMMUNICATION FOR PROFESSIONAL INVESTORS IN ITALY, FRANCE, AUSTRIA, GERMANY, SPAIN, PORTUGAL AND LUXEMBOURG

KEY INVESTMENT THEMES 2025

Our roadmap for the new investment landscape

Your Partner for Progress.

INTRODUCTION

The global economy avoided recession for a second year. Inflation began to cool and the major central banks embarked on a new cycle of interest rate cuts. However, geopolitical risk rose against the backdrop of a particularly busy election calendar around the world.

How will Donald Trump's return to the White House affect economic prospects in the US, Europe and beyond? How can investors position themselves for an increasingly divergent global growth outlook? Will inflation return in 2025? And to what extent will the adoption of AI continue? To answer these questions and more, Generali Investments' specialist, affiliated asset management companies present their views on the risks and opportunities for 2025.

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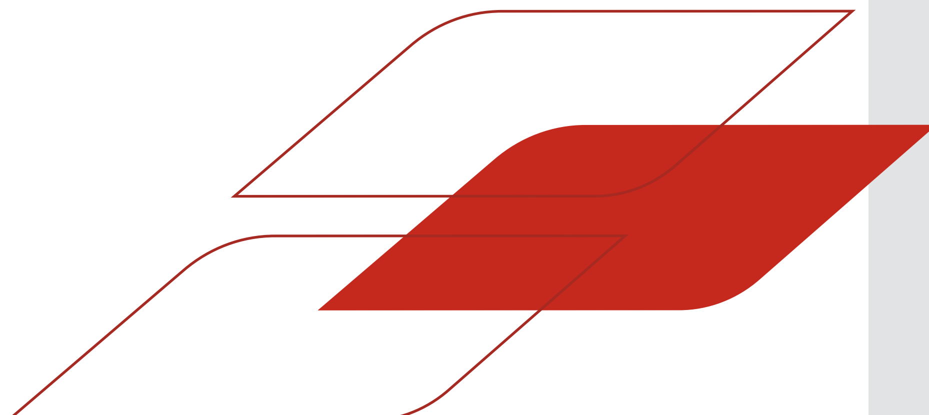


THE BIG PICTURE

The Market and Macro Research team at Generali Asset Management introduce the key themes they're monitoring for 2025.

2025 will be all about the implementation of Trumponomics. US economic exceptionalism is set to persist, but as the Republicans eye the mid-term elections, risking another inflation shock would not be wise. Our key themes for 2025 also includes the impact of technological innovation and rising concerns about sovereign debt sustainability.

1. Trump's sweeping victory: New challenges and opportunities

One key question for 2025 is whether President Trump will go 'full on' on his policy pillars: A) deregulation (banks, energy, etc); B) tax cuts; C) tariffs; and D) immigration. 2024 was very intense on the election front; inflation and inequality were key factors in the poor performance of incumbent governments (US, UK, France and even Japan). Trump's policies will not address the latter (corporate tax cuts will support elevated net income margins). But he may think twice about inflation. People are still upset about price levels, hence Trump may not go 'full on' on the most inflationary policies, (ex-China tariffs, the budget deficit and immigration). If instead he goes on unabated, the elephant will be in the Treasury room. Our central case sees modest US dollar gains from already rich levels. But a very aggressive policy stance, especially on tariffs, may exacerbate US dollar strength and threaten financial stability. Instead, a constructive 'grand deal' with partners would cause a dollar pullback.

2. Inflation risks – both sides now

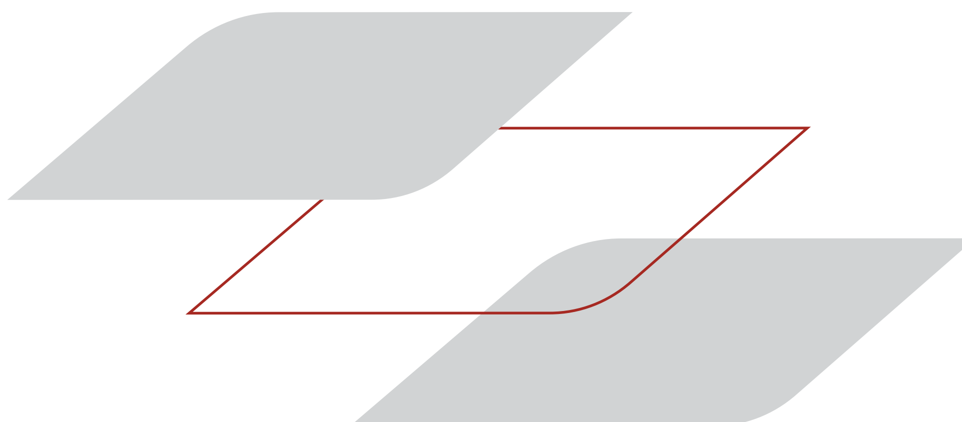
Inflation rates have eased off smoothly from their 2022 peaks (9% in US, >10% EA). But sticky price increases in services complicate the last mile towards 2% targets, as wage growth eases only sluggishly. This maintains upside risks for 2025, notably in the US amid still robust growth. Trump's plans of tariffs, tax cuts and immigration curbs add to medium-term risks. Yet in the euro area, inflation risk now seems two-sided. The economy struggles to gain traction. US tariffs would be disinflationary on this side of the Atlantic (regardless of some likely retaliation), adding to possible spillovers from Chinese deflation. This opens greater leeway for the ECB to cut rates (-150bp to 1.75%) than for the Fed (-100bp to 3.50-.75%) from end-November levels.

3. Productivity – can Europe catch up?

The transatlantic productivity gap has widened, with annual gains over 1995-2020 in the euro area (1.0%) only half that of the US (2.1%). Since 2020, output per hour in the euro area has almost stalled, while the US almost recouped its pre-pandemic trend. A small European catch-up is feasible near term, as euro area productivity is more cyclical and a mild 2025 recovery will help. Further out, however, the US seems much better equipped to reap the gains from AI and further deregulation, while Europe keeps struggling to agree on a banking union and a single market for services as key milestones to foster innovation and enhance scale and competition.

4. Debt sustainability – another Truss moment looming?

Government bonds have cheapened – massively but orderly – over the past couple of years, on a swap spread basis, on both sides of the Atlantic. This reflects many factors, including the large increase in government debt, QT, and bank balance sheet constraints. Yield curve steepening through the rate cut cycle may support the trend and keep bonds cheap on a relative basis. Stress in OATs has highlighted idiosyncratic sovereign risk. Could we also see similar developments in the US? We see limited Republican appetite for a strong fiscal impulse, from here (deficit > 6% of GDP already). The status of the US dollar also offers some cushion. A modest relaxation of the German fiscal stance looks likely after the February election, while France may well need another election in the summer before taking a clear direction. Sovereigns' 'risk-free' status has been damaged, which implies structurally lower risk premia relative to history.[1]



[1] Source for all data: Bloomberg as at 29 November 2024.

FIXED INCOME

GENERALI ASSET MANAGEMENT

MAURO VALLE
Head of Active Fixed Income,
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Diverging Economies: Eurozone vs. US rate trends

A major concern for European fixed income in 2025 will be the impact of potential US tariffs on European exports. Germany, the Eurozone's economic powerhouse, stands at the forefront of this risk. The German economy, already strained, now faces dual threats: tariff risks targeting its crucial automotive sector, and political instability. The collapse of its coalition government has led to snap elections and a provisional 2024 budget, constraining new policies. As a result, German GDP growth, forecasted to recover in 2025, will again have to face downside risks.

Euro area growth forecasts are likely to be revised downward over the next few quarters. In contrast, the US shows robust macroeconomic resilience, with the risk that inflationary pressures could rise again as the Trump administration's policies take effect. After the Fed's latest cuts, markets have shifted expectations for terminal rates higher. The ECB on the other hand, contending with economic softness and a steady disinflation trend, may extend its rate-cutting cycle, potentially pushing the terminal rate below 2%.

Diverging economic trajectories have widened the US-Euro rate spread by 50 bps in the last few months of 2024. Initially driven by rising US rates, the spread may soon reflect a decline in Bund yields. German 10-year yields have surpassed EU swap rates, signalling economic fragility, potential US tariff fallout, and anticipated fiscal spending. While further spread widening is possible, Bund rates are expected to settle back to the 2.0%-2.2% range in the near term.

The political deadlock in France remains a concern going into 2025. French-German bond spreads have widened between 70 and 95 basis points. The political impasse will not be resolved quickly, and it is difficult to say whether recent developments will be favourable for French rates. There is a meaningful risk that the market will test the 100 bps spread level from January onwards, with the resumption of funding activities.

Italy's outlook is relatively stable, with BTP spreads supported by a compliant budget and declining deficit. Growth will likely mirror EU averages despite Germany's slowdown. Spain continues to outperform, fuelled by over 3% growth and fiscal leeway, positioning its bonds to maintain strength.

Overall it seems that we are entering a period where euro rates are converging, due to varying economic trends, different abilities to manage fiscal expenditure, and global geopolitical impacts. In the future, the differentiations made by the markets between core and peripheral countries may continue, but they will be less important than in previous periods, and the focus will be more on the risk/return profile of eurozone bonds as a whole.[2]

CONNING®

CINDY BEAULIEU
CIO North America,
Conning

A constructive view of US fixed income but volatility remains

The US fixed income markets produced solid returns across most sectors in 2024, no easy task given the volatility in interest rates throughout the year. Additionally, both geopolitical and political uncertainties created a challenging backdrop in which to make tactical asset allocation decisions. Complicating all of this was the unclear direction of US monetary policy. When the FOMC finally began lowering rates in September 2024 and did so with an aggressive 50-basis-point cut, markets breathed a collective sigh of relief that the US Federal Reserve was willing to use its tools to avoid an economic downturn. While global geopolitical issues continue, US political uncertainty has been reduced as its presidential and congressional election results are now known.

As we look to 2025, continued easing of monetary policy and clarity around the US government makeup provide stability. The US economy is on strong footing as GDP is on track to grow approximately 2.8% in 2024, the unemployment rate is holding in the low 4% range, and the US consumer remains an active contributor to the economy thanks to still-supportive labor markets and despite continued inflationary pressures. Still, there are questions as we look ahead: how far and fast will the Fed lower rates and to what extent will fiscal policy decisions impact the economy and markets? We anticipate market volatility is likely to remain heightened in 2025.

From a fundamental perspective, we remain constructive in nearly all sectors of the market. Spreads are narrow, particularly in investment grade corporates, high yield, and high quality emerging markets. However, with interest rates higher, the all-in yield argues for a market-weight allocation for investment grade corporates, especially with improved fundamentals visible in most industries. Along these same lines, private placements provide an even higher yield for accounts that can afford to give up liquidity. Structured sectors offer the greatest opportunity for combining high-quality assets with attractive yields, particularly agency and non-agency mortgage-backed securities. We continue to see value in the esoteric asset-backed sector due to the combination of diversification and income it provides portfolios. Lastly, municipal sectors are another high quality investment, with the best relative value found in longer duration offerings.[3]

[2] Source for all data: Bloomberg as at 9 December 2024
[3] Source for all data: Bloomberg as at 26 November 2024

aperture investors

Bifurcated markets remain appealing for long-short credit

SIMON THORP
CIO of Global Credit,
Aperture Investors

The key driver of the strength in credit markets in 2024 has been a continued fall in inflation, which allowed for limited rate cuts while growth has remained positive. Flows into the asset class have been strong. During Q4 2024, however, it feels as though this 'Goldilocks' narrative has come under threat. We have seen increased economic weakness across Europe as demand has decreased and exports (especially to China) fell. This has been exacerbated by the US election result and the threatened tariffs from the incoming administration. Additionally, the lack of strong leadership in Europe to stand up to threats from the US and China is concerning.

Meanwhile, the US is predicted to grow strongly next year, aided by tax cuts and increased fiscal expenditure. Interest rate, credit and equity markets have started to price in this divergence.

As this pertains to credit markets, we would expect to see continued strong inflows with investors allocating to European investment grade in favour of US investment grade, while the weaker names in European high yield and leveraged loans (Bs & CCCs) are likely to underperform as the potential for rising default rates are factored into market pricing.

We think that European growth will be supported by rate cuts, some fiscal stimulus and possibly a reflating Chinese economy as President-elect Trump's bark may turn out to be worse than his bite.

We think that 2025 is likely to start with a similar backdrop to 2024 with optically attractive yield levels but historically tight credit spreads. We expect to find the most attractive convex longs in strong fundamental credits that become oversold or overlooked, leveraged loans benefiting from higher-for-longer rates and special situations that suit our more flexible investment mandate. Pro-cyclical sectors are likely to remain under pressure while we are cautious on French and German credits as political risk remains elevated.

We expect the heightened levels of spread dispersion that currently exist in credit markets to remain, providing an attractive opportunity set, both long and short, for discerning, fundamental investors. As we approach year-end, we find that the overall market remains strong but is becoming increasingly bifurcated. Underperforming credits are being severely punished, thereby increasing the scope of those opportunities.

sycomore am

Is 2025 the last stop to catch the fixed income train?

STANISLAS DE BAILLIENCOURT
Head of Fixed Income and Asset Allocation,
Sycomore AM

After a very sharp recovery in 2023, credit has performed strongly in 2024, on the back of robust corporate profitability. Companies' fundamentals remain resilient in a subdued growth context and default rates are still relatively low. Going forward, despite geopolitical tensions and a sluggish economic growth, we see no signs of a significant deterioration in credit risk.

Now that the inflation peak is behind us, central banks are entering an easing cycle with greater visibility in the eurozone, and rates have started to adjust downwards. We believe that in the years to come, rates are likely to continue to decrease progressively.

Thanks to the combination of rates and spreads, the lower ranges of the investment grade segment (BBB) and the higher range of the high yield segment (BB) are still currently offering an attractive yield profile. As deposit rates from the ECB are declining sharply from their peak at 4% during the first half of 2024, we consider this to be an opportunity for investors to switch to fixed income credit strategies to keep generating attractive returns while cash yields are set to fall rapidly.

2023 and 2024 were particularly favourable years for increasing investments into fixed income credit and we consider 2025 could be the last stretch of this window of opportunity for investing in corporate bonds.

We see responsible credit as a particularly rich vein of opportunities within the segment, particularly those transitioning to more sustainable practices. Year after year, we see a growing commitment from issuers to improve their ESG profiles and the trend is expected to continue in 2025. Article 9 funds which invest in companies involved in the ecological transition are a good alternative to seize these opportunities in the SRI credit universe.

At Sycomore Asset Management, we are proactively assessing sustainability-linked bonds (SLBs) as well as environmental impact bonds and increasing our investments in our different strategies. Increasing pressure on the auto sector due to potential tariff risk as well as a decrease in demand globally could provide attractive investment opportunities in companies offering mobility solutions or products with a positive environmental impact.

In the current central bank easing cycle, with corporate bonds still delivering attractive yields, we believe the trend observed in the last two years of increasing allocation to corporate credit should continue in 2025. It is also important to bear in mind that primary markets are very dynamic, offering both a wide range of investment opportunities and attractive premiums with a growing alignment with ESG targets.[4]

[4]Source for all data: 21 November 2024

Octagon

A strong year expected for US leveraged loans and CLO debt

MICHAEL NECHAMKIN
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Octagon Credit Investors

The relative stability of floating rate US leveraged loans and CLO debt tranches stood out in the volatile interest rate environment of 2024. This should continue in 2025. With compelling relative all-in yields versus high yield and investment grade corporate bonds, and with SOFR-based coupons that reset every 1-3 months, floating rate US loans and CLO debt tranches offer minimal interest rate duration (0.25 years or less) and an attractive risk/return profile. An improving earnings environment, better credit outlook, and supportive market technicals should act as tailwinds in 2025.

Investment grade CLO debt tranches offer elevated yields and lower default risk. CLO debt tranches are issued with ratings ranging from AAA to BB, in addition to an equity tranche that acts as the first-loss position. Furthermore comparatively higher yields versus similarly rated corporate debt, investment grade CLO tranches (rated AAA-A) have proven resilient to losses through multiple credit cycles; per Moody's Analytics, AAA and AA rated US CLO tranches have never experienced a loss of principal.[5]

As the interest rate outlook shifted over 2024, US loans and CLO debt tranches exhibited lower volatility compared to other fixed income segments. By virtue of their floating rate coupon, loans and CLO debt tranches provide an innate hedge against higher interest rates and duration-driven price risk. Yields should continue to benefit amid expectations of a higher terminal fed funds rate.

2025 expected to be another strong year for US CLO formation. Reflecting increased investor demand, near-record CLO issuance in 2024 provided strong technical support for the US leveraged loan market against limited true net loan supply. CLOs—the largest holders of US loans—are stable, non-mark-to-market buyers, which helps to limit both technically-driven volatility and excessive risk in the loan market, since CLO portfolios must adhere to various credit quality and diversification requirements.

Expected economic growth and gradual rate cuts in 2025 should provide a constructive backdrop. We are encouraged by broadly positive earnings trends and improving credit fundamentals. Forward stress metrics indicate a better default outlook: the pace of ratings downgrades has slowed, and fewer loans are trading at distressed levels. Conventional defaults (i.e., due to missed payments and bankruptcy filings) have decreased significantly, though distressed exchanges and other liability management exercises (debt restructuring outside of a typical bankruptcy process) have become more prevalent.

US loan spreads likely to tighten further. US investment grade and high yield corporate bond spreads have compressed to all-time tights and all-in yields are lower than loan yields. Even with recent spread compression, lower base rates, and higher prices, US loan yields remain attractive from a historical standpoint, with an average yield-to-maturity of in the 86th percentile[6] at the time of writing. CLO liability spreads have also tightened significantly, but still offer considerable incremental yield relative to comparably rated credit assets.

Emerging and frontier markets: Uncorrelated, underinvested, underrated

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Global easing policies and the changing contours of globalization create fertile ground for active emerging and frontier market bond investors. We have identified three key themes set to the drive these markets in 2025:

1. Not your parent's carry environment. Markets cannot rely on dovish-leaning DM central banks anymore to support the EM carry environment debt. Key reason: inflation. Newfound fiscal largesse, and the changing contours of globalization with redrawn global supply chains and demographics imply a deteriorating trade-off between growth and inflation. Structurally higher inflation risks means that central banks will be more reactive and rate cutting cycles should be shorter. At the same time geopolitical risks remain elevated. We expect shorter and more frequent ups and downs in global risk appetite and, hence, a more tactical market environment. Active, nimble approaches to EM asset allocation should therefore be rewarded.

2. Uncorrelated, underinvested, underrated: Frontier markets may answer some of the most pressing issues in 2025. Markets are dominated by two top-down risks – elevated geopolitical uncertainty in the wake of the US election and structurally higher inflation risks. Frontier markets offer unique diversification, effectively reducing fixed income portfolios sensitivity to these risks without sacrificing return potential. Firstly, frontier bonds carry a significantly lower duration as compared to larger EM fixed income indices and core bond markets. This means that potential losses will be more limited in case core yields rise further amid latent inflation worries. In 2022, when most bond segments suffered severe losses amid soaring inflation, frontier markets had limited losses and a faster recovery compared to main-stream bonds. Secondly, frontier markets are more driven by idiosyncratic risk rather than global factors. For example, frontier debt exhibits lower correlation with global geopolitical risk indices than hard currency EM debt or US high yield. At the same time, frontier debt does not sacrifice return potential, as a yield-to-maturity of currently around 14% offers a comfortable yield cushion.

3. Rising stars: Reform momentum rewards. We are particularly optimistic about emerging market countries showing decisive fiscal and monetary reform momentum. We have identified a group of BB rated countries with improving fundamentals that we believe are on a path towards investment grade status, several likely to come to fruition for during 2025. Further up the risk curve, Turkey stands out for its recent economic policy shifts and punitive forward-looking real rates, which support carry trade opportunities. Ecuador, buoyed by new government policies, and Argentina, which holds potential for a macroeconomic turnaround, are also on our radar.[7]

[5]Source: Includes all US cash flow CLO tranches ever rated by Moody's as of year-end 2023. "Loss of principal" refers to impairment. Impairment is defined as when investors receive, or expect to receive with near certainty, less value than would be expected if the obligor were not experiencing financial distress or otherwise prevented from making payments by a third party, even if the indenture or contractual agreement does not provide the investor with a natural remedy for such events, such as the right to press for bankruptcy. Source: Moody's Investors Service "Impairment and loss rates of Global CLOs: 1993-2023" (24 June 2024). Past impairment rates are not indicative/a guarantee of future impairment rates. [6]Source: BofA Global Research, US Leveraged Loan Strategy "Collateral Thinking: Demand strong, higher net supply in 2025" (15 November 2024). [7]Source for all data: 27 November 2024

EQUITY

US equity market eyes continued gains

DONALD TOWNSWICK
CFA, Director of Equity Strategies, Conning

Conning expects a typical equity market return in 2025, somewhere in the vicinity of 7-9%, and we see several tailwinds that support this view.

We expect 2025 earnings to be strong and that expectations for 2026 earnings will remain strong as well, which should have a positive effect on market returns since the market is a forward discounting mechanism. Consensus estimates from FactSet for calendar year 2025 are currently forecasting 14.6% earnings growth and 13% earnings growth for calendar year 2026. Even if we were to experience multiple compressions in 2025, these growth rates should allow for price appreciation in 2025.

Easing inflation should also help the equity market achieve positive returns. Inflation eats away at the real purchasing power of the consumer and also tends to sap consumer confidence, both market negatives. Over the past two years we have seen inflation drop from 9% to something closer to 3%, thanks to the US Federal Reserve's tight money policy.

This drop in inflation should allow the Fed to further ease its tight money policy. Current market expectations imply several Fed rate cuts in 2025, which should be positive for equities as future company earnings will be discounted back to the present at a lower rate, and lower rates tend to spur stronger economic growth.

The new Trump administration should be positive for stocks, especially if the Federal Trade Commission chair is replaced. If so, we should expect a slew of corporate mergers and acquisitions that could lead to higher stocks prices. In a general sense, the new administration is also more oriented toward a lighter regulatory hand, another positive for stocks. Equities could also benefit from a renewal of the Tax Cuts and Jobs Act of 2017 along with a further cut in the corporate tax rate.

Finally, while the equity market seems expensive now (trading at a price-to-earnings ratio of 27), this metric is distorted by a small group of very large and very expensive technology stocks. If the market achieves expected earnings growth, it should cause a broadening that could drive positive returns in the rest of the market.[8]

US small caps are a bright spot in the equity landscape

BRAD MCGILL
Portfolio Manager US Small Cap, Aperture Investors

Overall, in our view, the US small cap equity market remains a bright spot in the overall equity landscape, and we expect the broadening of performance beyond a narrow group of tech companies, known as the Magnificent 7, should bode quite well for small cap active management in 2025.

In recent years, there has been much debate about the merits of and prospects for small caps, driven largely by their historic underperformance relative to large caps. However, this narrative has shifted over the last six months as performance has begun to shift in a meaningful way: the Russell 2000 Total Return index has appreciated by almost 19%, outperforming the S&P 500 index by over 500bps.

There are several positive considerations to note. First, small caps typically perform well during US rate cutting cycles and up to a year after the final rate cut. Additionally, small caps have historically performed well after presidential elections as pre-election uncertainty dissipates, a trend that dates back to 1928.

We also see several important themes across the broader equity market landscape. While the US consumer sector was a laggard in 2025, we see good prospects for better performance in 2025. US household net worth continues to hit record highs, and while elevated interest rates and perhaps more importantly rate volatility has caused some US consumers to proceed cautiously, a more neutral Fed policy will support consumer confidence as the labor market is stable and recession fears have dissipated.

In addition, technology continues to be an exciting area within the small cap landscape. AI enthusiasm and related spending cycles have broadened beyond mega cap technology companies, and we see significant opportunities within the small cap universe. Cutting edge semiconductor manufacturing remains robust, and expansion of datacenters to support AI remains a clear area of growth for years to come. Software has also begun to outperform, driven by continued emphasis on global cloud computing as companies position themselves for enhanced analytic capability.

Finally, as we have shared in the past, we expect significant positive small cap earnings growth in 2025. While the pace of earnings growth is expected to accelerate, we also note positive revisions to small cap earnings expectations in recent months. This combined with small caps' still inexpensive valuation relative to their large cap peers, gives us optimism for our concentrated stock picking strategy.[9]

[8]Source for all data: Bloomberg as at 26 November 2024
[9]Source for all data: Bloomberg, as at 25 November 2024

ANIS LAHLOU
CIO European Equities,
Aperture Investors

European Innovation: Undervalued assets with upside potential

European equities are closing another year lagging behind their US counterparts, making them one of the most undervalued asset classes globally. The region's historically slower growth and current concerns over potential tariffs from the United States have contributed to the pessimism, especially given Europe's reliance on exports to the US and China, either directly or indirectly through global trade channels. Yet, beneath these concerns lies an opportunity—Europe's burgeoning innovation sectors (e.g., AI application to manufacturing and services) remain in our view overlooked and undervalued, setting the stage for a potential turnaround.

Many of the allocators we speak to have adopted a structurally underweight position in European equities, questioning whether valuation alone is sufficient to entice them back to the old continent. However, as we look towards 2025, we would like to highlight three important considerations that might shift the narrative.

First, market strategists have already accounted for the potential impact of US tariffs in their forecasts, with expectations of modest EPS growth of around +3-5%, front running the downgrades in the bottom-up STOXX 600 EPS 2025 estimates of +8%. In fact, we believe that the market has already partly priced in tariff impacts; if they are less severe, there could be significant upside potential for European equities.

Second, while geopolitical risks and tariff disputes remain key overhangs, Europe could find itself at an advantage if peace is achieved in Ukraine. Reconstruction efforts would drive demand for regional building, construction, and infrastructure, as well as foster rapid deployment of innovative solutions in construction technologies, automation, and AI-driven project management.

Finally, Europe's challenges could transform into relative opportunities if the ECB adopts a more aggressive monetary easing stance, providing critical support for economic activity and even decoupling from the Federal Reserve's trajectory. Sectors focused on AI, robotics, and automation could see enhanced investment flows, as the supportive monetary environment drives demand for innovation.

In conclusion, while Europe faces significant headwinds in 2025, these very challenges provide fertile ground for innovation and growth. During times of caution and uncertainty, it is essential to recognize the potential of Europe's most innovative companies, as they are well-positioned to thrive when others hold back. We believe the key lies in being prepared to seize these opportunities before the broader market sentiment turns.[10]

Is it time to re-evaluate European small-mid caps?

LUCA FINÁ
Head of Active Equity,
Generali Asset Management

For most of the past 30 years small caps have been perceived as among the most interesting areas to invest, with a large quantity of high quality, diversified and well-performing companies from which to choose from. In fact small caps massively outperformed wider indexes; on top of that, thanks to a lower level of sell-side research coverage, it was indeed possible, for the active investor, to find a significant amount of undervalued companies, generating a significant source of alpha.

Although most of the comments above are still valid today, small caps have been out of fashion for the past three years, underperforming the main geographic reference indexes by almost 25% and recording record cumulated yearly outflows, only recently partially reversed. Higher interest rates, a significant gap in shareholder distribution vs large caps and most of earnings growth concentrated in a few bunches of AI/tech mega-caps, forced global Investors to focus on the biggest market caps, leaving the small cap group trading at fundamental valuations more attractive than ever, both in absolute and above all in relative terms.

In fact, over the past 20 years, European small caps used to often trade at premiums vs large caps (average premium on fwd P/E of almost 20% since 2006 and slightly less than 10% since 1994), also thanks to their higher growth and quality. However, from 2021 they started to de-rate and keep on doing so, until recently, trading at double digit discount. There seems to be a disconnect between the public market view and the private view, looking at the multiples that PE firms and trade buyers are ready to pay in private transactions, and the significant premium over the trading prices required for the M&A in the listed market.

Luckily most of the headwinds small caps have faced since 2021 are fading and should be behind us. Indeed, some could become tailwinds. Interest rates in Europe have stopped rising and should decrease in the next couple of years providing relief to the asset class' higher proportion of floating debt (vs large caps), and also making the financing M&A transactions easier. Next year, both distribution and earnings growth differentials should improve for small and mid-caps, helping to restore their quality and growth status and probably bringing back some interest; in addition, in a market worried by possible US tariffs, small caps usually have greater domestic exposure than their larger peers. Although it is not a base case, historically small caps tend to be more cyclical than the wider market, so any renewed worries about significant deceleration, recession, or market drawdown could lead to an additional 0-5% underperformance, but in this scenario the investment case would be even more appealing over a three year market cycle, in our view.[11]

[10] Source for all data: Bloomberg as at 2 December 2024.
[11] Source for all data: DataStream, as at 25 November 2024

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Technology stocks are reasonably priced amid signs of a growing demand cycle

DAVID RAINVILLE
Tech Portfolio Manager,
Sycomore AM

We believe the technology sector offers a compelling landscape of opportunities in 2025, anchored by a cyclical bounce back in digitalization budgets as well as accelerating adoption of enterprise ready AI solutions. Global IT budgets are just starting to emerge from a prolonged cyclical downturn. Multiple positive indicators that suggest that, broadly, we believe the technology sector can deliver strong earnings revisions ahead.

Despite the concerns around tech valuations often portrayed in the media, equal weight technology indices trade 5-times lower than in January 2024, or 19x EPS, driven by the start of a cyclical upturn in earnings and an unimpressive performance year-to-date (+8% through the end of October vs. the Magnificent 7 at +50% and MSCI ACWI IT at +31%). We view lower starting valuations combined with improving fundamentals as clear signs for a market broadening ahead, potentially away from the mega-caps.

Within technology, we believe AI will continue to be the strongest top-down theme. Beneficiaries of AI adoption should continue to perform well as fundamentals continue to surprise to the upside. We are convinced that strong fundamentals driving stock performance is what distinguishes this AI-era from previous speculative tech bubbles like the dot-com era. We expect investments in AI infrastructure to grow significantly in 2025, primarily driven by major tech firms heavily allocating resources towards building foundational frontier models in a race to AGI (artificial general intelligence). Importantly, we'd also note that these companies investing into the technology are extremely well-capitalized and cash generating businesses with dominant market positions. They can continue spending for a long, long time if they start seeing a return on their investments.

Other than broader stock performance, what we also believe will change in 2025 is that not only the "picks and shovels" of the AI gold rush will perform. Specifically, we think AI-enabled features and software applications can start monetizing AI by providing true productivity enhancements to their customers. Hence, we think that other than NVIDIA and the AI data centre beneficiaries, some software companies will start seeing AI-driven, or at least enabled, bookings which will drive outsized growth for companies like ServiceNow and GitLab. This is an opportunity because Software-as-a-Service (SaaS) names are down -1% year-to-date, steeply underperforming semiconductors. With potential for improving bookings trends and valuations sitting at more than 30% discounts to 2019 level, we believe software can generate strong risk-adjusted returns over the next twelve to eighteen months and have started to recently increase our overweight on the sector.[12]

[12]Sources: Sycomore Research, Bloomberg, as at 5 November 2024

MULTI ASSET &
LIQUID ALTERNATIVES

GENERALI ASSET MANAGEMENT

Rethinking risk for Trump 2.0

CEDRIC BARON
Head of Asset Allocation Products,
Generali Asset Management

Trump's re-election raises many question marks for investors in 2025. It opens the door to more protectionism, more fiscal stimulus, and a tighter labor force, all preventing price declines and putting a stone in the shoes of central banks. Combined with the geopolitical instability, we think asset prices should be particularly volatile next year, from equities to bonds.

But volatility, as it stands for standard deviation of a normal distribution, may not be the right translation of what investors risk in this unpredictable environment. We think next year's returns are more a question of 'tail risks' (both on the upside and the downside). The Trump administration will have consequences on growth, inflation, monetary policy, and geopolitics, all increasing the risk of extreme consequences for asset prices. Important market moves happen when convictions are high, positioning is stretched, and extreme risks are not well reflected in portfolios. We think we're close to this situation in US equity markets.

On the other hand, some regions totally ignored by most international investors, like Europe and China, could benefit from potential positive support. An end of the war in Ukraine would ease gas price issues in Europe and be a relief for many German companies. The fiscal support that has started to be announced in China could be followed by even more targeted measures on consumers and revive growth as well as interests from international investors.

In this highly uncertain environment, we think multi-asset strategies are particularly well equipped to diversify risks in a fragmented environment, to implement structural hedges, and to position for potential extreme events.

Indeed, while our tactical asset allocation, based on a combination of fundamental and quantitative analysis, enables to enhance our strategic asset allocation performance through allocation moves, our overlay strategies are designed to add value in the uncertain environments like the one described above. The use of options in equity and bond markets provides opportunities to enhance returns by both benefiting from upside scenarios and mitigating against market drawdowns. We specifically target two types of mitigation: the limited ones that are addressed with option strategies and the extreme ones covered by systematic strategies designed to react in extreme events while limiting negative carry impact.

On top of this, we screen a large number of markets to find the best opportunities for upside due to particularly undervalued and disliked assets that are well suited for optionality, that benefit the most from a change in investment case triggering violent rebounds. We think this part of our investment process will be particularly adapted to the Trump 2.0 investment environment.

Plenisfer INVESTMENTS

Shifting sands in global markets present price dislocation opportunities

MAURO RATTO
Co-Founder and Co-Chief Investment Officer,
Plenisfer Investments

Global markets are undergoing significant changes, creating opportunities to capitalize on price dislocations across sectors and regions. The "Trump trade," which has dominated the investment landscape in last quarters, is expected to wane by early 2025. As the market stabilizes, these shifts could reveal valuable prospects.

We are in a very prolonged economic cycle, buoyed by substantial public expenditure and large budget deficits in developed economies. This underscores the existing dynamic of corporate balance sheets remaining robust at the same time as government debt ratios continue to climb historic highs. This disparity supports narrow credit spreads, especially in investment grade corporate bonds, which are now viewed as the "new risk-free" assets in many developed countries. In contrast, sovereign debt, with its high debt-to-GDP ratios, presents a different risk profile – think of France or Italy for example, where uncertain political situations complicate the risk analysis of the sovereign bonds.

For 2025, we think investors could strategically leverage areas where dislocations present value. US equity markets, benefiting from extended stimulus, show signs of stretched valuations. Meanwhile, European equities trade at notable discounts, weighed down by a strong US dollar and geopolitical uncertainties. This valuation gap between European and US equities presents opportunities for selective stock-picking, particularly in sectors positioned to benefit from the energy transition, infrastructure development, and supportive public policies.

Emerging markets offer dual avenues for exploration. Despite geopolitical and currency pressures, select corporate bonds trade more favourably than their sovereign counterparts. Countries like Brazil and Mexico demonstrate both challenges and opportunities due to currency fluctuations and economic ties to US trade policies. A potential depreciation in their currencies would be a good buying signal for overlooked areas in both equities and fixed income markets. Trade tariffs and other external factors add complexity to these scenarios, but a flexible investment strategy can uncover promising opportunities.

As the Trump trade recedes, a strategy that balances short- to medium-term curve positioning should best capture real rate advantages. Emerging markets with orthodox economic policies that maintain high real rates stand out for potential upside. Additionally, China's position, relatively insulated from broader geopolitical shifts, also supports targeted investment in sectors independent from global macro trends.

While risks remain, the evolving market landscape should reveal opportunities for flexible, diversified strategies that pivot to capitalize on market dislocations. Our focus remains on adaptable positioning that navigates between developed market equities, emerging market assets, and sectors driven by public spending, structural changes, and undervalued currency plays.

LUMYNA

Alternative credit and multi-strategy hedge funds should shine in 2025

ALEXANDER SCHOENFELDT
Head of Investments,
Lumyna

In 2024 we saw a dramatic shift in the investment and policy outlook, driven by increasingly divergent conditions across global markets. The continued softening in conditions in Europe and China is in sharp contrast to relatively buoyant growth in the US, which is potentially being propelled further by ongoing fiscal stimulus from the incoming administration. Japan, while experiencing relatively muted economic performance, remains in a gradual interest hiking cycle, contrasting sharply with rate cuts being made by most other developed market central banks.

Equities have performed very strongly in the US this year, albeit with gains led by a small number of highly valued technology related companies. Hedge funds produced a solid performance, with UBS data through end-October indicating a 10% return YTD, although with a much more conservative volatility profile than equities. This contrasts strongly with global fixed income markets, which are largely flat for the year, lagging both equities and hedge funds.

Within this context, an allocation to liquid alternative UCITS strategies could play a key role in investors' portfolios going forwards, as the ability to access different sources of returns can widen the toolkit available to investors and should provide 60/40 portfolios with a much-improved overall risk/return profile.

At Lumyna we continue to see attractive opportunities for alternative credit strategies, as we expect rates to stay higher for longer, especially in the US. Furthermore, while spreads in higher rated credit instruments are quite tight, there are much better potential returns available from funds with an opportunistic mandate that can take advantage of event-driven situations around refinancing, or credits that are dislocated due to shorter term challenges which are in the process of being resolved.

Multi-strategy hedge funds that can opportunistically allocate across a broad spectrum of asset classes are also expected to be a beneficiary of the current environment, as they can efficiently deploy capital to the most attractive situations in what is likely to be a rapidly evolving investment landscape. In summary, we are optimistic about the year ahead and feel that liquid alternatives are well placed to capitalise on the opportunities and challenges that are likely to unfold in the coming months.

PRIVATE MARKETS
& REAL ASSETS

M&A, AI and purpose-driven investing poised to drive private debt in 2025

SANDRINE RICHARD
Head of Direct Private Debt,
Generali Asset Management

European private debt markets are set to benefit from a resurgence in M&A deal flow as it becomes easier to accurately price deals and execute transactions due to lower rates. The outlook for existing portfolio companies is similarly positive. Lower interest rates should reduce debt burdens and ease debt servicing, allowing businesses to more effectively channel resources. Although returns across all asset classes may be lower, the illiquidity premium inherent to private debt should remain intact, as it continues to fill the financing gap left by traditional bank lending. As we move into 2025, we have identified the following themes shaping the private debt landscape.

1. The search for low volatility. Recent years have seen heightened market volatility, driven by events such as the pandemic, geopolitical conflicts, increased political polarisation, sharp inflation peaks, and rising interest rates. Uncertainty, now a constant in global markets, is motivating investors to seek asset classes that offer lower volatility and steady returns over the medium to long term. Private debt, with its structured agreements and tailored investment vehicles, provides predictable cash flows and a measure of insulation against market shocks, making it a preferred choice for those seeking stability. The ongoing shift toward alternative financing, including private equity-led buyouts backed by private debt, underscores the alignment of interests between equity holders and lenders.

2. Diversification within consolidation. Investor behaviour is shifting toward working with fewer asset managers due to regulatory, compliance, and administrative burdens. This trend comes as fundraising remains challenging, with data showing that only a limited number of top-tier asset managers secure the majority of capital inflows, with size and distinct strategic positioning proving crucial for success. Investors are leveraging private debt to diversify their portfolios while maintaining robust risk management through strategic partnerships with proven asset managers.

3. Purpose-driven investing and human capital. Investors increasing want their investments to demonstrate purpose and impact. With an emphasis on climate change, energy transition, and workforce conditions, private debt provides a distinctive avenue to direct funds with clearly defined purposes at the investment's inception. In particular, sponsor-led SME debt supports ESG integration, with direct collaboration allowing for ESG KPIs and potential margin adjustments tied to sustainable achievements. There has been positive feedback on ESG incorporation, reinforcing private debt as a vehicle for supporting responsible growth. Finally, AI integration can boost business agility in responding to market changes. Prioritizing sustainability, climate resilience, and human capital—valuing expertise over automation—will remain critical.

infranity

Resilient returns: Infrastructure debt and equity opportunities shaping 2025

PATRICK LIEDTKE
Chief Client Officer
& Chief Economist,
Infranity

Infrastructure continues to stand out as a resilient and dynamic asset class, poised to offer substantial opportunities in 2025. The infrastructure debt market has demonstrated remarkable resilience, with annual investments exceeding €350 billion in recent years, a trend expected to persist. Europe, in particular, continues to offer robust supply and attractive returns, driven by ambitious energy transition and digitalization targets. These trends are largely fuelled by mid-cap players, often private-equity-backed, who exhibit strong borrowing appetite across the capital structure despite higher interest rates. The floating-rate nature of much infrastructure debt, coupled with stable contracted cash flows, supports valuation stability. For these reasons we believe infrastructure remains a defensive asset class in a volatile economic climate.

Enhanced return opportunities within the debt market are expected to grow, with a notable rise in appetite for Ba and B-rated infrastructure debt, offering a 200–400 basis point premium over corporate bonds. For lenders, refinancing activity in 2025 will be particularly significant, as transactions closed between 2020 and 2022 mature or undergo margin step-ups. This dynamic will create opportunities to reinforce positions in successful credit profiles, particularly within the mid-market, where bilateral or lead roles in structuring transactions can yield attractive risk-adjusted returns. These dynamics ensure spreads and illiquidity premiums remain elevated, with high-quality transactions continuing to deliver significant value.

On the infrastructure equity side, 2025 marks a potential turning point following a challenging period for fundraising. Fundraising volumes in 2023 hit a five-year low, and 2024 has shown only modest improvement. Despite these headwinds, the repricing of assets, with discount rates increasing by 100–250 basis points, has created a favourable environment for funds with 'dry powder' ready to deploy. Mid-market assets, offering less competition and better value than large-scale projects, remain particularly attractive. Investors are increasingly favouring core+ assets, including development platforms, which provide strong downside protection through contractual safeguards, stable cash flows, and robust management teams.

Long-term structural drivers also continue to underpin the infrastructure market. Digitalization, the energy transition, and recovery initiatives such as the US Infrastructure Investment and Jobs Act demand staggering investment levels, estimated at \$3.3 trillion to \$6.3 trillion annually. Given constrained public financing, private capital will play a pivotal role, promoting steady growth in the sector. Coupled with rising investor sentiment and underallocation among institutional investors, we believe infrastructure is poised to sustain robust growth in 2025 and beyond.[13]

sosteneo
Infrastructure Partners

Partnering with utilities: A blueprint for the energy industry?

UMBERTO TAMBURRINO
Managing Partner, CEO and
CIO for Europe, Sosteneo

We believe that private capital can play an increasingly vital role in the energy sector, particularly as a strategic partner to utilities. Over the past five years, utilities have expanded rapidly, accumulating significant debt. With rising interest rates post-Covid, many now face pressure to reduce their leverage while maintaining earnings. This presents a new opportunity to co-invest with utilities in high-quality projects that are ready to build.

Utilities often control premium assets that are ideally positioned near grid connections, and are now more open to external partnerships due to debt pressures. Specialist infrastructure managers are able to joint venture with utilities to provide the equity capital needed, but with project financing carried solely on the manager's portion of ownership – an approach that can enable utilities to keep consolidating revenue without adding debt.

Of course, it requires sophisticated structuring and expertise, but the result is mutually beneficial. Utilities secure necessary capital to continue building out their portfolio of assets while still consolidating earnings and maintaining joint control over decision-making. Meanwhile, investors gain access to prime projects with strong, stable return potential.

In addition, as assets like coal plants are phased out in line with decarbonisation goals, utilities are typically at the forefront of investing in new assets that support the transition to clean energy. Private capital plays a crucial role in this transition by providing external funding for clean energy projects, enabling utilities to meet sustainability targets and grow earnings without further burdening their balance sheets.

Specialist infrastructure managers can complement the needs of utilities, with structuring expertise, rapid capital deployment, the capacity to manage substantial investments, and technical understanding of the technology. Additionally, projects with strong counterparties and a robust contractual framework for the construction and operational phases can be appealing for investors that value stable and visible cashflows. In particular, long-term contracts with energy users can secure the revenues from the electricity produced (e.g., by solar farms) or the capacity provided (e.g., by battery storage assets) for 10, 15, or even 20 years. In some cases, the energy user can even be the utility itself, which provides an alignment of interest with investors.

Looking ahead to 2025, more of these strategic partnerships are anticipated, with specialist infrastructure managers like Sosteneo positioned to offer the distinct skills, reliability, and flexibility utilities seek. In our view, this model is a blueprint for future collaboration with utilities to expedite renewable energy projects and unlock unprecedented access to high-quality assets for investors.

[13] Sources for all data: Infranity internal analysis, Preqin, and Infralogic as of October 2024

Easier financial conditions lift expectations of a recovery in commercial real estate

OLIVIER TERRENOIRE
Head of Europe,
Generali Real Estate

The outlook for the commercial real estate market has improved in 2024. Economic growth ticked up in early 2024 and although projections have been adjusted downwards during the second half of the year, the faster than expected reduction in inflation has had a positive effect on investor interest. Global central banks began to unwind their monetary policy tightening, beginning with the ECB in June, the Bank of England in August, and the US Federal Reserve in September. Lower interest rates are gradually feeding through to the real estate sector, therefore reducing pressure on financing costs and lifting investment activity. For this reason, we believe commercial real estate, especially the prime segment, provides attractive investment opportunities, particularly as it can enhance portfolio stability complementing the performance of a multi-asset class portfolio. Activity in the European commercial real estate investment market has increased during the first three quarters of the year, and given the more stable outlook supported by the expected easing of interest rates, further improvement is anticipated.

We see opportunities in logistics, hospitality, and commercial real estate debt. Rising geopolitical uncertainty and the potential for global trade disruptions are driving companies to restructure their supply chains, fuelling increased demand for near-shoring and the associated need for industrial and logistics facilities, including distribution warehouses and last-mile logistic hubs. Hospitality has seen a particularly positive year with investment volumes rising across EMEA and particularly in southern Europe, where the proportion of international chains remains well below the levels in the US, although the gap is expected to narrow further in the coming years. According to GreenStreet, operational performance of the sector returned to pre-pandemic levels across the EU, while it still sits below pre-pandemic levels in the US. The commercial real estate debt market offers a compelling value proposition to real estate investors. Senior loans with conservative loan-to-value ratios are designed to provide stable cash flows while offering downside protection. But there are also other options that offer higher returns in exchange for a higher level of risk (e.g. mezzanine loans).

Looking ahead, there are several structural drivers that will impact the commercial real estate market over the coming years. Demographic shifts, remote working trends, near-shoring and increasing transparency in relation to ESG factors all have a significant impact on the industry. Various studies indicate that the real estate market is responsible for around 40% of global carbon emissions. At Generali Real Estate, €19.8bn of our assets have been externally certified. Being at the forefront of these trends is crucial to build a resilient portfolio.[14]

[14]Source: UNEP FI, as at April 2022

Thank you.

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IMPORTANT INFORMATION

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