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VANTAGE POINT 1Q2025

Rekindling the Cycle

Investment Institute

INTRODUCTION

Welcome to another edition of Vantage Point, the quarterly economic and markets outlook from the BNY Investment Institute*

As we near the end of the year, we're turning a page on many of the risks that loomed over markets in 2024. With the US election behind us, inflation moderating and the labor market finding its balance, the Federal Reserve (Fed) has begun its path toward lower rates, setting the stage for renewed optimism in 2025.

We share the market's cheer and believe the global economy is likely entering a New Cycle (50% probability). We expect growth to reaccelerate for many regions, fueled by easing monetary policy, leading toward a controlled re-leveraging cycle and a rebound in US business investment. Fiscal policy should also be supportive, and lower wage growth is likely to keep service inflation under control. However, with growth above trend and tariffs likely increasing the price of goods, this may lead to the Fed hitting the pause button on policy easing around mid-year.

There is also a less optimistic scenario for next year, where growth remains positive, yet the lagged effects of tighter monetary policy have a longer shadow than expected. Additionally, uncertainty around the implementation and timing of fiscal policy contributes to businesses holding back on spending, reducing the boost to activity that we would expect in the New Cycle scenario. This Soft Landing (30% probability) scenario continues the trends experienced throughout much of 2024.

While the first two scenarios appear favorable for investors, recession risk remains over the next year. We anticipate a stable labor market and healthy corporate profits should prevent widespread layoffs. However, if the Fed remains overly cautious about inflation, fiscal policy stumbles in its execution, and China fails to adequately stimulate domestic demand, the probability of a Shallow Recession (20% probability) could increase.

As always, we create detailed forecasts for each scenario, assign probabilities and share our insights on how each path might influence markets. In our most likely scenario, we anticipate gradually looser monetary and/or fiscal policy will drive growth above potential. While inflationary pressures persist, they should remain manageable, ultimately rekindling a New Cycle.

Eric Hundahl, CFA
Head of Investment Institute,
BNY Advisors

BNY Investment Institute consists of our macroeconomic research, asset allocation, manager research and operational due diligence teams.

EXECUTIVE SUMMARY

We base the outlook on the idea that financial market moves largely reflect growth, inflation and monetary policy. Tactical investment opportunities arise when our views significantly differ from consensus.

Table 1: Our Outlook vs. Consensus

	Q1 2025	Takeaway
Growth	□ □ ● □ □	US growth is in line with consensus over the next 12 months, however, risk is skewed to the upside. Growth elsewhere is seen as somewhat weaker than consensus.
Inflation	□ ● □ □ □	Inflation is expected to exceed market expectations over the next 12 months, especially in US.
Policy	□ ● □ □ □	Policy is gradually loosened but there are risks of an early pause to the cutting cycle.

How to read the heatmap. **Blue** indicates much better than expected (relative to the consensus) growth, much lower than expected inflation and significantly greater than expected monetary policy accommodation. **Light blue** indicates better than expected growth, lower than expected inflation and greater than expected policy accommodation. **Grey** indicates that expectations for economic growth, inflation and policy are broadly in line with the consensus. **Light orange** indicates worse than expected growth, greater than expected inflation and a tighter than expected monetary policy. **Orange** indicates significantly worse than expected growth, much greater than expected inflation and a much tighter than expected monetary policy.

Table 2: Tactical Investment Views

unfavorable ⟷ favorable

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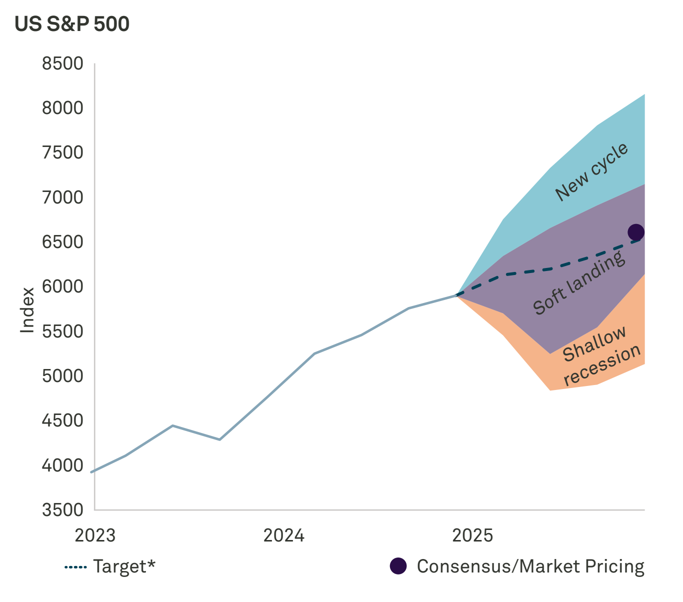
Major Asset Class	Q1 2025	Change	Takeaway
Global Equity	□ □ □ ● □	↑	Pro-growth macro tailwinds to support near-term equity advances.
Sovereign Bonds	□ □ ● □ □	↓	Attractive carry, but inflation risks and more gradual cutting cycle limits bond returns.
Credit	□ ● □ □ □		Spreads are very compressed and better risk-reward is found elsewhere.
Real Assets	□ □ ● □ □		Favorable on assets that hedge against volatility and geopolitical uncertainty.
Cash	□ □ ● □ □		Monetary policy is being loosened. Better returns and/or protection are found elsewhere.



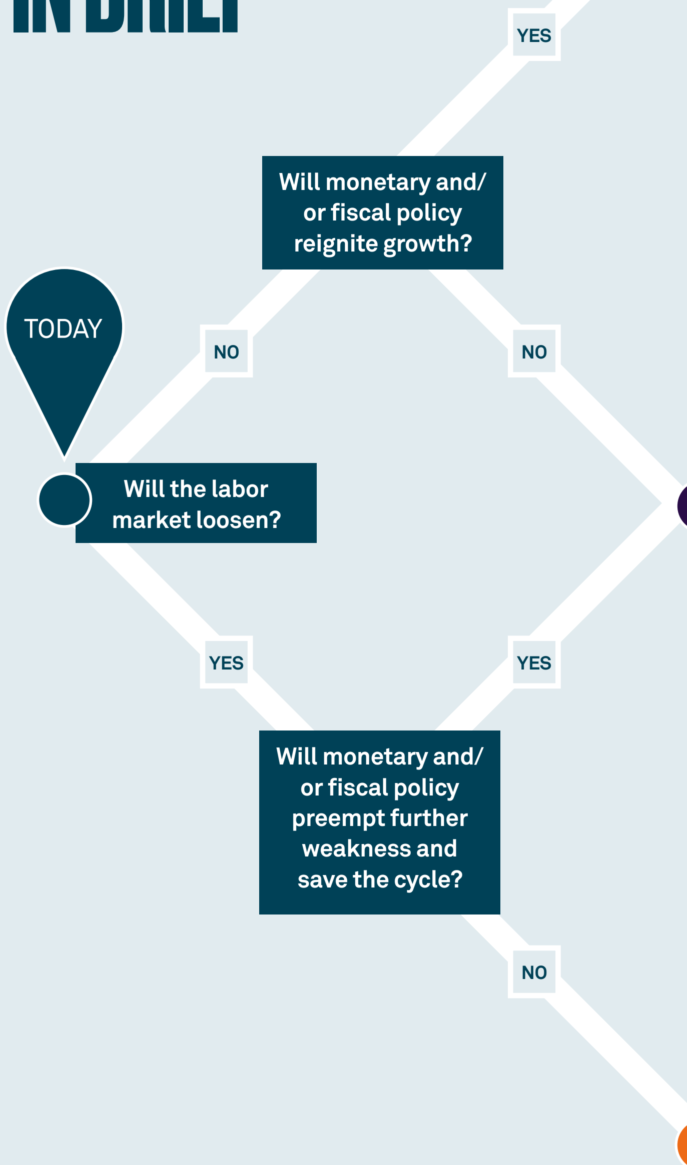
Source: LSEG Datastream/Fathom Consulting. Data as of 2 December 2024.
*Target is the expected outcome based on the average of three scenarios weighted by how likely they are to occur. Please see additional disclosures and glossary.

Table 3: 12-Month Outlook

S&P 500	Base Case	Probability Weighted
EPS Estimate	282	269
Earnings Growth	15%	10%
Price/Earnings	25	24
Approximate Level	~7,000	~6,500
Total Return Estimate	+18%	+8%

Source: BNY Investment Institute; Data as of 2 December 2024.

SCENARIOS IN BRIEF


TODAY
Will the labor market loosen?
NO
Will monetary and/ or fiscal policy reignite growth?
YES
NO
YES
Will monetary and/ or fiscal policy preempt further weakness and save the cycle?
YES
NO

New Cycle (50% Probability)

Equities	Sovereigns	Credit	Real assets	Cash
▲▲	▼	▲	▲	▼

Equity Outlook (End-2025)	Level	Return
S&P 500	-7,000	+18%

MACRO

- Growth accelerates above potential, as looser monetary and/or fiscal policy drive stronger demand.
- Reemergence of inflationary pressures but relatively contained initially. Fed pauses cutting cycle in mid-2025.

MARKETS

- Most positive scenario for risk assets – pushing equity multiples higher, risk spreads lower near-term.
- Bonds do less well, and the UST yield curve bear-steepens.

Soft Landing (30%)

Equities	Sovereigns	Credit	Real assets	Cash
▲	▲	▼	▬	▬

Equity Outlook (End-2025)	Level	Return
S&P 500	~6,300	+6%

MACRO

- The US economy slows below trend, as the tight monetary policy takes greater hold and trade policy uncertainty rises.
- Inflation eases to target as monetary and/or fiscal policy are loosened sufficiently to avoid a further slowdown.

MARKETS

- Equity price multiples relatively stable but weaker earnings growth. Credit spreads widen toward long-term averages .
- Global bonds do well with slowdown concerns and rate cuts lowering real yields.

Shallow Recession (20%)

Equities	Sovereigns	Credit	Real assets	Cash
▼▼	▲▲	▼▼	▲	▲

Equity Outlook (End-2025)	Level	Return
S&P 500	~5,300	-12%

MACRO

- Growth surprises to the downside as labor market cracks.
- Global inflation falls on slumping demand. Fed cuts fast/deep, but too late to save the cycle.

MARKETS

- Bad outcome for equites. Equity bear market (-20% intra-year), but short-lived (2 quarters). Credit spreads widen beyond long-term averages, restraining credit returns, but sovereign bonds outperform on lower rates.

Source: BNY Investment Institute; Data as of 2 December 2024.

GROWTH

Our Outlook vs. Consensus

unfavorable ⟷ favorable

US

Our probability weighted forecast for the US economy sees growth slow to roughly trend (~2%) by mid-2025 before recovering further out. In this respect, we are close to the consensus among other forecasters.

Digging a little deeper, this average expectation is a combination of three quite different scenarios. Our base case is an optimistic one. It sees growth rebound in 2025 in a New Cycle, as the equity rally continues, and as investment in new technologies begins to bear fruit. This gives both firms and households the confidence to ramp up their spending in an environment where borrowing costs are no longer rising.

Risks around our base case lie to the downside. If we are wrong about the rebound in US economic activity, we are more likely to see growth slow to a little below trend than we are to see an outright US recession. In Soft Landing, the pace of the equity market rally slows, along with spending, as firms and households continue to adjust to the higher interest rate environment.

In our judgment, the odds of a US recession, although fading, remain above average by historic standards. In our more pessimistic scenario, Shallow Recession, we are yet to see the full effects of the rapid tightening of policy that has taken place over the past three years. The US economy suffers an outright contraction towards the middle of 2025, albeit a shallow one.

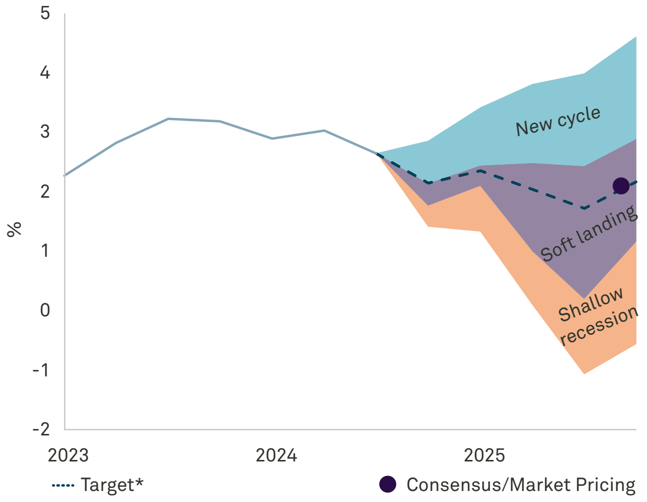
EUROPE AND CHINA

We are less bullish on growth prospects outside of the US. In the Eurozone, we expect year-on-year growth to remain close to 1% for at least the next year. China's economy has slowed over the past year, and our forecast sees growth remaining close to, or a little above 4% (i.e., missing China's growth target).

Our base case for the Eurozone is a Soft Landing, as ECB rate cuts should prove supportive. However, in contrast to the US, the monetary tightening that began in 2022 was not accompanied by a renewed fiscal loosening. That, combined with structural growth challenges (e.g., greater competition from China) , makes a re-acceleration in economic activity less likely. With headwinds stemming from a challenging environment for international trade, our base case for China is an ongoing balance sheet recession. That does not necessarily imply an outright contraction of economic activity, but a period of below trend growth, deleveraging, rising unemployment, and ongoing downward pressure on prices.

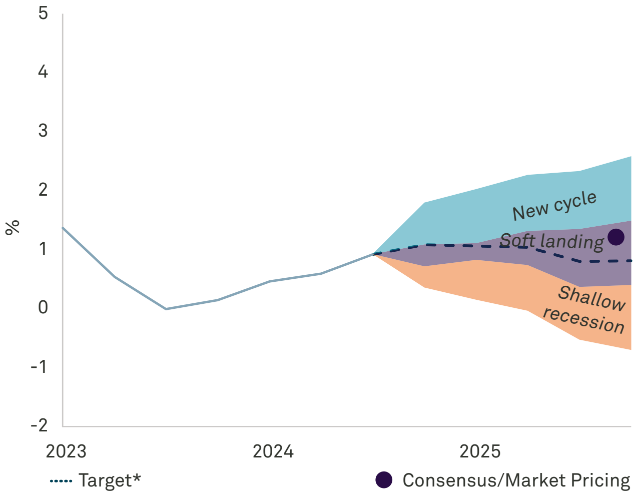
Outside of the US, the risk to growth is to the downside. Activity is already slowing down, and structural economic challenges persist. Both the Eurozone and China are heavily reliant on exports and sensitive to an increase in trade tariffs. Lower interest rates in Europe and more targeted fiscal support in China could rekindle growth but we see the scenario as unlikely in the near term.

US GDP
FOUR-QUARTER PERCENTAGE CHANGES



Source: LSEG Datastream/Fathom Consulting Data as of 2 December 2024.

EUROZONE GDP
FOUR-QUARTER PERCENTAGE CHANGES



Source: LSEG Datastream/Fathom Consulting Data as of 2 December 2024.

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INFLATION & POLICY

Our Outlook vs. Consensus

unfavorable ⟷ favorable

US

Our probability weighted expectation for US policy rates is broadly in line with market pricing and the expectations of other economic forecasters, as surveyed. However, we see US inflation coming in higher than implied by the swaps market and above economist consensus. A good part of the pick-up in US inflation that we anticipate reflects the likely increase in tariffs on US imports and greater fiscal stimulus. As such, we see risk of re-pricing of rates higher.

Our base case for US policy rates in New Cycle sees the Fed effectively on hold for some time. Inflation reaccelerates in this scenario, as a reduction in economic slack combines with an increase in tariffs on US imports to push prices higher. Nevertheless, with investment in new technologies starting to bear fruit further into the forecast, and with the tariff increases representing a one-off shift in the price level rather than a sustained pick-up in inflation, we expect policy makers to pause the loosening rather than embark on a new tightening cycle.

The risks around our base case for both US policy rates and inflation lie to the downside. In Soft Landing, the more likely of our two alternative scenarios, the pick-up in inflation is modest. There are further cuts in the policy rate in this scenario, but the cycle remains gradual and not much faster than cuts implied by market pricing. In Shallow Recession, a greater degree of economic slack offsets the impact of higher tariffs and inflation drifts sideways for much of 2025 before falling below target further out. The Fed can cut aggressively here, with the policy rate approaching 2% towards the end of 2025.

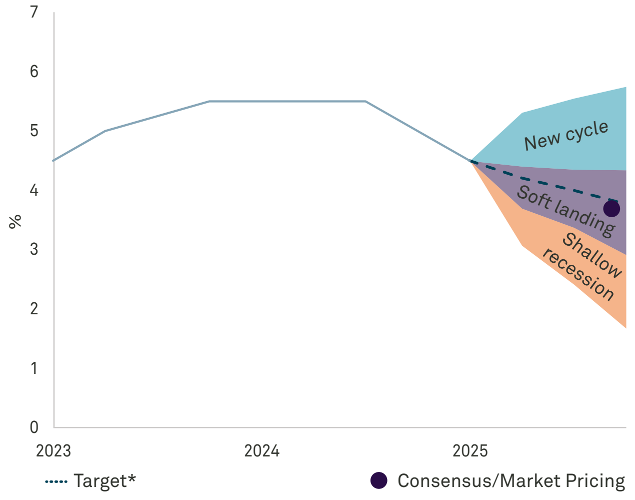
EUROPE AND CHINA

Policy outside the US is likely to be more accommodative given relatively weaker growth prospects and greater downside risks. Inflation stickiness in Europe may temper cut expectation, while in China the battle against deflation is likely to continue. On balance, our probability-weighted outlook is broadly in line with the consensus.

Market pricing sees nearly double the number of cuts from the European Central Bank (ECB) compared to the Fed over the next twelve months. In our most likely scenario, New Cycle the market's expectation for easing is likely too aggressive and will moderate as growth outperforms and inflation pressures resurface. In China, we anticipate a slow unfolding of more forceful fiscal stimulus –partly in response to the rollout of tariffs from the incoming US administration. Further monetary stimulus is also expected but could be limited in a New Cycle scenario in which Fed rate cuts stall.

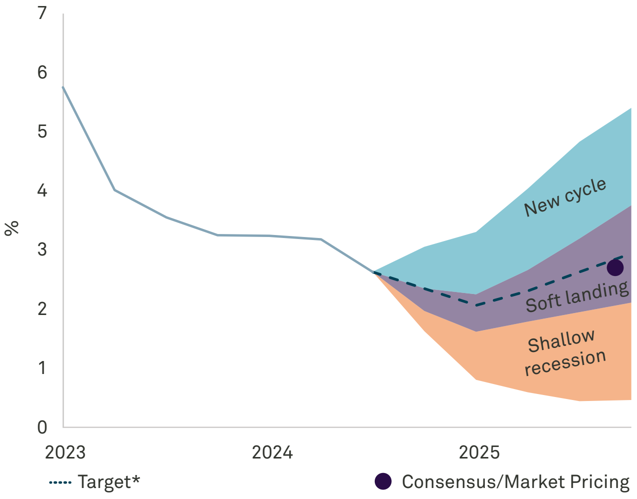
However, in contrast to the US, we asses a moderately higher risk of recession in Europe, which is likely being reflected in market pricing and explains the divergent rate paths. Sentiment remains low and economic momentum weak, which may validate more aggressive monetary policy loosening. In China, the downside risks are a bit more limited by an emerging, though, fragile, stabilization of the real estate sector. China's export sector also remains formidable but could face more widespread protectionism from the US and beyond. The balance of risks could change more notably if policy stimulus pivots more decisively toward boosting domestic consumption.

US FEDERAL FUNDS RATE
PERCENT



Source: LSEG Datastream/Fathom Consulting. Data as of 2 December 2024

US CPI
FOUR-QUARTER PERCENTAGE CHANGES



Source: LSEG Datastream/Fathom Consulting. Data as of 2 December 2024

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ASSET CLASS VIEWS

Summary

In 2025, macro risks favor US growth, prompting a pro-risk stance in tactical asset allocation. However, with rising inflation risks, we adopt a neutral view on global rates. We remain favorable on global equities, expecting US market leadership to continue, driven by pro-growth tailwinds like monetary and/or fiscal policy easing, deregulation and the Artificial Intelligence (AI) theme. We favor US over international markets and developed over emerging markets.

While elevated yields support income returns, inflation risk and gradual easing cycles temper our outlook on global government bonds. Despite a pro-risk lean, uncertainty around policy and geopolitical risks may challenge the risk-on environment over 2025. Stay vigilant as the cycle rekindles.

Major asset class	Tactical view	Strategic view	Comments
Global Equity	□ □ □ ● □	□ □ □ ● □	We're favorable on the tactical outlook for global equities, led by US markets. Supporting the view is a combination of pro-growth macro tailwinds (incl. monetary policy easing), recent upside growth surprises, and AI theme. Across regions, we prefer US over international, and DM over EM.
Sovereign Bonds	□ □ ● □ □	□ □ ● □ □	Elevated yields and correspondingly favorable income returns remain present. However, our neutral view on global government bonds stems from ongoing inflation risks, and expectations of a more gradual easing cycle, which limits duration driven gains.
Credit	□ ● □ □ □	□ □ ● □ □	We expect spread widening on growth and trade volatility and a rotation toward cheaper, safer fixed income assets. Total returns to be constrained despite attractive income. We prefer higher quality credits over HY.
Real Assets	□ □ ● □ □	□ □ ● □ □	Maintain favorable view on gold given volatility hedging potential. We also favor infrastructure given equity exposure but stability. Commodity exposure is a diversified hedge to potential inflationary pressures.
Cash	□ □ ● □ □	□ ● □ □ □	Cash attractiveness is supported by low volatility, elevated income returns, and rates that may remain elevated in shallow cutting cycle. However, we see better expected return opportunities elsewhere.

Equity	Tactical view	Strategic view	Comments
Developed Market Equity	□ □ □ ● □	□ □ □ ● □	Our favorable view is underpinned by loosening monetary policy (outside of Japan), a benign global growth backdrop, and a slow disinflationary process that most likely will not endanger gradual cutting cycles. Moreover, the AI theme has room to run in 2025.
US Equity	□ □ □ ● □	□ □ □ □ ●	View supported by easing policy backdrop, solid corporate fundamentals, and AI theme expected to remain firm through 2025. Paired with an increasing near-term upside growth risk stemming from fiscal policy, and deregulation, we've upgraded our view. We continue to lean toward smaller capitalization firms while emphasizing quality exposure. Much remains uncertain and multiples are a key vulnerability given potential for yield curve steepening if inflation overshoots.
UK Equity	□ □ □ ● □	□ □ □ ● □	Attractive valuations on both relative and historical average basis imply that minimal less bad news could support advances in the asset class. Further, 12-month forward EPS growth expectations remain low compared to peers and below average compared to history.
Europe ex UK	□ □ □ ● □	□ □ ● □ □	The leading indicators we track have been conflicting, but we still expect some improvement ahead. Earnings expectations have recovered somewhat but remain weak. Income returns are significant, with dividend plus buyback yields providing more than 4%, or about ~70+% of the total return assumed in our long-term capital market assumptions.

Source: BNY Investment Institute; Data as of 2 December 2024.

KEY	unfavorable		neutral	favorable	
	🟧	🟧	⬜	🟦	🟦

Equity	Tactical view	Strategic view	Comments
Japan Equity	□ □ ● □ □	□ □ ● □ □	Reflation is durable and underpinned by rising real incomes, increasingly entrenched inflation expectations, and gradual BoJ policy normalization. However, global trade and financial volatility, domestic political and fiscal uncertainty, and waning tailwinds from Yen weakness keep us neutral.
EM Equity	□ □ ● □ □	□ □ ● □ □	Emerging markets to benefit from China's broad, but slow, stimulus which limit large downside macro risks in 2025. A bit more Fed easing will also help. But we stay neutral and await further clarity on the incoming US administration's trade policies. We're cautious on any accompanying financial volatility.
China Equity	□ ● □ □ □	□ ● □ □ □	The policy pivot to stimulating growth and curbing deflation is encouraging. More policy upside could come into view in 2025. But policy support will also (likely) square off against elevated trade tariffs and supply chain risks. We await more favorable tactical entry points.
EM ex China	□ □ □ ● □	□ □ □ ● □	As this segment of EMs is less linked to China (or more strategically aligned with the US), it is better placed to withstand (or even gain from) a re-orientation of global trade and supply chains. Underlying fundamentals reflect tech leadership, friend-shoring and a growth counter-balance to China.

Fixed Income	Tactical view	Strategic view	Comments
US Treasuries	□ □ ● □ □	□ □ ● □ □	We assign a low likelihood to a rapid deterioration in growth that would trigger an aggressive Fed cutting cycle near-term. However, attractive yields and correspondingly favorable income returns keep us engaged. We are neutral as growth and inflation risks are inflecting higher on the prospective policies of the incoming administration – limiting the prospect of duration gains.
Intl. Sovereign Debt	□ □ ● □ □	□ □ ● □ □	FX hedged income returns remain attractive in absolute terms and versus US Treasuries. But a stronger trade-weighted USD is likely to slow disinflation progress in other DMs and steepen yield curves. DM industry remains under pressure, but ongoing consumer/services recovery to push up growth and inflation risks a bit more than we had previously anticipated.
Global IG	□ ● □ □ □	□ □ ● □ □	Spreads are rich relative to history, and, amid a firmer footing for US growth and trade volatility elsewhere, we expect high grade corporate spreads to widen modestly. Fundamentals should hold up. But risk-adjusted- and relative-returns are not compelling.
High Yield Debt	□ ● □ □ □	□ □ □ ● □	Spreads have become richer. Amid heightened trade and financial volatility, weakening commodity prices and only gradual policy easing, we expect spreads to re-widen on HY corporates' rising issuance and stalling margins.
EM Local Currency Debt	□ □ ● □ □	□ ● □ □ □	We pare back our EM local debt view to neutral. Despite sound inflation fundamentals and reasonable real rates, emerging markets are likely to confront a stronger USD and higher long-term US rates. Firmer than expected US growth, rising tariffs and slower trade, and a shallower path of Fed rate cuts will inhibit EM local currency outperformance.
EM USD Debt	□ □ ● □ □	□ □ ● □ □	Our neutral view balances a likely softening of global trade in 2025 against decent policy buffers, cheap currencies, and improved macro flexibility. Valuations are less expensive than IG and HY credits.

Source: BNY Investment Institute; Data as of 2 December 2024.

BNY INVESTMENT INSTITUTE

BNY Investment Institute draws upon the breadth and expertise BNY Investments to generate thoughtful insights on macroeconomic trends, investable markets and portfolio construction to facilitate higher probabilities of higher outcomes for our portfolio managers and our clients.

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Equities are subject to market, market sector, market liquidity, issuer, and investment style risks, to varying degrees. **Bonds** are subject to interest-rate, credit, liquidity, call and market risks, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. **Commodities** contain heightened risk, including market, political, regulatory, and natural conditions, and may not be appropriate for all investors. **High yield bonds** involve increased credit and liquidity risk than higher-rated bonds and are considered speculative in terms of the issuer's ability to pay interest and repay principal on a timely basis. Investing in **foreign denominated and/or domiciled securities** involves special risks, including changes in currency exchange rates, political, economic, and social instability, limited company information, differing auditing and legal standards, and less market liquidity. These risks generally are greater with emerging market countries. **Small and midsized company stocks** tend to be more volatile and less liquid than larger company stocks as these companies are less established and have more volatile earnings histories. **Currencies** are can decline in value relative to a local currency, or, in the case of hedged positions, the local currency will decline relative to the currency being hedged. These risks may increase volatility. **Alternative strategies** may involve a high degree of risk and prospective investors are advised that these strategies are appropriate only for persons of adequate financial means who have no need for liquidity with respect to their investment and who can bear the economic risk, including the possible complete loss, of their investment. The strategies may not be subject to the same regulatory requirements as registered investment vehicles. The strategies may be leveraged and may engage in speculative investment practices that may increase the risk of investment loss. Investors should consult their financial professional prior to making an investment decision.

INDICES AND DEFINITIONS

Japan (Nikkei 225): The NIKKEI 225 is an index that tracks the performance of the largest 225 companies traded in the Japanese market. **10Y UK Gilt** – Average yield of a range of UK government bonds all adjusted to the equivalent of a ten-year maturity. **Phillips Curve:** An economic theory that inflation and unemployment have a stable and inverse relationship. US **Consumer Prices (CPI) Index** measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rate represents the inflation rate. The **10Y US Treasuries Average Yield** of a range of Treasury securities all adjusted to the equivalent of a ten-year maturity. The **CBOE VIX Index (VIX)** is an indicator of the implied volatility of S&P 500 Index as calculated by the Chicago Board Options Exchange (CBOE). The **Majors Dollar Index (USD)** measures the value of the US dollar relative to a basket of currencies of the most significant trading partners of the US including the euro, Japanese yen, Canadian dollar, British pound, Swedish krona, and Swiss franc. The **MSCI EM Index (Emerging Markets Equities)** tracks the total return performance of emerging market equities. The **S&P 500 Composite Index (S&P 500)** is designed to track the performance of the largest 500 US companies. **Europe STOXX 600** Index represents the performance of 600 large, mid and small capitalization companies across 18 countries in the European Union. **Bloomberg US Corporate High Yield:** covers the universe of fixed-rate, non-investment grade corporate debt in the US. **Bloomberg US Corporate Investment Grade:** designed to measure the performance of the investment grade corporate sector in the US **1-mth. 1-year forward swap:** the avg. interest rate for 1-mth. in 1-year forward. **GDP:** gross domestic product is the total monetary or market value of all the finished goods and services produced within a country's borders over a given time period. **Fed funds Rate:** the target interest rate for overnight lending and borrowing between banks. **Purchasing Managers Index (PMI):** An economic indicator derived from monthly surveys of private sector companies. A level above 50 indicates expansion compared to the prior month and below 50 contraction. Investors cannot invest directly in any index. **Soft landing:** a gradual and controlled economic slowdown, often aimed at preventing a recession or minimizing its impact. **Global Financial Crisis:** The severe economic downturn that began in 2007-2008, characterized by widespread banking failures, a collapse in housing markets, and subsequent global recession. **Shallow recession:** a shorter and less significant decline in economic activity than a typical recession. **New cycle:** an acceleration of economic activity above recent trend growth. **Neutral Rate of Interest** (r-star or r*) is the short-term interest rate that would prevail when the economy is at full employment and stable inflation. A rate at which monetary policy is neither contractionary nor expansionary.

STATISTICAL TERMS

Skewness in statistics represents an imbalance and an asymmetry from the mean of a data distribution. In a normal data distribution with a symmetrical bell curve, the mean and median are the same. **Probability-weighted mean** is similar to an ordinary arithmetic mean, except that instead of each of the data points contributing equally to the final average, data points are weighted by the statistical probability for a particular scenario outcome. **Duration** is a measure of a bond's interest-rate sensitivity, expressed in years. The higher the number, the greater the potential for volatility as interest rates change.

OTHER

QE: quantitative easing. **Fed:** US Federal Reserve. **ECB:** European Central Bank. **BOJ:** Bank of Japan. **BOE:** Bank of England.

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