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The year ahead: Navigating Trump 2.0.

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Election-year uncertainty has been replaced by policy uncertainty. That doesn't seem to bother investors in U.S. equities. Is the optimism justified? Time will tell.

U.S. equities were already faring well in 2024 before polls opened on November 5—and then continued to build on their gains once the election results were revealed. Large-cap stocks, as measured by the Russell 1000 Index, climbed 6% between election day and early December; small-cap stocks, as measured by the Russell 2000 Index, rose nearly 8%. Although a broad sell-off in the second half of the month erased most of these gains, investor sentiment still appears quite ebullient. For the year, U.S. large-cap equities posted a 24.5% total return and small-caps gained a respectable 11.5%. Equities outside the U.S. did not fare nearly as well. The MSCI World ex USA Index was up just 4.7% over the year, while the MSCI Emerging + Frontier Markets Index gained 7.5% in U.S. dollar terms. Bitcoin (the ultimate speculative vehicle) surged 122%, briefly touching the $106,000 mark post election and finishing the year at $92,661. What will the coming year bring? Judging from the post-election performance of equity markets and bitcoin, investors expect good tidings—even if the ride turns rocky from time to time.

Looking back, looking ahead

Exhibit 1 provides a stylized depiction of SEI's 2024 and 2025 views on key economic data points and policy issues. Our original forecast for 2024, made at the end of 2023, is represented by the boxes in the top bars for each category; checkmarks represent actual outcomes. As previously cautioned when presenting this template, this is not a quantitative exercise; it is meant to illustrate the degree to which our expectations for 2024 proved accurate.

Exhibit 1: What we expected, what happened, what might happen

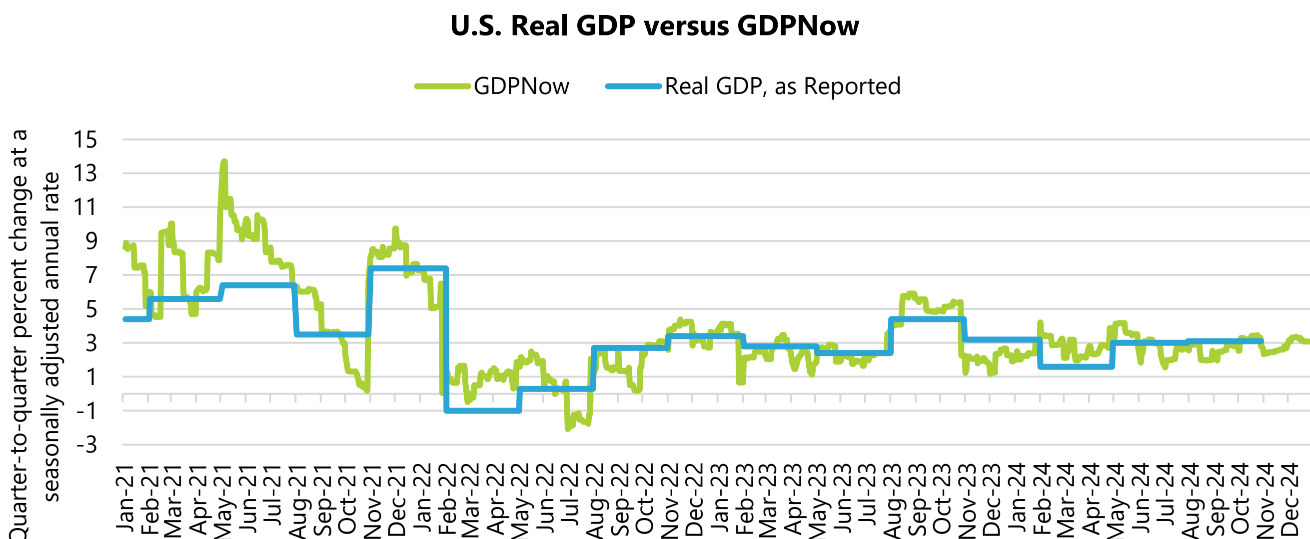
Area	BEARISH	NEUTRAL	BULLISH
Economic Growth	CONTRACTIONARY (2024, 2025)		EXPANSIONARY
Labor Markets	WEAK (2024, 2025)		STRONG
Inflation	VOLATILE (2024, 2025)		STABLE
Monetary Policy	TIGHT (2024, 2025)		LOOSE
Fiscal Policy	CONTRACTIONARY (2024, 2025)		EXPANSIONARY
Geopolitical Risk	HIGH (2024, 2025)		LOW
Investor Sentiment	EXCESS OPTIMISM (2024, 2025)		EXCESS PESSIMISM

Legend
- ☐ What we expect(ed) at the start of the year
- ✓ What happened over the full year
- ☑ Similar expectation and outcome

Source: SEI. For illustrative purposes only.

Regarding economic growth, the U.S. exceeded our expectations for the second year in a row. We were anticipating an average performance in the first half followed by a more significant deceleration that would bring growth closer to the stagnant/modest growth conditions experienced in other major developed countries. We thought that higher interest rates would bite into consumer spending more than they did. Instead, we got another year of above-average growth. The Atlanta Federal Reserve's GDPNow statistic, highlighted in Exhibit 2, shows the data released thus far for the fourth quarter. It suggests that the U.S. economy still has momentum behind it, advancing at a 3.1% annualized pace as of December 28. At least we were not forecasting a recession, which was a popular outlook this time last year.

Exhibit 2: The U.S. economy keeps humming

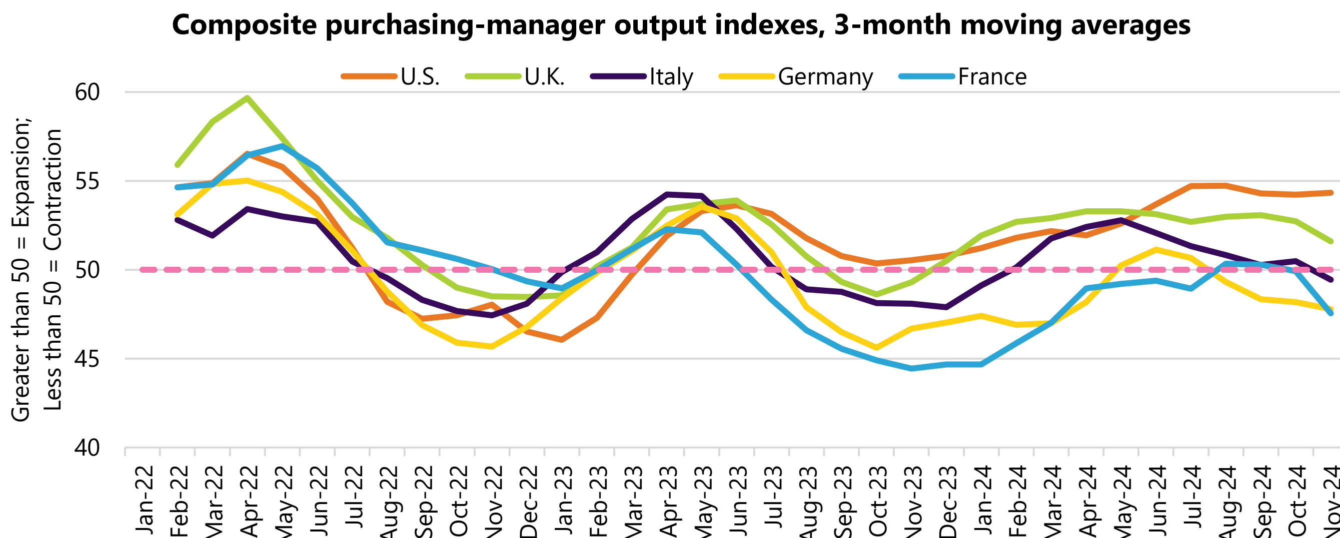


Source: Bureau of Economic Analysis, Federal Reserve Bank of Atlanta, SEI. Reported GDP advanced one month to align with GDPNow data.

The election of Donald Trump and Republican majorities in both the Senate and the House of Representatives improves the odds that U.S. economic growth will continue to run at a healthy pace of 2% to 2.5% in the year ahead. Tax-policy uncertainty has been greatly reduced. There will be no major upheaval in the federal tax code at the end of 2025. The only question is how much more expansive fiscal policy will get.

U.S. inflation-adjusted gross-domestic product (GDP) is on track to grow 2.8% in 2024. The U.K. and Canada will each likely register a gain of 1.1% to 1.2%. Europe's growth rate should be less than 1%. Purchasing-manager surveys, as we show in Exhibit 3, underscore the performance gap between the U.S. and other countries. The S&P Global Composite PMI output index, which includes manufacturing and services, is firmly in positive territory and has stayed at a relatively high level in recent months. The U.K. also remains above the expansion/contraction line, but actual business activity has been stagnant in recent months. Europe, meanwhile, has been weak. The two main engines of European growth (France and Germany) have seen severe deterioration in economic conditions.

Exhibit 3: Purchasing managers are happiest in the U.S.



Source: IHS Markit, SEI.

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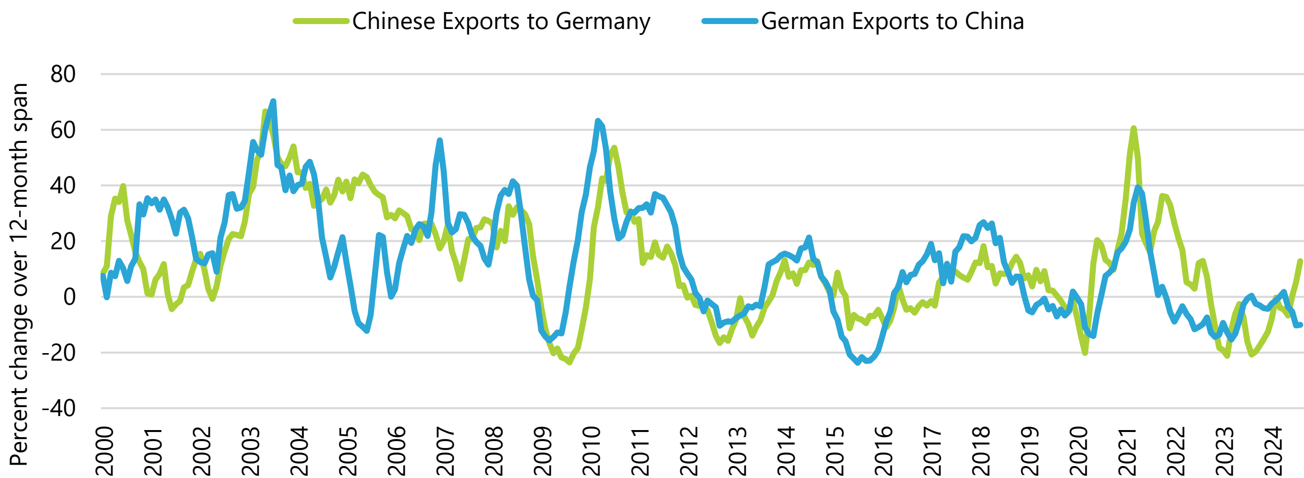
It is hard to see a significant turnaround in Europe. Heavy reliance on manufacturing is a major factor behind the region's poor performance. Germany has been particularly hard-pressed by tepid demand from China for its cars and capital goods. In Exhibit 4, we highlight German-China merchandise trade. German exports to China have been consistently negative over the past few years. China exports to Germany also have been moving lower—until the past year or so.

Since domestic demand in China remains quite weak, the country has resorted to the tried-and-true playbook of exporting itself out of its economic doldrums. The strategy worked coming out of the 2007-to-2009 global financial crisis (GFC), and Germany benefited immensely as Chinese companies bought its machines and chemicals and households snapped up its luxury cars. It is not likely to work so well this time around. Barriers to Chinese imports are on the rise, and not just in the U.S.; Europe has already slapped stiff tariffs on Chinese electric cars (exacerbating German manufacturers' concern that China will retaliate against their own goods).

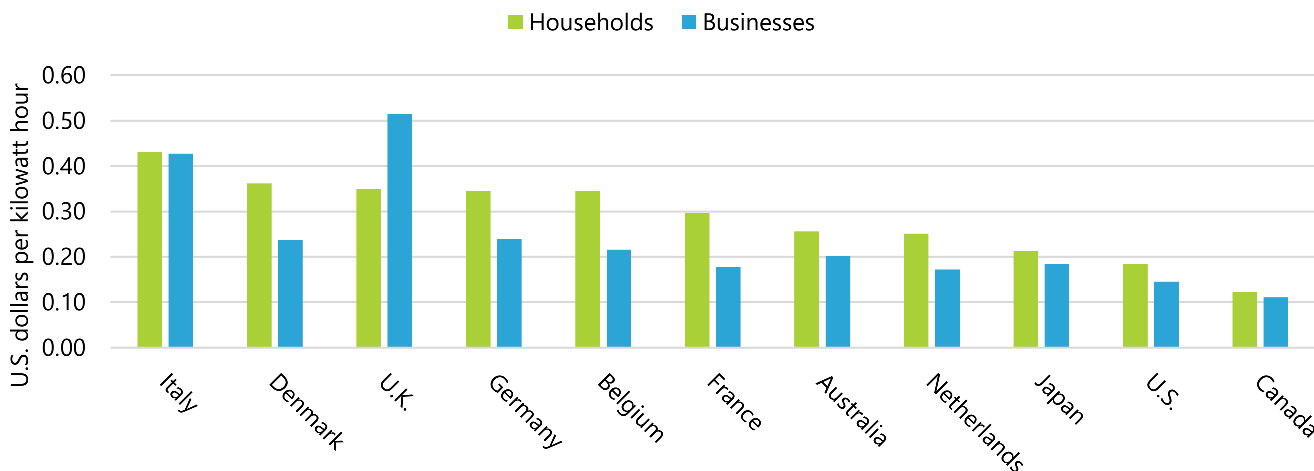
Exhibit 4: The German export machine is misfiring



Source: IMF Direction of Trade Statistics, SEI.

Making matters worse for Europe is the high cost of energy. Although the price of electricity in Europe has fallen sharply from its peak at the end of 2022, the cost per kilowatt-hour remains much higher there for both households and businesses than in the U.S. and Canada, as illustrated in Exhibit 5. The U.K. stands out as exceptionally expensive for businesses, with the price of electricity averaging $0.515 per kilowatt compared to $0.145 in the U.S. The U.K.'s reliance on imported natural gas, higher distribution and transmission costs, higher taxes and environmental levies, and weak currency relative to the U.S. dollar are some of the reasons for the discrepancy that makes energy-intensive manufacturing an expensive proposition in the country.

Exhibit 5: Electricity prices are shocking in the U.K. and Europe



Source: GlobalPetrolPrices.com, SEI. Electricity prices per kilowatt Hour in U.S. dollars, taxes and levies included, as of March 2024.

Canadian households and businesses enjoy even lower electricity costs than the U.S., even though its government is aggressively pursuing a carbon-pricing system that makes fossil-fuel consumption more expensive each year. Canada benefits

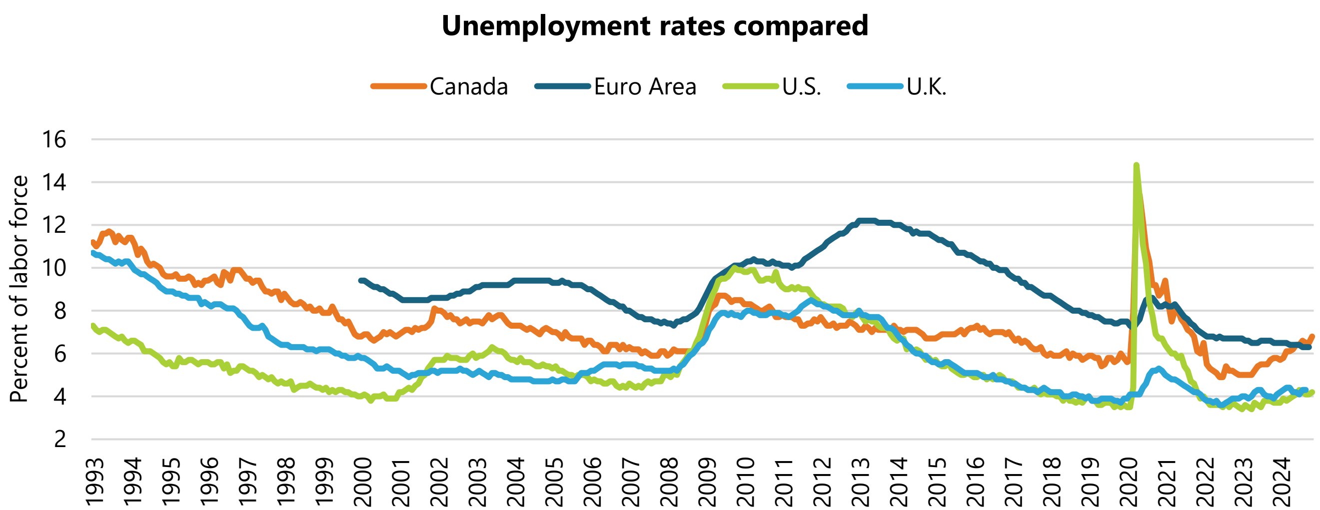
from the fact that nearly 60% of its energy needs comes from cheap hydropower. In addition, there are government-owned utilities that prioritize affordability over profit, while most provinces operate under regulated electricity markets that ensure price stability and affordability. Taxation of electricity is also quite low in Canada relative to European countries.

That advantage is offset by the squeeze on household incomes caused by higher interest rates, especially on home mortgages. The typical term for a mortgage in Canada is five years. Therefore, households are still in the process of seeing their rates readjust to reflect the sharp jump in 2022. To make matters worse, Canadians never experienced the debt contraction recorded in the U.S. after the GFC. Canadians now devote nearly 14.5% of their after-tax income to debt service—up from 12.7% at the end of 2021 and much higher than the equivalent reading of 7.7% in the U.S.

Labor markets still rather tight

Labor markets in the advanced economies have stayed buoyant, as we had expected. Unemployment rates, highlighted in Exhibit 6, are still quite low in the U.S. and the U.K., although both countries have recorded an upward drift in their jobless rates over the past two years. The eurozone, meanwhile, has registered a further drop despite the region's sluggishness in business activity; however, its jobless rate remains much higher than that of the U.S. and the U.K. Much of this is related to demographics. The shrinking labor forces in many countries will become even more widespread in the years ahead.

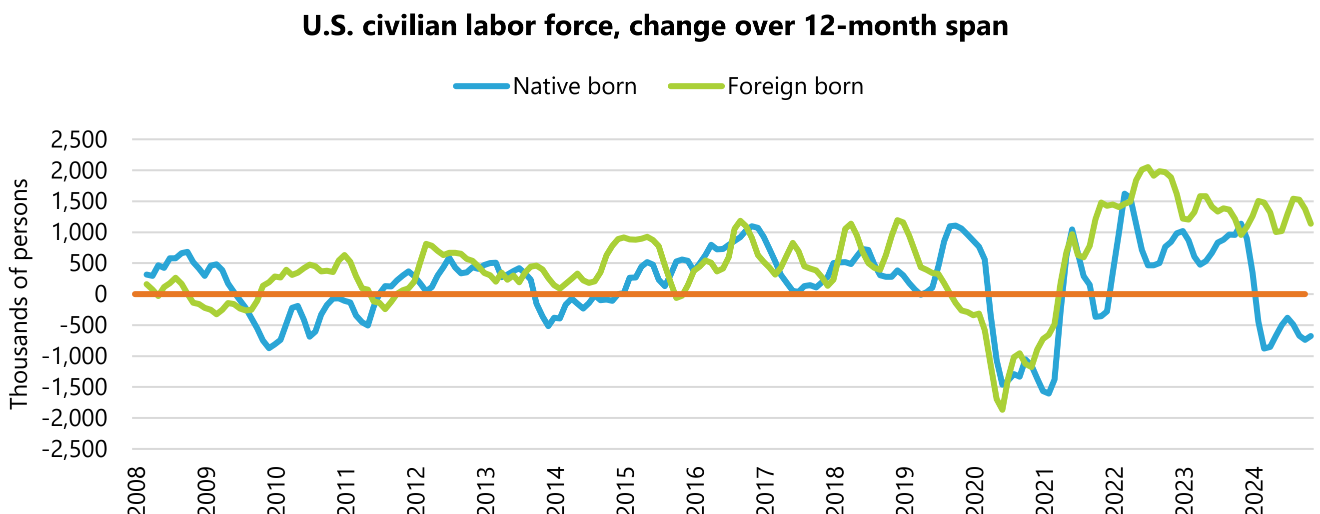
Exhibit 6: Jobless rates are still low, Canada excepted



Source: FactSet, SEI.

That is not the case in Canada, however. Unlike the other countries shown in Exhibit 6, Canada has experienced a sharp rise in the unemployment rate. The climb to 6.8% as of November is not the result of a surge in layoffs; it reflects rapid population growth and labor-force expansion. Canada's population has grown 7.1% since 2022, while the labor force has expanded 6.7%, far outpacing job creation. The U.S. also has experienced a boom of immigrants into the labor force, as we show in Exhibit 7.

Exhibit 7: Migrants kept the U.S. labor force from shrinking



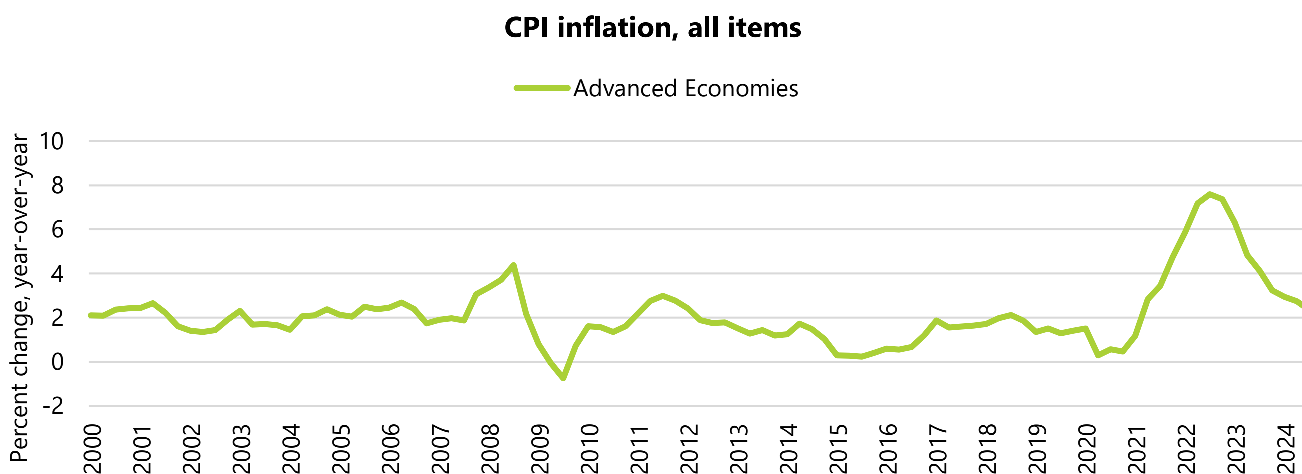
Source: Bureau of Labor Statistics (BLS), SEI. Three-month moving averages. Data not seasonally adjusted.

The number of foreign-born persons in the civilian labor force swelled by 1.1 million in the past year, more than offsetting the 676,000 decline in the number of native-born workers over the same period. This trend probably will continue, even as the incoming Trump administration seeks to stop the flow of migrants into the U.S. and plans an aggressive deportation push. Our working assumption is that deportation efforts will be concentrated on the criminal element and those persons who have already been issued deportation orders. These efforts may be hindered by the legal system and by the fact that some countries, like Venezuela and China, refuse to take back people who have emigrated. Nevertheless, the flow of new immigrants across the southern border has already been sharply curtailed. We assume the U.S. labor market will ease a bit further in 2025 as growth in hiring slows. The demand/supply balance nevertheless will remain on the tight side, helping to keep wage growth at elevated levels.

Inflation more likely to wax than wane

Inflation in advanced economies continued to decelerate more dramatically than we anticipated in 2024, moving toward the 2% mark that major central banks have each set as their goal. The eurozone and Canada reached this level in October. The U.K.'s year-over-year inflation rate fell to 2.3%, while the U.S. declined to 2.7%. As illustrated in Exhibit 8, consumer price inflation for all advanced economies is still higher than it was in the period between the GFC and the COVID-19 supply-chain disruptions. Inflation today is more in line with the pre-GFC experience.

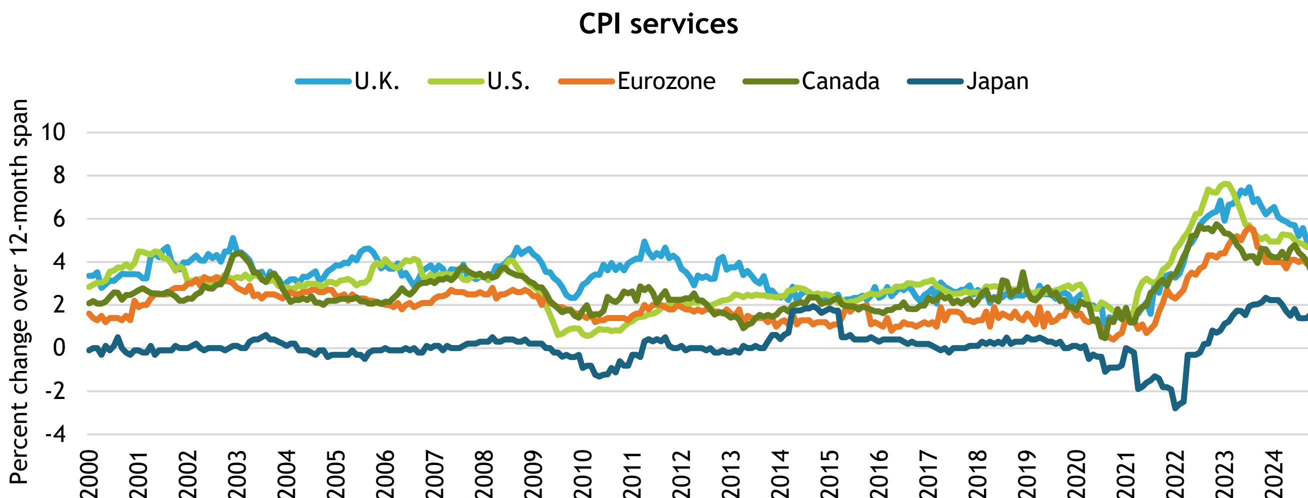
Exhibit 8: Is 2% now a floor instead of a ceiling?



Source: Oxford Economics, SEI.

This improvement, while certainly welcomed, is the result of actual price declines in commodities and other goods. As shown in Exhibit 9, services inflation in the largest economies remains a problem. It appears particularly sticky in the U.K. and the U.S., where services prices have climbed 5% and 4.5%, respectively, over the past 12 months. These are also the countries where unemployment rates are low and labor-market conditions are the tightest. Even in Canada and the eurozone, where unemployment rates are considerably higher, services inflation remains in the 3.5%-to-4.0% range.

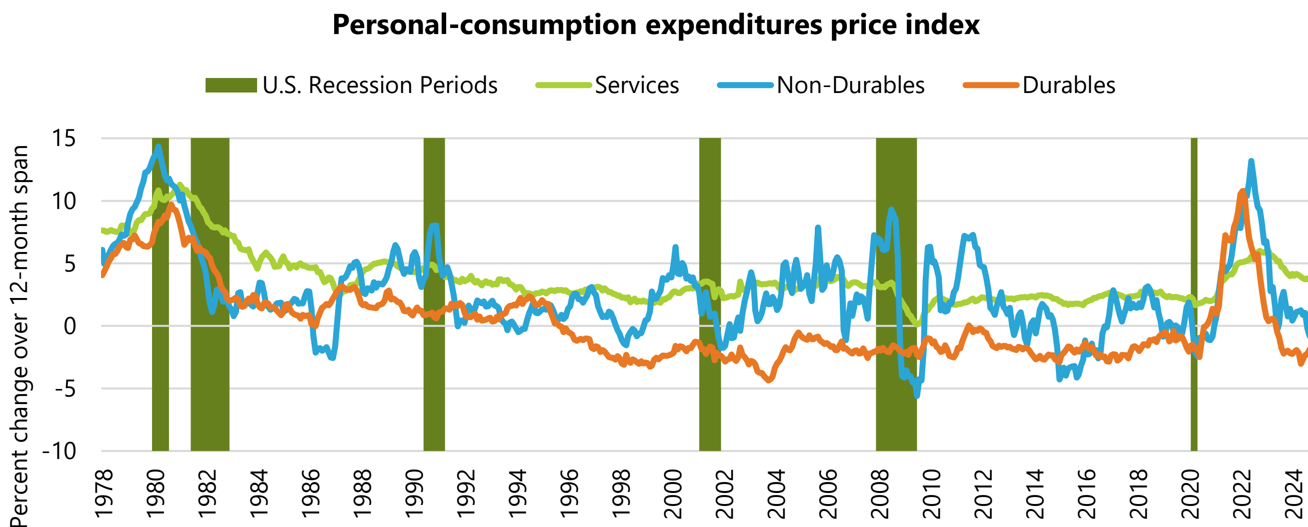
Exhibit 9: Services inflation down but not out



Source: FactSet, SEI.

Focusing on the U.S., Exhibit 10 tracks the three major categories of the personal-consumption expenditures (PCE) price index—durable goods, nondurables and services. Services inflation by this measure is lower than services inflation measured by the consumer-price index (CPI) mostly because shelter costs have a higher weight in CPI. That noted, the year-over-year change in services prices is still more than a percentage-point higher than it was in the 2010s. We don't anticipate much more improvement in the near-term given our view that the labor market will remain tight—and will perhaps tighten further if the incoming Trump administration reduces the flow of foreign-born persons into the workforce. Also, it is hard to improve productivity in services. We expect wage inflation to remain in the 4%-to-4.5% range, which should keep services inflation elevated as well.

Exhibit 10: Goods deflation coming to an end?



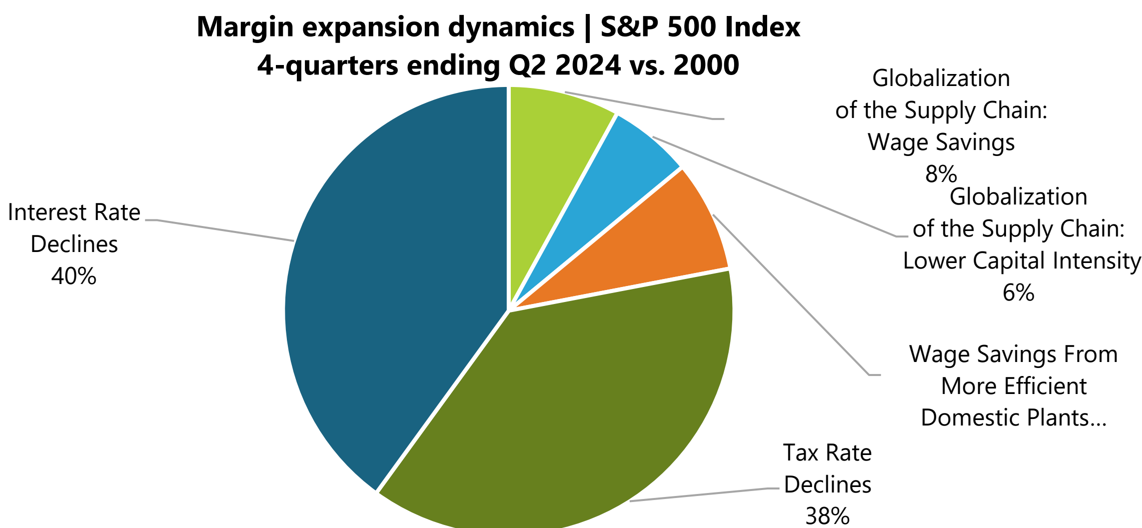
Source: Bureau of Economic Analysis (BEA), SEI.

Unlike services, inflation in nondurable goods tends to be volatile due primarily to the cyclical price swings in food and energy. This component of the PCE has recorded an absolute decline in the past 12 months. While we assume nondurable goods inflation will stay subdued in 2025, the category's historical volatility should be noted.

The big question is whether price declines in durable goods will continue. Those who see a return to a sustained overall inflation rate of 2% or less probably believe that goods deflation has become a permanent feature again, just as it was before the onset of the COVID-19 pandemic. We think there's a good chance that this is not the case. The decline in prices in 2024, for example, could simply stem from a further normalization of the demand-and-supply balance that had been seriously disrupted in 2020 and 2021.

More importantly, we think that many of the secular tailwinds that boosted U.S. manufacturers' profit margins have turned into headwinds. Exhibit 11 shows the drivers behind that expansion since 2000. Notably, two-fifths of the improvement came from the secular decline in interest rates.

Exhibit 11: Margins improvement could be ending



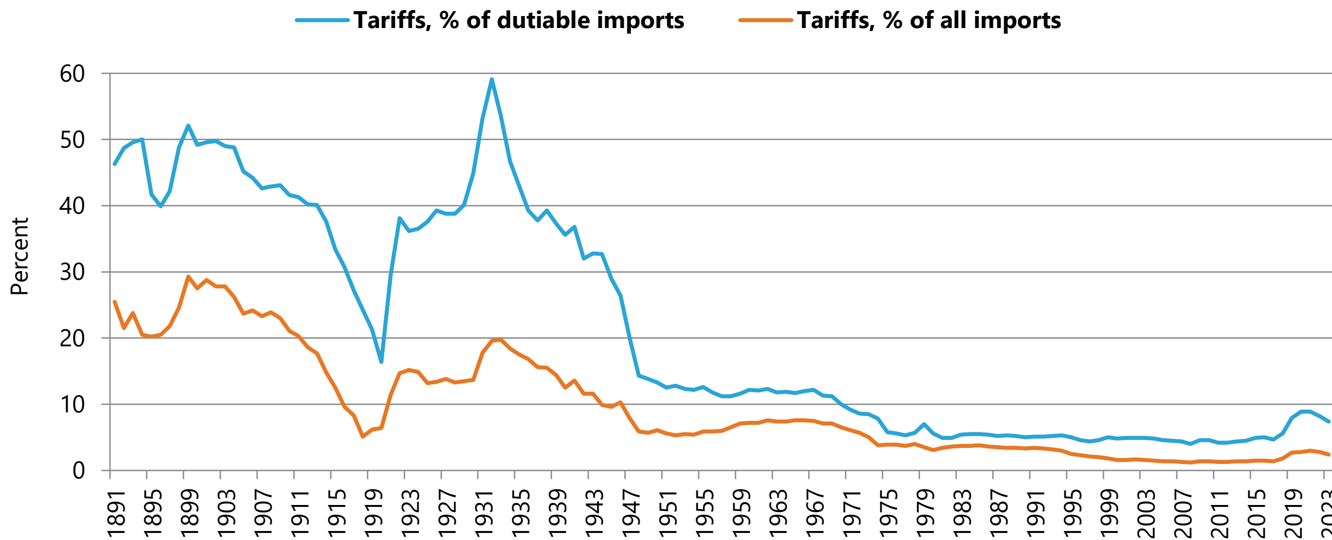
Source: U.S. Census Bureau, U.S. Bureau of Labor Statistics, Corporate Reports, Empirical Research Partners Analysis, SEI. *Excludes financials and REITs.

Financing costs are now on the rise and will become a more negative factor as lower-cost debt matures and is refinanced at higher interest rates. Lower tax rates and the ability to "jurisdiction shop" for the country with the most advantageous tax regime provided nearly another two-fifths of the gain in profit margins. This factor may no longer be in play and may even reverse in the years ahead outside of the U.S. as governments seek to repair their fiscal positions.

Granted, President-elect Trump may push for a lower corporate tax rate; there is speculation that the statutory rate could fall as low as 16% from the current 21%. It is not clear, though, whether there is enough support in Congress for this change when the priority is to extend and enhance tax breaks for households and individuals.

The globalization of supply chains, both in terms of wage savings and lower capital intensity, have accounted for 14% of the increased margin enjoyed by U.S. manufacturers over the past 24 years. Under a Trump administration, the benefits of globalization could be severely reduced, depending on how aggressively tariffs are implemented. Exhibit 12 tracks the history of tariffs imposed on merchandise imports entering the U.S.

Exhibit 12: Tariffs will increase – we just don't know by how much



Source: U.S. International Trade Commission, SEI.

If Trump were to impose across-the-board tariffs on imports from China, Canada, Mexico and other countries at the magnitudes he has suggested, we would see a surge in levies to levels much like those of the 1930s. It would have a devastating impact on U.S. manufacturers of all stripes as input costs rise and exporters face retaliation. This worst-case scenario is unlikely. Rather, we expect a more targeted approach—which would still be disruptive, as it could leave such levies at their highest point since the 1950s. To say the least, there are many unknowns when it comes to the new administration's trade policy.

While productivity improvements in domestic manufacturing will likely continue, it is a small part of the pie. We think that companies with pricing power will end up pushing whatever higher costs they endure onto the end users of their products and services. The era of sustained deflation in durable goods may therefore be ending.

Monetary policy: More rate cuts ahead

Our call on monetary policy last year was accurate. While markets were pricing in 150 basis points of cuts in the federal-funds rate through the end of 2024, we were aligned with the Fed's projection of 75 basis points. As it turned out, the Fed ended up cutting its benchmark rate by a full percentage point. The central bank waited until September to make its first cut of one-half percentage point, then implemented two quarter-point reductions—one in November, and one in December.

We also thought that the Bank of Canada (BoC), the European Central Bank (ECB), and the Bank of England (BOE) would be hesitant to cut their respective policy rates until later in the year. Canada was the first to implement a rate reduction in early June, followed by the ECB a few days later. The Bank of Japan (BOJ), meanwhile, finally began to increase its policy rate in March. While the BOJ has pushed the rate on overnight money out of negative territory, there is a long way to go before one can say that monetary policy in Japan is back to normal. Exhibit 13 tracks the changes in central-bank policy rates.

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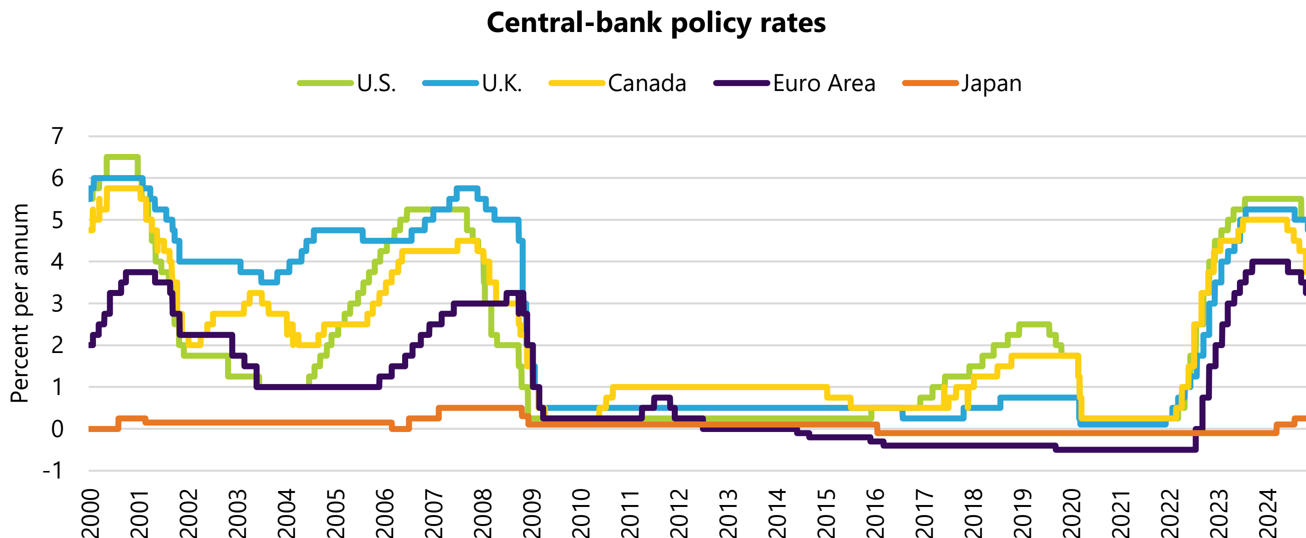
Policy rates in the advanced economies will likely ease further in 2025. As was the case this time last year, we are not convinced that it is necessary for the U.S. to follow the crowd. Some members of the Federal Open Market Committee (FOMC), the policy decision-making arm of the Fed, now appear to be having second thoughts as well. Although the U.S. central bank lowered the Federal funds rate in December, its accompanying rhetoric and subsequent projection updates shifted to the hawkish side. The FOMC's December median forecast for 2025 versus that of September indicated slightly higher GDP growth and lower unemployment—but a meaningful upward revision in overall inflation to 2.5%, from the 2.1% estimated in September. In view of these new projections, the Fed has penciled in only two cuts in the federal-funds rate, to reach 3.9% by year-end 2025, versus the full percentage point decrease projected just three months ago. This new forecast aligns more closely with our expectations, although we think there is the possibility that the federal-funds rate will remain unchanged through the entire year.

Exhibit 13: Going down the policy-rate mountain



Source: FactSet, SEI.

In the U.K., the BOE kept its key interest rate unchanged at 4.75% at its latest meeting, but there were three dissenters (who wanted to reduce the rate) out of the nine members of the Monetary Policy Committee. Although growth in the U.K. economy has been disappointingly slow in recent quarters, we find these dissents surprising given the stickiness of inflation and the higher-than-expected wage growth of recent months. Of all the major central banks, the BOE probably has the toughest job navigating between economic stagnation and persistently high underlying inflation.

Countries and regions with structurally lower inflation and weaker economies should see more aggressive rate reductions than the U.S. or the U.K. The BoC has been particularly aggressive, bringing its target rate down to 3.25% from a peak of 5% in June. The Canadian central bank is obviously worried about the country's growth outlook and the financial hardship endured by over-leveraged households at a time when the unemployment rate is rising sharply. The December rate cut amounted to 50 basis points and comes hard on the heels of a similar reduction in October. Perhaps the latest rate cut reflects a pre-emptive move in case tariff negotiations with the Trump administration do not go well. Whatever the reason, the widening interest-rate gap versus U.S. short-term rates has pushed the value of the Canadian dollar down to levels that have rarely been seen in the past 20 years.

The ECB's deposit rate could fall from the current reading of 3% into the 1.25%-to-1.75% range by the end of 2025. Pressure on the ECB to adopt an aggressively easy monetary policy will become more intense if a trade war materializes with the U.S. Even if trade tensions ease, the European economy is unlikely to break out of its torpor anytime soon. A poor demographic profile, political instability in Germany and France, and a manufacturing sector squeezed by high energy costs and weak demand should ensure that the ECB errs on the side of easing.

Fiscal policy: A surplus of deficits

We expected fiscal policy to be expansive in 2024—an accurate call, and an easy one to make. In the U.S., spending has been mostly on autopilot given Congressional deadlock and the fact that the country was in a presidential election year. In Europe, subdued economic activity naturally limits the growth in tax revenues, while incentives to speed the transition to lower carbon emissions help to keep government expenditures high. All advanced countries, meanwhile, face an inexorable rise in payments for old-age benefits, further hikes in military spending, and much higher interest expense. The same drivers of government spending and deficits are likely to remain in place in 2025. If anything, the rise of populism and discontent with established political parties could place even more upward pressure on fiscal spending.

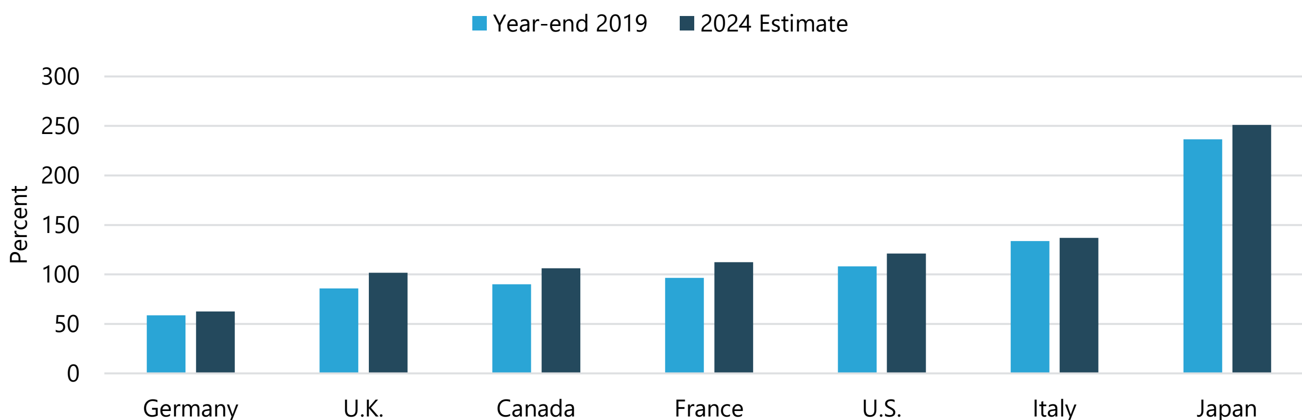
The election of Donald Trump and the Republican victories in the House of Representatives and the Senate guarantee the extension of most tax cuts embodied in the Tax Cuts and Jobs Act passed in 2017. Additional tax cuts are likely, including at least

one or two of the promises made by Trump on the campaign trail such as eliminating taxes on tips, overtime, and Social Security benefits. Given the paper-thin majority enjoyed by Republicans in the House, each member of Congress will have extraordinary leverage to get a little something in exchange for their support. One top priority for those from high-tax states is an easing of the deductibility limit on state and local taxes (SALT). It is a change that has bipartisan support but could be expensive. According to the Penn State Wharton Model, full elimination of the cap on deductions would reduce expected revenues by some $1.1 trillion over a 10-year timeframe.

Other countries at least try to pay lip service to fiscal responsibility, but even they are recording higher spending over time that is not matched by revenue increases. The U.K., for example, appears to be pursuing a tax-and-spend policy that places greater emphasis on the spending side of the equation in the near-term. The autumn budget raises taxes an additional 1% of GDP per year versus baseline in the form of higher employer contributions to the National Insurance system, higher capital gains and inheritance taxes, and the charging of value-added tax on private school fees. These revenue-raising measures are more than offset by average annual spending increases that are estimated at roughly 2% of GDP in coming years. Although the government forecasts that non-investment day-to-day spending will be in surplus by the 2029/2030 fiscal year, seeing will be believing.

Even Germany, a country that has consistently chosen austerity over fiscal expansion, might modify its so-called debt brake (a fiscal rule that limits structural net borrowing to less than 0.35% of GDP). Germany certainly has been successful in preventing the accumulation of debt, as we show in Exhibit 14. Gross general government borrowing amounts to less than 63% of GDP, only four percentage points of GDP higher than was the case in 2019. The U.S., the U.K., Canada, France and Japan not only have much higher debt-to-GDP ratios but also have recorded increases in those ratios of 14 to 16 percentage points.

Exhibit 14: Debtor's prison



Source: FactSet, SEI. Data as of October 2024.

Germany's poor economic performance in recent years and the underinvestment in infrastructure are trying the patience of the electorate. The increasing popularity of the Alternative for Germany is a worrisome development for established parties. The debt-brake rule, however, is enshrined in the nation's constitution; removing it requires a two-thirds majority in both houses of the parliament.

Geopolitics: Tensions reduced but still simmering

Our views on the various hotspots in the world were fairly accurate. The conflict between Ukraine and Russia has dragged on, although Russia appears to have gained the advantage through sheer attrition. Israel has prevailed over Hamas and Hezbollah, weakening Iran strategically and militarily in the process. China amped up its bullying of Taiwan and continues to aggressively push its interests in the South China Sea.

The outlook for 2025 does not appear quite as concerning as that of 2024 at this time last year. The surprising collapse of the Assad regime in Syria represents a major setback for both Russia and Iran. Israel and Hezbollah have reached a tentative peace agreement, and Hamas seems more willing to negotiate an end to the carnage. Ukraine and Russia also might come to the negotiating table in 2025, pushed along by the Trump administration.

Of course, things can still go awry diplomatically. Ukraine and Russia could escalate hostilities in the near term to gain a negotiating advantage. A weakened Iran might decide to accelerate its acquisition of a nuclear weapon, which could elicit military responses from Israel and the U.S. There's a good chance that tensions between China and the U.S. will continue to rise as the two countries engage in a tit-for-tat trade war. In a multipolar world where the U.S. is not as dominant as it once was, there will always be geopolitical concerns. For the most part, though, investors have tended to ignore most of the news coming from the world's hotspots.

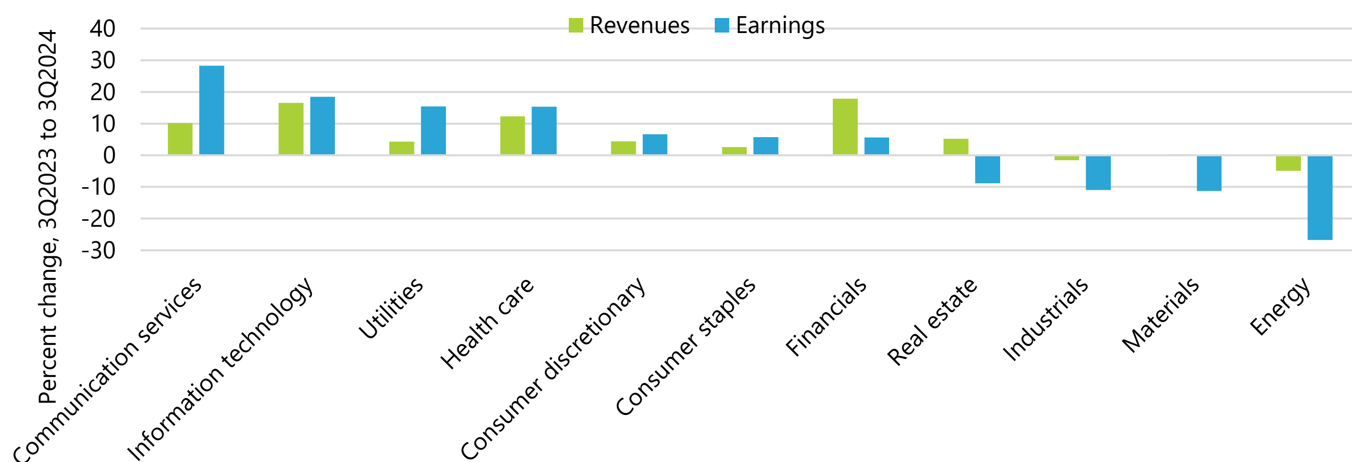
Political dissatisfaction is rife, however. France, Germany, and Japan have seen their governing coalitions collapse in recent months. Canada's Justin Trudeau enters this year's federal election cycle as an extremely unpopular incumbent. While the shifting political winds in these countries are governmentally important, it is unclear what impact they will have on markets. It probably doesn't improve the prospects for fiscal discipline.

Investors are still walking on the sunny side of Wall Street

At the beginning of 2024, we noted that investor sentiment was extremely bullish—so much so that we harbored concerns that U.S. equities might stumble early in the New Year. Of course, the U.S. equity market barely skipped a beat, suffering its worst decline of the year from mid-July to early August when the S&P 500 Price Index fell nearly 10%.

A stronger-than-expected economy and extraordinary earnings gains among the big tech companies that benefit from the development of artificial intelligence (AI) capabilities and the buildout of the infrastructure supporting AI provided all the bullish rationale that investors needed. Exhibit 15 highlights the revenue and earnings gains between the third quarter of 2023 and the third quarter of 2024. Although equities have risen more sharply in total-return terms than earnings themselves in 2024 for 10 of the 11 S&P sectors, the positive overall earnings trend dominated any concerns investors might have about the direction of future economic growth, inflation, interest rates, or government policy. The election of Donald Trump merely turbocharged the optimism going into the end of the year.

Exhibit 15: Strong as a bull

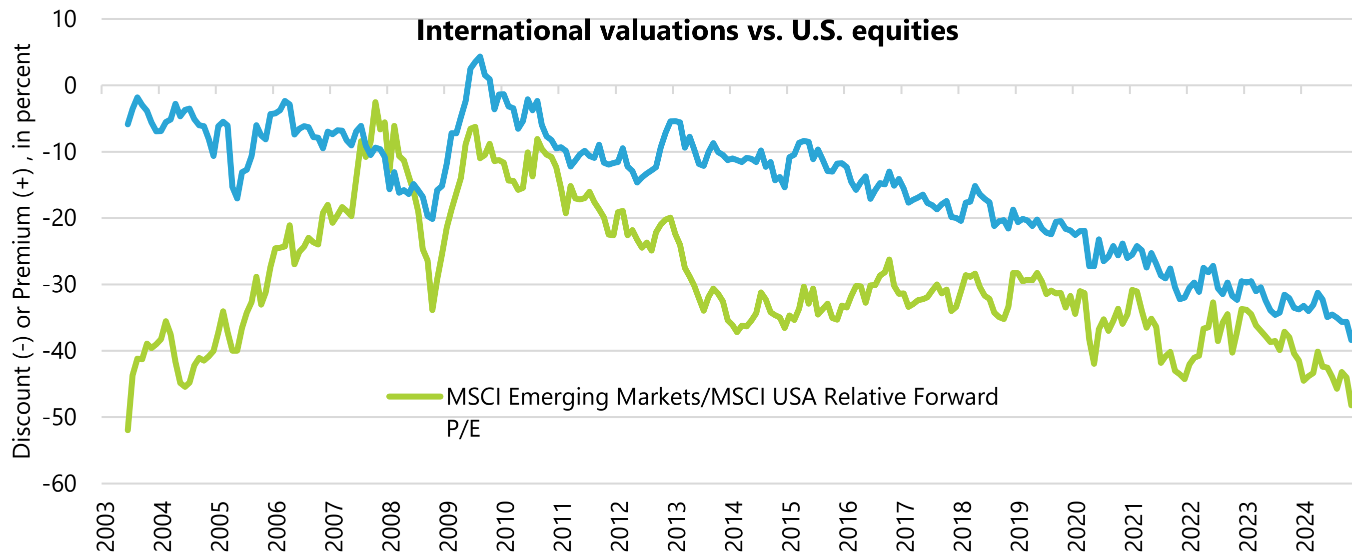


Source: Yardeni Research, SEI.

The expansion of earnings multiples contributed 11.5 percentage points to the S&P 500 Index's 25% total return in 2024—seven points lower than in 2023, but a substantial rise nonetheless. We would not bet on another large expansion of the price-to-earnings ratio in 2025. Large-cap equities are now priced at a multiple of 21.5 times next year's expected earnings. That places the market's current valuation near the top 5% of forward price/earnings readings since 1996. On top of that, this multiple is based on earnings expectations that are hardly depressed and could be subject to some downside revisions as the year progresses.

Exhibit 16 highlights how cheap equity markets have become outside the U.S. advanced-economy stock markets. The MSCI World ex USA Index now trades at a 36.5% discount to the forward multiple on the MSCI USA Index. Emerging markets trade at an even steeper discount to the MSCI USA Index, amounting to 45.7%. It is true that U.S. economic earnings growth has been stronger, that U.S. companies have been more dynamic and innovative, and that the large-cap U.S. equity universe has a much greater exposure to AI and other technological advances. These factors justify much of the valuation chasm. Nonetheless, large-cap U.S. equities seem priced for perfection and do not appear to be discounting the possible downside inherent in the Trump administration's economic policies. Little attention is being paid to the tail risks that are lurking outside of view.

Exhibit 16: When is cheap too cheap?



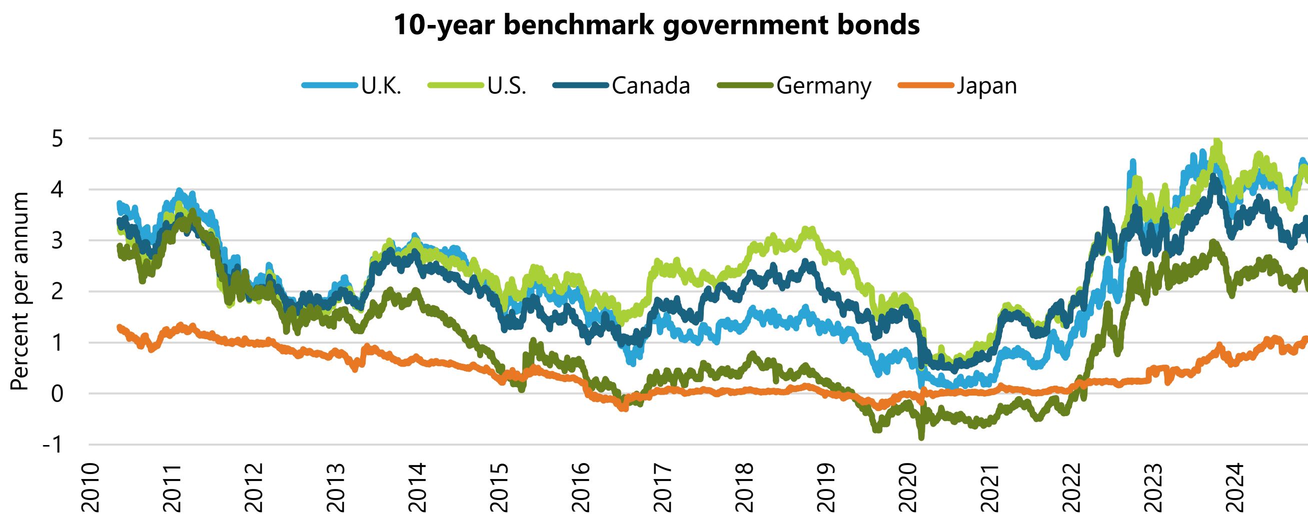
Source: MSCI, SEI

In the fixed-income space, there is a strong possibility that bond yields in the U.S. will rise further in 2025. We were correct last year in forecasting that the 10-year Treasury note yield was more likely to trade sustainably in the 4%-to-5% range than in the 3%-to-4% range, as was the consensus view. We still see that higher range holding in 2025, although yields may fluctuate toward the upper end as concerns mount over the deterioration of the U.S. fiscal position and the impact that tariffs and other policy decisions may have on future inflation.

Ten-year bond yields in the U.K. have been tracking closely with comparable U.S. maturities for the past two years, as we show in Exhibit 17. There doesn't seem to be any reason this should change in the near term. Meanwhile, the yield spread between the U.S. and those of Canada and Germany have widened in the past year as the latter two economies struggled economically and inflation decelerated more quickly. France has also struggled, but its benchmark bond has increased in yield owing to the country's political disarray and the electorate's resistance to any meaningful fiscal reforms. The country recently suffered a credit-rating downgrade, and its yield is now on par with that of Greece.

Japan is still in a world of its own. The yield on the government's 10-year finally nosed above the 1% mark for the first time since 2011. Given our assumption that deflation is in the rear-view mirror for that country, some further rise in longer-term yields seems likely.

Exhibit 17: Benchmark bond yields begin to diverge



Source: FactSet, SEI.

The divergence in interest-rate and growth trends between the U.S. and other countries has also kept the U.S. dollar at a high level in recent years; the U.S. currency typically fluctuates in broad multiyear cycles. It peaked on a trade-weighted basis in October 2022 but has not depreciated to any significant extent. Instead, the dollar has traded in a rather narrow range. It will likely remain buoyant in the near term, supported by the favorable interest-rate spread versus other major countries and the generally optimistic tone that prevails in the markets.

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A moderate tariff war could strengthen the U.S. currency further. That would reduce the U.S. trade deficit, but also hurt the growth prospects of the exporting countries subject to the tariffs. One way to offset that negative impact would be for those countries to allow a further depreciation of their currencies against the U.S. dollar. However, when it comes to currencies, there are many moving parts that lessen our confidence in any particular outcome. Treasury Secretary nominee Scott Bessent has suggested the possibility of a "Mar-a-Lago Accord" that would be similar in nature to the Plaza Accord agreed to with the other G-5 nations (France, Germany, Japan and the U.K.) under the Reagan administration in September 1985. That earlier currency agreement, backed by aggressive currency-market intervention, facilitated a sharp retreat in the U.S. dollar's value and eventually improved the U.S. trade balance.

Given Trump's transactional approach to policy, there is a danger that his administration will pursue a policy based on maximizing tariffs in the hope of forcing high-surplus nations, especially China, to dramatically alter their trade policies and allow their currencies to appreciate. Such a strategy could lead to volatility and tail risk that is not currently reflected in today's equity and bond prices.

Interesting times indeed.

A summary of our views.

- Election-year uncertainty has been replaced by policy uncertainty, but this has not prevented a powerful post-election rally in U.S. equities.
- The U.S. economy enters 2025 with decent momentum. We have penciled in inflation-adjusted growth of 2.0% to 2.5% versus 1.0% to 1.5% for Canada, the U.K., and Europe.
- Unemployment rates remain low in the U.S. and other advanced countries, with the notable exception of Canada. The incoming Trump administration is determined to stop the flow of migrants across the border and plans an aggressive deportation push. It remains to be seen how aggressive that push will be.
- We expect the inflation improvement seen in 2024 to stall out in the U.S. and the U.K. The imposition of tariffs could place further upward pressure on the U.S. inflation rate in 2025; the extent and magnitude of any levy is highly uncertain.
- Cuts in the federal-funds rate in 2025 could be limited to just one-half percentage point or less.
- Countries and regions with structurally lower inflation and weaker economies should see more aggressive rate reductions than the U.S.
- The election of Donald Trump and the Republican victory in the House of Representatives and the Senate guarantee the extension of most tax cuts embodied in the Tax Cuts and Jobs Act passed in 2017. Additional tax cuts are likely.
- Other countries' fiscal policies may not be quite as profligate, but they, too, will likely see worsening deficits over time owing to demographics, rising geopolitical tensions, higher financing costs, and a surge in populist politics.
- The geopolitical outlook for 2025 does not appear quite as concerning as it appeared this time last year. However, political dissatisfaction with the governing class is rife in many countries.
- Large-cap U.S. equities seem priced for perfection and do not appear to be discounting the possible downside inherent in the Trump administration's economic policies.
- There is a strong possibility that bond yields will rise further in 2025 as concerns mount over the deterioration of the U.S. fiscal position and the impact that tariffs and other policy decisions may have on future inflation.
- Given Trump's transactional approach to policy, there is a risk that his administration will pursue a policy based on maximizing tariffs in the hope of forcing high-surplus nations, especially China, to dramatically alter their trade policies and allow their currencies to appreciate. We expect increased financial-market volatility as a result.

Please refer to the latest installment of Chief Investment Officer Jim Smigiel's *SEI Forward* for more details about our views and positioning.

Glossary

Dividend yield is a financial ratio indicating how much a company pays out to its shareholders in the form of dividends. The dividend yield is calculated by dividing the amount of dividends paid per share over a designated time period by the stock's current price.

GDPNow is the Federal Reserve Bank of Atlanta's forecasting model for estimating GDP growth. It is designed to provide a "nowcast" (as opposed to a forecast) of GDP growth prior to the official release by the U.S. Bureau of Economic Analysis.

The global financial crisis (GFC) refers to the period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009.

Gross domestic product (GDP) is the total monetary or market value of all the goods and services produced in a country during a certain period.

The **Personal-Consumption-Expenditures (PCE)** price index measures the prices that consumers pay for goods and services to reveal underlying inflation trends. The core PCE price index, the primary inflation monitor used by the Federal Reserve, excludes volatile food and energy prices.

Policy rates are the interest rates set by central banks, used to influence other interest rates. This includes the Fed's **federal-funds rate** in the U.S.

Price/earnings (P/E) ratio is calculated by dividing the current market price of a stock by the earnings per share. Price/earnings multiples often are used to compare companies in the same industry, or to assess the historical performance of an individual company.

A **tariff** is a tax imposed by the government of a country on imports or exports of goods.

Index definitions

Consumer-Price Indexes (CPI) measure changes in the price level of a weighted-average market basket of consumer goods and services purchased by households. A consumer price index is a statistical estimate constructed using the prices of a sample of representative items whose prices are collected periodically. The **core CPI** excludes volatile food and energy prices.

The **MSCI Emerging Markets** is a free float-adjusted (i.e., including only shares that are available for public trading) market capitalization-weighted index that tracks the performance of emerging-market equities.

The **MSCI Emerging + Frontier Markets Index** captures large-cap and mid-cap representation across 24 emerging markets countries and 28 frontier markets countries. The index includes 1,469 constituents, comprising about 85% of the free float-adjusted market capitalization in each country.

The **MSCI USA Index** tracks the performance of the large- and mid-cap segments of the U.S. equity market. The index's 624 constituents comprise approximately 85% of the free float-adjusted (i.e., including only shares that are available for public trading) market capitalization in the U.S.

The **MSCI World** tracks the performance of the large- and mid-cap segments of equity markets across 23 developed-market countries. The index's 1,517 constituents comprise approximately 85% of the free float-adjusted (i.e., including only shares that are available for public trading) market capitalization in each country.

The **MSCI World ex USA Index** tracks the performance of the large- and mid-cap segments of equity markets across 22 of 23 developed- market countries--excluding the U.S. The index's 887 constituents comprise approximately 85% of the free float-adjusted (i.e., including only shares that are available for public trading) market capitalization in each country.

The **Russell 1000 Index** tracks the performance of 1000 of the largest U.S. equity securities based on market capitalization. The index is a subset of the Russell 3000 Index, which comprises the 3,000 largest U.S. companies, and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership.

The **Russell 2000 Index** tracks the performance of the small-cap segment of the U S. equity market. The index is a subset of the Russell 3000 Index, which comprises the 3,000 largest U.S. companies, and includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership.

The S&P 500 Index is a market-weighted index that tracks the performance of the 500 largest publicly traded U.S. companies and is considered representative of the broad U.S. stock market. The **price return (the S&P 500 price index)** excludes dividends and other payouts that would be included in the **total return**.

The **S&P Global Composite PMI Output Index**, a weighted average of the Manufacturing Output Index and the Services Business Activity Index, tracks business trends across both manufacturing and service sectors.

Important information

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