Amplia Outlook 2025

Introduction

Predicting the future is a curious exercise—a pursuit that walks the line between educated guessing and outright speculation. It reminds me of a famous anecdote about the weather forecast: when a meteorologist claimed with 100% certainty that it would not rain, a sudden downpour drenched the city. This serves as a poignant reminder of the humility required in forecasting, whether for the weather, markets, or geopolitics. The year 2025 beckons with its unique challenges and opportunities, but as we venture into its possibilities, we must remember the limits of prediction and the inevitability of surprises.

This outlook will explore three key pillars shaping the landscape of 2025: **Macro**, **Valuation**, and **Sentiment**. We will also weave in some intriguing esoteric insights to provide a broader perspective. Lastly, we publish our return expectations for 2025 together with some discussion about uncertainty.

Macro

US tariffs are set to dominate the macroeconomic discourse in 2025, with the potential to reshape global trade dynamics and economic growth. The US administration has signalled its intention to raise tariffs to 10% globally and as high as 60% on Chinese imports. If implemented, these measures could result in severe disruptions. China's anticipated retaliation might include restricting the export of critical components, such as rare earth elements vital for artificial intelligence and other advanced technologies. Such restrictions would disrupt supply chains globally, potentially adding billions to production costs in sectors reliant on these materials. The ripple effects of a trade war could decrease global economic growth rates significantly, with smaller and trade-dependent economies bearing the brunt of the impact.

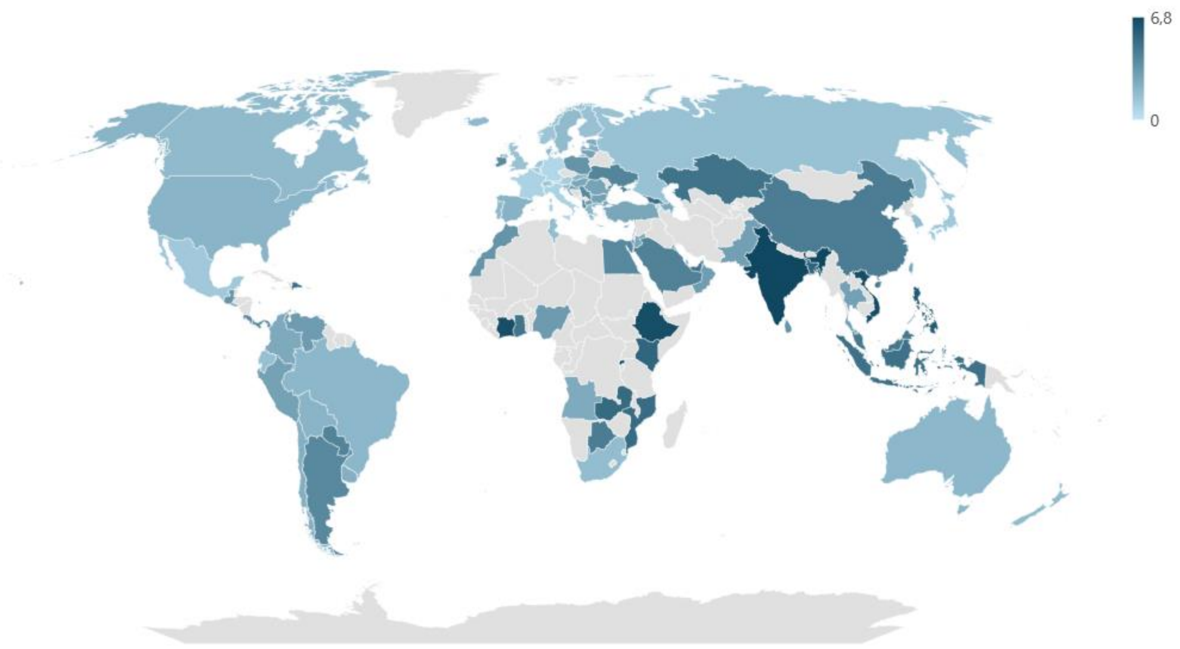
Geopolitical risks are equally prominent in the macroeconomic landscape. The ongoing tensions between China, Taiwan, and the US could lead to significant disruptions in trade, further compounding global economic uncertainty. On a more optimistic note, a potential truce in Ukraine might spark economic recovery efforts, particularly in Europe, where the construction and materials sectors stand to benefit from rebuilding initiatives. Conversely, escalating tensions in the Middle East, such as a direct confrontation between Iran and the US, could cause crude oil prices to surge by tens of dollars per barrel, with each $10/barrel increase potentially shaving 0.1% off global economic growth. Additionally, any serious talks about a US withdrawal from NATO could compel European nations to increase defence spending, potentially straining budgets and reducing public investment in other sectors.

In the United States, fiscal policy is poised to play a transformative role, with an estimated $5.8 trillion in economic stimulus expected over the next decade. This injection could boost domestic demand, with positive spillover effects on economies like Germany and China (in absence of tariffs), which maintain strong trade relationships with the US. However, these measures could also stoke inflationary pressures. Deportation policies targeting the illegal workforce, coupled with tariffs and aggressive fiscal easing, could create an inflationary environment. Initially, these actions might spur growth, but the longer-term risks include diminished competitiveness and the potential for stagflation—a toxic combination of stagnant growth and rising prices.

Europe's economic struggles continue, hindered by excessive regulation and high taxation. While there are signs of potential reform, driven by competitive pressures, progress remains slow. Germany's reliance on exports, particularly in its automotive sector, underscores the region's vulnerability to global trade disruptions. Germany's car industry, which accounts for approximately 20% of its GDP, faces risks from any decline in global demand or increases in trade barriers, potentially leading to significant contractions in output and employment.

Meanwhile, Japan balances slow economic growth with an aging population, while emerging markets grapple with heightened sensitivity to the US dollar and global inflation trends. Commodity-exporting nations, such as Brazil and Australia, could benefit from higher prices if inflation rises, whereas commodity-importing countries may face increased costs and fiscal pressures. The USD's strength adds another layer of complexity, as emerging markets with high external debt denominated in dollars may struggle to manage inflationary pressures and currency depreciation.

Epected Real GDP growth 2025



Source: Amplia, Bloomberg

Valuation

Valuation levels across most equity markets remain elevated, reflecting optimism about future growth prospects. Historical average price-to-earnings (P/E) ratios for major markets, such as the S&P 500, have typically hovered around 16-17x earnings. Currently, however, many indices are trading at significantly higher multiples, suggesting heightened sensitivity to interest rate changes and inflationary shocks. Elevated P/E ratios mean that even minor deviations from expected inflation or growth trends could trigger significant market corrections as the P/E ratio itself is a proxy for interest risk sensitivity (duration).

The disparity within the S&P 500 is particularly striking. The so-called “Magnificent 7”, comprising major technology and AI-driven companies, trade at a forward P/E ratio of 40, while the “Not That Magnificent 493” companies in the index exhibit far more modest valuations (P/E of 22). This bifurcation highlights the speculative nature of high-momentum stocks, which often price in transformative future scenarios rather than current fundamentals.

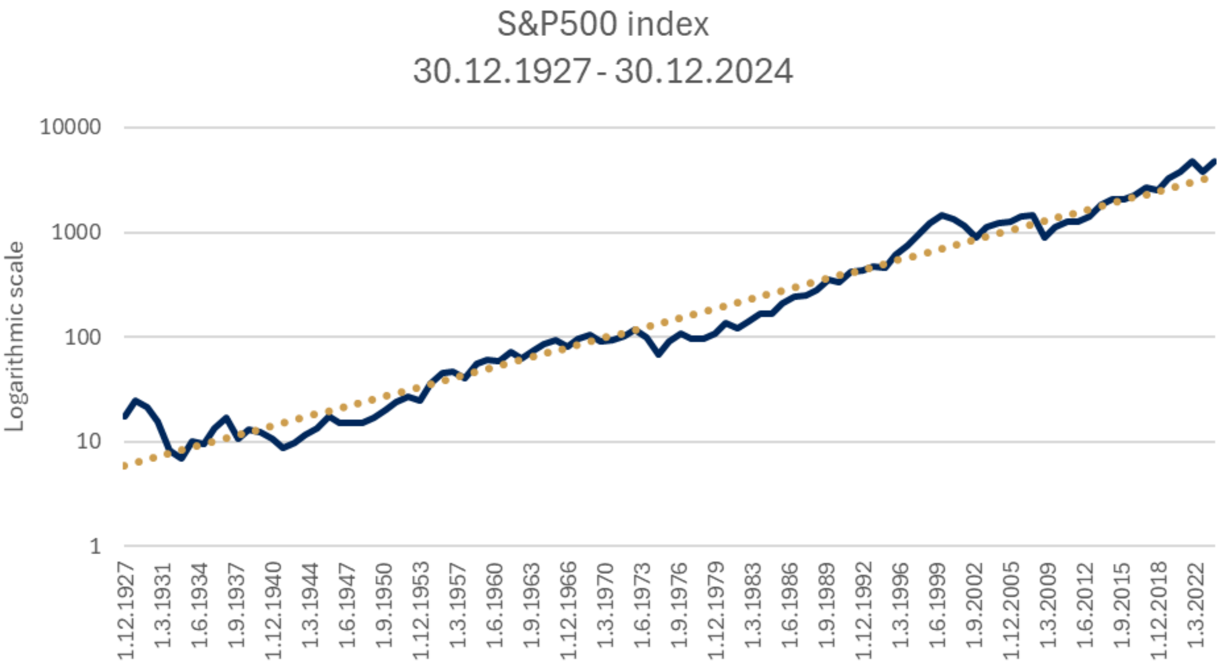
Companies linked to artificial intelligence and emerging technologies exemplify this trend. Their valuations often anticipate a future where these technologies have seamlessly integrated into daily life. The same speculative optimism extends to sectors like micro nuclear power plants, where the promise of innovation drives investor enthusiasm. However, these lofty valuations are highly sensitive to changes in discount rates, and any upward movement in interest rates could result in sharp market adjustments.

Timing the market based on valuation has historically been challenging. Amplia’s own valuation metrics, while robust, are designed to divide valuation levels into four broad categories rather than pinpoint specific market turning points. These signals, though reliable, occur less frequently than once a year, emphasizing their utility in long-term rather than short-term decision-making. While valuations provide context, they are best used in conjunction with broader economic and sentiment analyses.

Sentiment

Market sentiment at the outset of 2025 is characterized by optimism, with indices hovering around all-time highs. This buoyant sentiment, however, brings inherent volatility. The short-term hiccups, though momentary, often grow more alarming the longer markets continue their upward trajectory.

The fact that markets are at their all-time-highs is not a signal of any sort. Over the long run, market averages tend to trace a path of all-time highs, because of the Brownian motion like pattern still touching the peak only occasionally.



From these levels, sentiment can only turn worse. The critical question is the extent to which sentiment might deteriorate and whether it could trigger a self-reinforcing downward spiral. Market turns often stem from sentiment shifts alone, where changes in investor psychology push the equity risk premium (ERP) higher, impacting the weighted average cost of capital (WACC) and justifying a lower valuation. This creates a self-reinforcing loop—a "circulus in probando." The reverse is equally true: in periods of poor sentiment and falling markets, a mere shift in optimism can drive justified corrections upward as the ERP eases.

This delicate balance—a rightful fear of fear itself—creates an unstable equilibrium for markets and lies at the heart of sentiment-driven volatility. Prolonged negative sentiment can extend beyond financial markets to affect real-world economic decision-making. Managers may delay future projects or may hesitate to deploy capital amid higher funding costs. This materialized poor sentiment can inject itself into the broader economy, compounding challenges and creating long-lasting effects.

The year 2025 will likely see swings in sentiment of varying duration and intensity. While front-running these swings is futile, Amplia's approach focuses on analysing longer-term sentiment changes to align with broader economic and valuation trends. Without a significant downturn in the economy, there is little reason to expect prolonged sentiment deterioration. However, given today's ERP levels, any shift in sentiment could render current valuations expensive, reinforcing the importance of vigilance.

Esoteric Insights

To round out this outlook, let's explore some thought-provoking facts aligned with our themes:

The ***Butterfly Effect***, a concept rooted in chaos theory, illustrates how small changes in one region can have outsized impacts globally. For example, a single tariff adjustment by the US could ripple through international supply chains, altering production and consumption patterns worldwide. Similarly, the ***pendulum swing of inflation*** often precedes significant technological or policy shifts, as seen during the industrial revolutions, the energy crises of the 20th century and potentially the anticipated rise of AI as the next transformative force. Lastly, *the **resilience of ecosystems and economies alike depends on diversity***. Just as ecological systems thrive on biodiversity, economic systems benefit from a variety of industries and trading partners, underscoring the importance of maintaining a balanced and inclusive approach to growth.

Return expectations for 2025

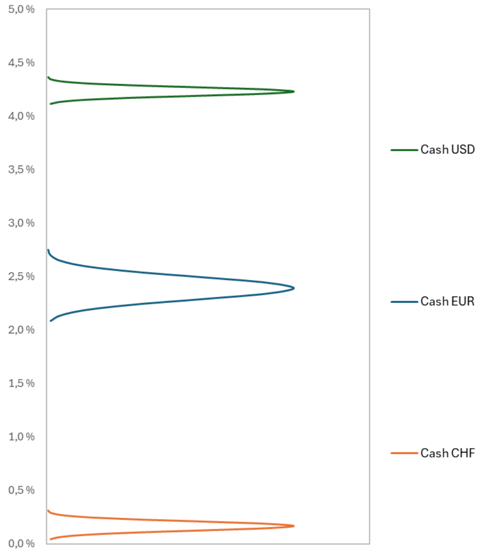
Return expectations belong in an annual outlook like lining in a coffin. The metaphor may seem morbid, but it is not as far from the mark as the return expectations themselves are bound to turn out. For an investor, it is comforting to have a reasonable and aesthetically pleasing forecast to lean on as the year turns. At best, return expectations serve as a reminder of why to invest at all. However, if misinterpreted, they might also create the illusion of an ability to cherry-pick investments based solely on return preferences, in a risk-free manner. The metaphor thus serves as a *memento mori*, a reminder of the inherent risks associated with investing.

To illustrate the futility of relying on single point estimates for expected returns, we have chosen to include the density function around our expected values. This distribution accounts for the (random) volatility around the forecast.

Cash

Starting with the simplest asset class, our return expectations for cash in EUR, USD, and CHF are:

	Return expectation 2025
Cash EUR	2,4 %
Cash USD	4,2 %
Cash CHF	0,2 %



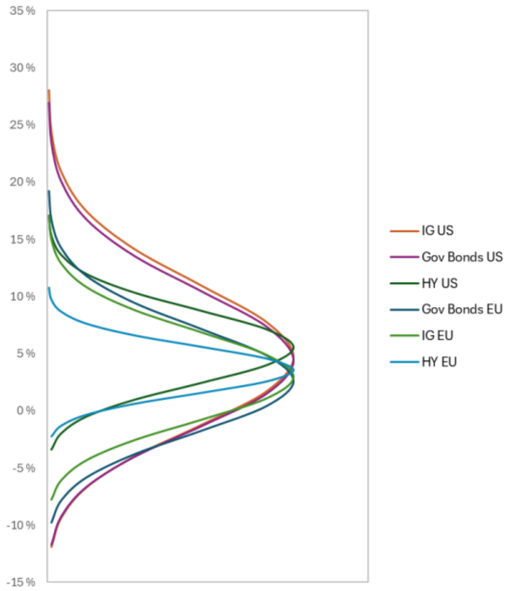
Source: Amplia, Bloomberg

As can be seen, we are confident about the cash returns, as we have assessed the distribution to be relatively narrow around the expected value (the highest point in the distribution).

Bonds

The situation becomes a bit more complex when we consider bonds. Our return expectations and corresponding distributions are:

	Return expectation 2025
Gov Bonds EU	2,6 %
Gov Bonds US	4,4 %
Investment Grade EU	3,0 %
Investment Grade US	4,7 %
High Yield EU	3,6 %
High Yield US	5,5 %



Source: Amplia, Bloomberg

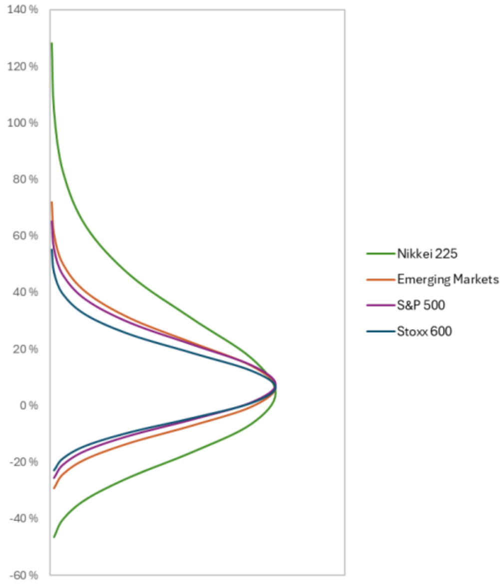
The peaks of the distributions remain neatly clustered above the risk-free rate. However, as we can see, the probable range of outcomes has expanded significantly. For example, U.S. government bonds with a duration of nearly six years could easily experience fluctuations of ±10%.

Equities

Finally, climbing the risk ladder, we have equities. These offer even more variability and, perhaps, entertainment:

	Return expectation 2025
Stoxx 600	6,5 %
S&P 493	6,2 %
Mag 7	10,7 %
S&P 500	7,6 %
Nikkei 225	4,6 %
Emerging Markets	6,6 %

Once again, the expected values are strikingly similar, while the distributions are highly scattered, highlighting the lack of meaningful information in the location of the most probable outcome.



Source: Amplia, Bloomberg

Limitations of Return Expectations

Introducing normal market volatility into the framework of return expectations might seem unsettling and does come with certain shortcomings. Our expected returns are contingent on a scenario where the broader environment remains relatively stable. However, assuming such stability implies a further assumption that volatility itself will deviate significantly from historical norms. This, of course, may or may not hold true.

Despite these caveats, we remain confident that our expected returns reflect our best judgment. When interpreted appropriately, they provide insights into the likely direction of market movements. However, investors must remember that forecasts are no substitute for a thorough understanding of the risks inherent in every investment decision.

Conclusion

As we navigate the uncertainty of 2025, this outlook serves as a guide—not a crystal ball. By focusing on key macroeconomic trends, valuation dynamics, and sentiment patterns, we aim to provide a framework for understanding potential risks and opportunities. Amplia remains committed to vigilance, observing markets and economies without succumbing to haste. Our approach is guided by humility, recognizing that the art of prediction is as much about preparing for the unexpected as it is about foreseeing the likely.

To echo the anecdote from our introduction, forecasting is an inherently imperfect science. Just as the meteorologist's certainty was undone by an unexpected storm, the future will undoubtedly surprise us. But through careful observation and measured responses, Amplia aims to weather the uncertainties of 2025 with resilience and adaptability.

On 21st December 2024,

Yours sincerely,

Mikael Simonsen