

A Calm After the Geopolitical Storm?

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

This year has been eventful in terms of geopolitical hotspots flaring up. The Israel-Gaza conflict was arguably the most intense, with multiple strikes between Iran and Israel – the first time these old foes have struck each other directly. The Russia-Ukraine theater also witnessed shifting dynamics, with Ukraine taking Russian territory earlier in the year, only to see Russia making significant advances later in the year. With a new US president soon to be inaugurated, how will the geopolitical landscape evolve in 2025, and what are the implications for markets?

The current situation in Ukraine is increasingly favoring Russia, which continues to gain territory as Ukraine grapples with a severe manpower shortage. Trump has expressed a desire for a swift resolution to the conflict, aiming to reduce US military and financial support for Ukraine. However, without significant shifts on the battlefield, Russia could eventually achieve de facto control. This would make it difficult for Trump to broker a peace deal unless Russia's core demands are met – central to which are guarantees that Ukraine remain outside of NATO. Ukraine may be willing to offer a prolonged delay in NATO membership (perhaps 10 years) as a compromise, given the decisiveness of this issue for both sides and Ukraine's weak position on the ground.

But would Russia accept this compromise? A key driver of negotiations from the Russian side is the strain on its domestic economy. Inflation remains above 10%, and the central bank has responded by raising interest rates, which has tightened economic conditions. It's unclear how long Russia can sustain this fiscal and economic pressure, and Moscow will likely be forced to seek an off-ramp eventually. The relaxing of sanctions against its energy sector would be an important win for Russia and could lead to compromises on other issues. Russia is also currently losing men at a run rate of half a million per annum, a pace that can't be sustained indefinitely.

We see a low probability of a "grand bargain" peace deal, and myriad unresolved issues could make any ceasefire fragile. Our base case is a partial agreement and ceasefire next year, likely with vague terms that leave long-term issues unresolved. Yet a cessation of hostilities and easing of sanctions would be a positive surprise for global markets, leading to lower risk premiums. Sanction relief for the energy sector could lower oil and gas prices by adding supply at the global level, even if Europe does not buy Russian energy directly. The materials and industrials sectors would likely see meaningful tailwinds, driven by an estimated \$500 billion reconstruction effort in Ukraine over the next decade. Transportation and logistics could rebound if Ukraine reopens for trade, restoring critical networks like air transportation.

In the Middle East, multiple battlefronts have seen dramatic change in the past few months. Israel has decimated Hezbollah's leadership and capabilities through an intense air and ground campaign in southern Lebanon. Hamas's leadership and capabilities have also been significantly depleted, at great cost to the Gaza Strip as a whole and leaving that theater incapable of mounting further resistance in the near term. And more recently, a lightning-quick advance by rebels has led to the collapse of the Assad regime in Syria, marking a significant setback to Iran and leaving its regional "axis of resistance" severely degraded. The loss of Syria disrupts Iran's resupply corridor for Hezbollah, further limiting Iran's ability to rebuild the group. Israel has also damaged Iran's air defenses, leaving Iran more conscious of its own vulnerabilities.

But perhaps counter-intuitively, these developments may lead to a lower risk that the conflict will escalate and incite a regional war. Israel emerges as the dominant regional power, with its enemies severely weakened and less capable of retaliating. The key question now centers on Syria's future direction. The risk of fragmentation of the country is high. Yet we view the likelihood of Syria transforming into a Taliban-like extremist regime as relatively low for now. A government that promotes freedom and democracy is certainly not in the cards, yet a more pragmatic approach to managing a diverse country, albeit with

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About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

a conservative constitution, may be achievable – and that would be sufficient to reduce the risk of another flare-up with Israel in the near term. The future government is also less likely to ally itself with Iran than it might have been in the past.

Looking into 2025, we expect geopolitical volatility in the first half of the year as these hotspots evolve and various agents jostle for position to prepare for the new US president. Yet toward the latter part of 2025 and beyond, we see a decline in geopolitical risks in both Ukraine/Russia and the Middle East.

Such a reduction in geopolitical risk would likely lower risk premiums, boosting markets – particularly in sectors such as industrials and transportation, which stand to benefit from lower energy prices and Ukraine’s reconstruction efforts. That said, tensions between China and the US may continue to rise even as risks ease in other regions. We view US/China friction as more of an ongoing “cold war,” however, and not one we expect to heat up much in the year ahead.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team’s views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald
Sovereign Analyst,
Global Emerging Markets
Fixed Income

CS 3.00 (unchanged)

The US economy remains supported by consumer and business strength in the near term. While growth remains robust and in line with expectations in the near term, the outlook for the second half of 2025 is less certain due to policy changes likely in the Trump 2.0 administration. Current expectations around immigration, tariffs, tax cuts, and deregulation point to a net drag on growth from the fourth quarter of 2025 onward but remain compatible with an economic soft landing.

November’s rebound in non-farm payrolls and upward revisions to prior-month reports underpin the ongoing resilient picture in the economy, but cooling should be expected in 2025. The rise in the unemployment rate to 4.2% was cushioned by the falling labor force participation rate, and there has been a gradual downward trend in new-job postings. Layoffs remain modest, but the unemployment rate is still expected to gradually drift upward in the coming months; gross hiring remains weaker than the ability to absorb all the labor force growth.

While November’s 2.7% year-over-year gain in the Consumer Price Index showed inflation’s persistence, the underlying data were less concerning and allowed for the Fed to cut its key rate by 0.25 percentage points in mid-December. November’s surprisingly higher durable goods inflation was likely sparked by October’s hurricanes, the after-effects of which are expected to dissipate. In fact, rents and owner-equivalent rents generally shifted lower as tenants gradually enter into new tenancy agreements. The upside surprise in the Producer Price Index, at 3%, can be explained largely by a rise in prices for food, specifically eggs, which is the result of recent avian flu outbreaks rather than underlying pressures.

A large 0.4% rise in average hourly earnings pushed the annualized rate for September, October, and November to 4.4%, compared with 4.2% in the prior three months – the fastest rise since last August – but ADP salary growth points to a more benign picture ahead for labor income. Real consumption growth is set to slow to around 3% in the fourth quarter, down from 3.7% in the third, and is expected to continue to slow in 2025 from the strong levels of 2024, but will remain robust.

Europe remains on the weaker side, but a gradual cyclical recovery continues as domestic demand recovers. Real wages have now adjusted and the labor market outside of Germany has been broadly resilient. Real income growth is expected to translate into stronger private consumption in the first quarter, which should spur domestic investment. Monetary loosening by the European Central Bank should also encourage a fall in household saving, which remains elevated, while credit growth also is now increasing. Nonetheless, the structural outlook for industrial and export-oriented countries remains subdued, and political and fiscal factors limit any change. Trump’s tariffs and trade diversion from China in a trade war scenario have the potential to weaken Europe’s 2025 growth outlook further.

Rates

Gunter Seeger
Portfolio Manager, Developed
Markets Investment Grade

CS 3.00 (unchanged)

It’s time to rethink the assumption that rising interest rates inevitably lead to economic slowdowns. Last year, virtually all major bank economists and strategists were predicting a recession, continuing their predictions of recession for 2022 and 2023. No recession ever occurred. When mortgage rates rose to 7%, everyone predicted a slowdown in home prices. Instead, home prices rose. Rising rates also were supposed to hobble risk markets. That didn’t happen either. We became bearish on long-term Treasuries early last year, which proved prescient. What the conventional wisdom may be missing is the impact of the enormous fiscal spending that has taken place in the wake of the pandemic.

Credit

Steven Oh, CFA

Global Head of Credit
and Fixed Income

CS 3.50 (unchanged)

The summary theme heading into 2025 is one of a favorable fundamental outlook that is highly supportive for credit. At the same time, valuations already fully reflect that positive outlook. And while valuations can and most likely will become even more overvalued to start the year, it is prudent to have a risk posture that is neutral to benchmarks while taking on differentiated alpha exposure.

While equities have the potential to benefit from upside surprises, credit spreads have very limited capacity to tighten much, and any excess returns will be primarily driven by yield. Total return expectations should be appealing, but spread returns will be limited for most credit assets.

Currency (USD Perspective)

Anders Faergemann

Senior Sovereign Portfolio
Manager, Emerging Markets
Fixed Income

CS 2.75 (unchanged)

The king dollar is back, supported by widening US rate differentials with the rest of the world. Adding to the strong US dollar theme is US economic growth, which is holding up better than previously anticipated. We see a clear divergence in policy expectations between the Fed and other central banks, especially the ECB. All these factors favor the US dollar over the euro, in particular, but we expect US dollar strength will remain broad-based, particularly in the first quarter of 2025. Still, while the medium-term outlook for the US dollar is being bolstered by signs that US exceptionalism is becoming structural, long-term valuations indicate that other triggers may need to emerge to spark new, sustainable gains in the currency.

Political uncertainty and underlying growth weakness in core Europe further weigh on the euro, suggesting some individual underperformance in the European single currency. Markets will be watching the outcome of the German election at the end of February and signs of further instability in France. The only factor preventing a major slump in the near term is current positioning and broad consensus on all the current market themes.

Trump 2.0 is producing diverse expectations for the US and the rest of the world. Our initial take is that Mexico and China will be most affected, but a universal tariff or an outright trade war would likely be very negative for European growth. The magnitude and sequencing of Trump's policy announcements will dictate how the Fed and the US dollar will react.

Currency markets are in wait-and-see mode until Trump's inauguration and the emergence of details on his executive orders. Tariff threats and a change in immigration policies may lead to a surge in US inflation, adding caution to the Fed's rate-cutting cycle. While the inflation spark may turn out to be a one-off, the knee-jerk reaction could take the US dollar higher and put euro/US dollar parity back in play.

Emerging Markets Fixed Income

Joseph Cuthbertson
Sovereign Analyst, Global
Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 3.00 (unchanged)

Local Markets (Sovereign)
CS 3.25 (+0.25)

For most emerging market (EM) economies, the macro environment remains favorable, with the solid fundamental trend intact. These fundamental improvements are reflected in sovereign credit rating upgrades, with 2024 being the best year for upgrades since 2011. As we go forward, the balance of upgrade candidates far outweighs downgrade candidates in number and aggregate index weight. This includes several potential rising stars and names returning to the B bucket from CCC as more sovereign restructurings are completed. Our expectation for commodity prices is also optimistic for the asset class.

Into 2025, we expect the emerging market/developed market growth differential to stay favorable for EMs. While President-elect Trump's win creates a headwind for some EM countries, we continue to stress the overall solid fundamentals in EM, which we expect to remain intact. Outside of a few names, we see limited direct impact of tariffs on our corporate names. Some issuers already have significant production assets based in the US, which could be used to mitigate the effect further. The second-order implications for GDP growth and the potential diversion of exports to other regions could affect companies either positively or negatively depending on the final tariff levels. With waivers and exemptions, we expect the actual tariff rate to be lower than the headline number.

In the corporate space, EM's fundamental picture remains resilient. Thus far, third-quarter earnings have been as expected, with a skew toward beats. The default expectation for 2025 for the CEMBI BD HY index is 1.7%, which is at the lower end of the 10-year range. While supply expectations for 2025 as a gross number are higher than in 2024, the net number is US\$83 billion lower, which underpins a firmly positive technical for EM corporates. We believe that issuers will try to come to market before the inauguration, which is why investors are holding higher cash levels.

We expect that the market will differentiate among EM names, favoring those where sound fiscal and monetary policymaking that exhibits a credible direction of travel can be found. International financial institutions and external support continue to provide positive momentum for Egypt, Jordan, and Nigeria, for example. Recently, political noise in Romania and South Korea has injected volatility into some parts of EM, creating opportunities for investors and reminding us that the market rewards good governance over the medium term.

More persistent inflation and the anticipation that the policy mix under President-elect Trump will keep the Fed more cautious, as well as the added uncertainty around the sequencing of policymaking and any second-order effects from these policies, will likely keep EM central banks on the conservative side. Especially in the face of a potentially stronger US dollar, this means a slower pace of rate cuts, with many countries possibly leaving rates above their neutral level. As a result, we have become more bearish on local markets.

Multi-Asset

Peter Hu, CFA
Portfolio Manager,
Global Multi-Asset

CS 2.50 (unchanged)

Reports on Trump's major policy proposals – tariffs, immigration crackdowns, and tax cuts – often describe them as “run-hot” measures, focusing mainly on their inflationary aspects. However, less attention is being paid to the potential disinflationary effects of his pro-business, deregulatory, and domestic energy initiatives. As these policies take shape, the market likely will be torn between these opposing inflationary and disinflationary forces.

While US inflation has been stable recently, reflation remains a risk factor for markets. We should also consider that lower inflation might emerge in 2025 as productivity increases. Trump's policies aim to boost US economic growth, potentially at the expense of other countries. It matters both for inflation and markets whether this incremental growth is driven by demand or supply. We are positioned for supply-led environments that will create an upward thrust on rates and can accelerate growth without fueling inflation, thereby reducing chances of significant declines in the yield curve.

This potential “soft landing” might differ from previous ones if the global growth gap continues to favor the US – not just due to tariffs but also because of the nation's current leadership in AI. This leads us to favor equities and the US dollar over duration and tight credit spreads. We maintain our positive score, with a tendency to increase risk during periods of headline-driven volatility.

Global Equity

John Song

Analyst, Global Equities

CS 3.00 (unchanged)

Consumer and business confidence surveys continue to show improvement post-election, though the overall pick-up remains more measured than in 2016. Deregulation and the prospect of tax cuts provide tailwinds, but the high level of prices and government deficits are tempering the outlook.

Industrials and financials are emerging as key beneficiaries of rising sentiment, supported by increasing signs that the inventory destocking cycle may be nearing an end. In tech, the Magnificent Seven stocks are largely being carried by two key names, while a notable rotation is taking shape that favors software and previously lagging sectors over AI-related semiconductors and hardware. This shift reflects both broader market breadth dynamics as well as fundamental issues around large language model (LLM) scaling and China's capex outlook.

Healthcare continues to face a political overhang related to the possible appointment of Robert F. Kennedy, Jr., as Secretary of Health and Human Services, but at this point that case looks overstated. Meanwhile, early holiday spending data indicate that consumers were in more of a mood to spend than in prior years. Some of this strength may be due to a compressed shopping calendar and a pull-forward effect driven by tariff considerations.

Global Emerging Markets Equity

Taras Shumelda

Portfolio Manager,
Global Equities

CS 3.00 (+0.25)

We have become slightly more bearish, reflecting movement in the global EM (GEM) benchmark's forward multiples to a slight premium to their long-term historical average along with flat to slightly negative forward earnings revisions. For us to take a more bullish stance and for the GEM markets to outperform, we would need to see positive forecast revisions or a risk-on environment globally.

In China, topline growth is under pressure at consumer goods companies, which are focusing more on cost control, inventory management, and shareholder returns. In technology, there is short-term volatility in the Nvidia supply chain. Property companies remain weak, with November sales at the nation's top 100 developers down 17% from October and down 7% year over year, compared with a 5% year-over-year gain in October.

In India, regulatory action on unsecured loans, non-bank financial companies, and digital lending has affected credit growth and consequently consumption. Government spending has been weak so far. The extended monsoon season has affected some segments. India's GDP slowed to 5.4% for the second quarter of the 2025 fiscal year, which was below expectations. In the Reserve Bank of India's quest to balance growth and inflation, one should expect volatility in growth numbers but predictable consumer prices.

Latin America remains pressured by budget woes and by Brazilian President Lula's health issues, which create uncertainty about policy continuation. In December, the MSCI EM Latin America Index moved into bear market territory year to date. In EMEA, third-quarter results were generally good, and all eyes are now on whether the peace process in Ukraine can be initiated.

On the portfolio level, we favor adding to financials and funding with chip manufacturers.

Quantitative Research

Qian Yang

Fixed Income
Quantitative Strategist

Our US Conviction Score is virtually unchanged, as credit spreads tightened by 8 bps and the curve flattened by 7 bps, offsetting each other.

Global credit forecasts improved but continue to be negative; our model relatively favors EM over DM. In DM industries, it favors brokerage, banking, and communications and dislikes basic industry, consumer goods, and utilities. Among EM industries, the model likes real estate and financials and dislikes oil and gas and transportation.

Our global rates model forecasts lower yields for the US, the UK, and Oceania and higher yields for Europe and Japan. Real yields, macro forecasts on short rates, and yield curve momentum are the main factors driving those yield forecasts. The model also forecasts a steeper curve except for Japan, Australia, and New Zealand.

The rates view expressed in our G10 model portfolio is slightly overweight in global duration. It is overweight the UK, New Zealand, Australia, Sweden, and Japan. It is underweight France, Germany, and North America. Along the curve, it is overweight the six-month, 10-year, and 20-year while underweight the two-year, five-year, and 30-year.

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