



A VIEW FROM THE SQUARE

January 2025

New Year, Same Questions

Moving into a new calendar year can often be seen as a chance to reset portfolio allocations and look ahead for the next 12 months. While that is true, it is no different to moving into a new month or quarter and as such, the questions that we have been asking ourselves over the last couple of months are still appropriate. This month, we thought we would share a few of those questions and what our thoughts are.

Will the “Magnificent 7” continue to Trump other regions?

One of the major questions following the results of the US presidential election is to what extent will Donald Trump’s trade actions take effect. Recently however, investors have been focusing too much on Trump’s promises, while dismissing the fact that his political constraints and the macro-outlook are the polar opposite of what they were in 2016. While it is highly likely that tariffs will be implemented over the next 12-18 months, they won’t be to the level first expected. Three main comparisons which highlight the differences are inflation in 2016 was 1.5% (below the 2% target) whereas today it sits up around 2.4%. Government debt as a % of GDP was 97% whereas today it is around 115% and lastly, the 10-year Treasury yield was around 1.6% whereas today it is around 4.5%.

The bottom line is that the US equity market, particularly the “Magnificent 7” stocks are expensive relative to past valuations and if the AI “gold rush” continues, there is no reason why these stocks and other US growth stocks cannot continue to grow. But, if there is a recession or rotation (i.e. selling expensive stocks and buying cheaper stocks), then US stocks would struggle and in particular, the highly priced technology stocks. The passive indices, which have a high exposure to the highly priced technology stocks due to their size relative to other companies would suffer considerably and for that reason, we are positioned with a balance across growth, value and medium sized companies with flexibility to adjust should there be any significant moves.

Elsewhere, other regions such as the UK and Europe do not look as strong on the economic front which reduces our desire to buy indices in these regions, but individually, some stocks look attractively priced. Particularly in the UK, where we see several companies, both large and small, growing earnings at similar rates to their US peers but trading on a considerably lower valuation. This is a good environment for active stock pickers.

Will government bond yields go up or down from here?

In 2024, “long was wrong” in terms of duration (time to the bonds maturity) as expectations of the Federal Reserve interest rate easing programme were dialed back. As the yield curve steepened (longer dated bond yields rising more than shorter dated bond yields), bonds with several years until maturity fell.

Looking ahead to 2025, expectations of how many interest rate cuts from central banks such as the Federal Reserve and Bank of England have dialed back and while we do accept there may be rapid rises should there be excessive fiscal stimulus from Governments, particularly in the US, it is widely expected that the bond yields will finish the year lower.

We do remain cautious that there is a chance of inflation being more elevated as the year goes on and that may result in bond yields staying at the current elevated levels for longer. For that reason, we remain suitably positioned to a medium level of duration to capitalise on falling yields while managing volatility.

Has gold had its day?

Relative to many of our peers, Gold has been a core position within client portfolios and has been a strong contributor. Over the last couple of years, we have seen the gold price rally strongly and the question we are asking is whether it has reached a peak at this point.

In our view, while geopolitical risks such as the war in Ukraine have created more demand for this safe haven asset, the main driver is that central banks have emerged as a key source of gold demand over the past couple of years. A desire to reduce the exposure of their reserves to USD-denominated assets has been driving the increase in the purchase of gold among emerging market central banks (such as India, China, Poland, and Türkiye). The United States response to Russia's invasion of Ukraine underscores the vulnerability of holding reserves in traditional currencies. According to the World Gold Council, there was over a 100% increase in central bank net gold purchases in 2022 compared to the average of the previous 5 years and that has been sustained in 2023 and 2024. The Peoples' Bank of China is likely to remain a major buyer of gold for the next few years and given the large size of their total reserves, their gold purchasing programme will have a meaningful market impact.

As such, we will remain overweight gold until we see significant evidence that central bank purchases are likely to reduce.

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3 January 2025

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