Campbell Alexander Financial Management Ltd
Personal and Corporate Financial Planning

Annual Letter

January 2025

Trade friction represents a new challenge for 2025.

2024 Investment Review

We revisit the key themes for 2024.

Steady as she slows

In 2024, we anticipated a gradual deceleration in the US economy, with markets pricing in the likelihood of a slight recession. Instead, the US economy exceeded expectations, with growth forecasts upgraded from 1.15% to 2.6% by year-end. This resilience drove strong equity market returns, showcasing the strength of US fundamentals.

Our recommendations focused on balancing concentration risk in the S&P 500 with diversified exposures, including Equal Weight and US Small Caps. In contrast, the UK faced continued challenges, with low growth and limited corporate earnings momentum.

Pause before pivot

Despite expectations for mid-year rate cuts, the US Fed delayed its much-anticipated pivot as the US economy showed resilience. The first cut, a 50-basis-point reduction, came in September.

To align with these shifts, we emphasised dynamic duration management throughout the year. In June, we overweighted duration to capture bond market rallies. Later, as attention turned to debt supply and the UK budget, we reverted to a neutral duration stance to manage risks.

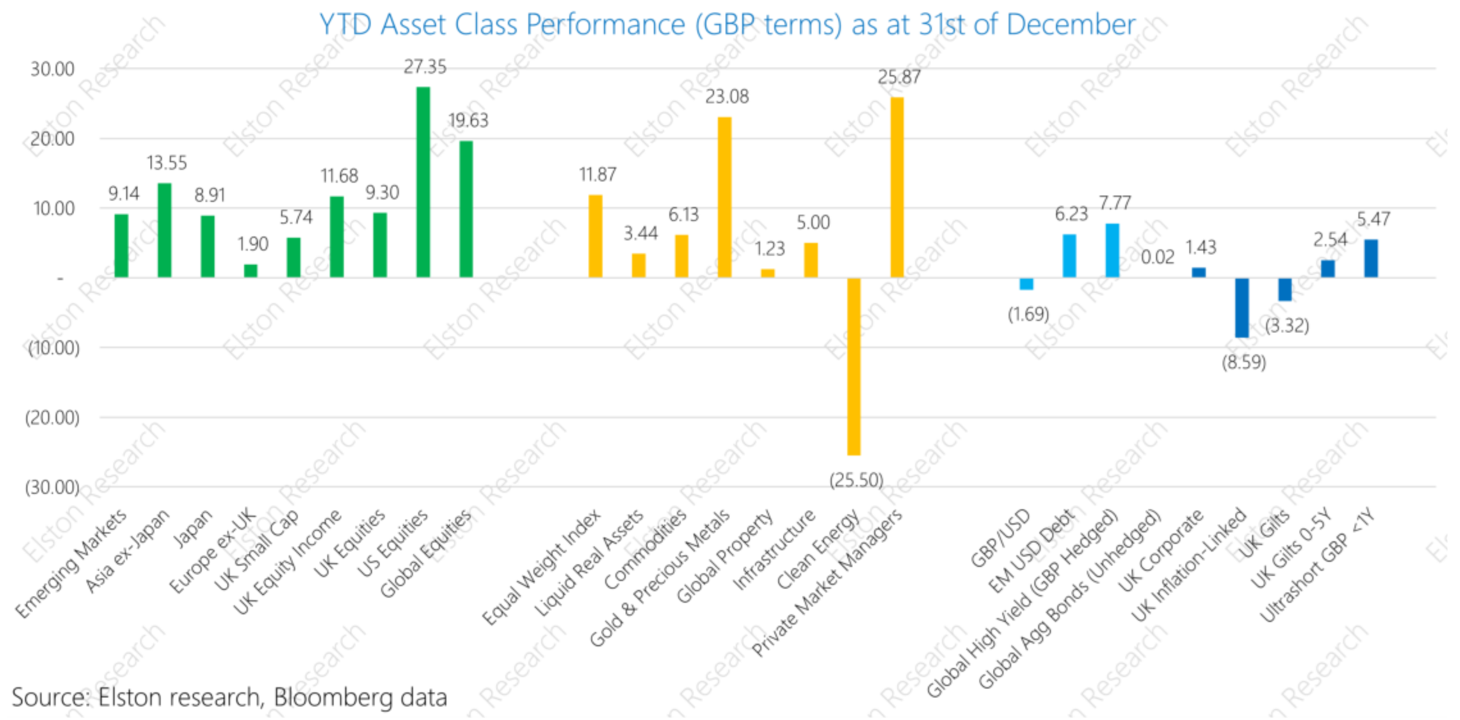
Portfolio resilience

Portfolio resilience was a defining theme of 2024. Cyclical sectors, alongside factors like momentum and yield, delivered strong performance. Inflation-linked bonds and liquid real assets helped hedge against inflation risks. Meanwhile, Private Market Managers and Gold & Precious Metals outperformed other asset classes, demonstrating the value of diversification.

Political and Geopolitical risks

Political shifts in the UK and US had significant implications for bond yields and currencies, while geopolitical tensions—including the Russia-Ukraine war and escalating Middle East conflicts—added uncertainty. These risks underscored the importance of maintaining a diversified, flexible investment approach.

Asset class performance for 2024 is summarised below:

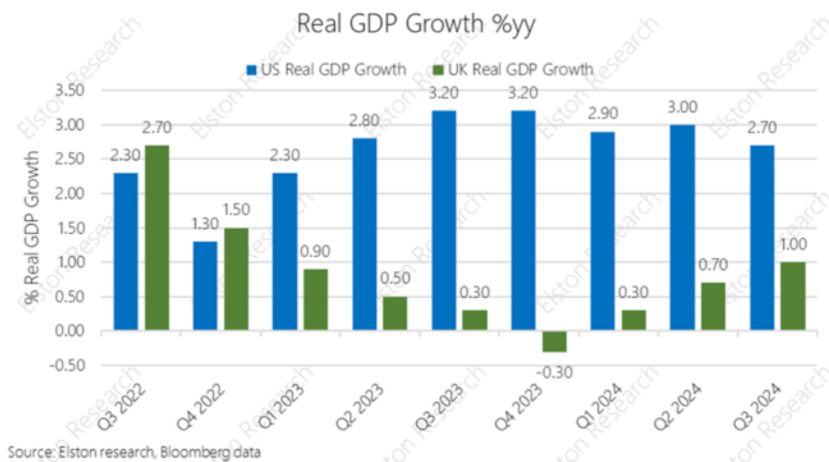


2025 Investment Outlook

America First: US exceptionalism to continue

America First policy making will underpin US economic, earnings and market exceptionalism. US economic growth is outpacing the UK and EU. It benefits from higher energy prices and defence spending. American dominance of technology sector means its corporate earnings in aggregate have been more resilient, relative to the rest of world and the UK. In the US, higher earnings growth has been rewarded with higher valuation multiples. Anything that could lead to multiple compression (higher-for-longer interest rates, slower earnings) is a risk to US equities. Nonetheless, we see US equity markets as continuing to dominate global equity market performance. Furthermore, given the levels of market concentration, selectivity and balance within US equities remains key. We are concerned about that lack of earnings growth for UK equities (whilst acknowledging their lower valuations). We see the primary rationale for holding a moderate position in UK equities is its less correlated nature, making it a useful diversifier.

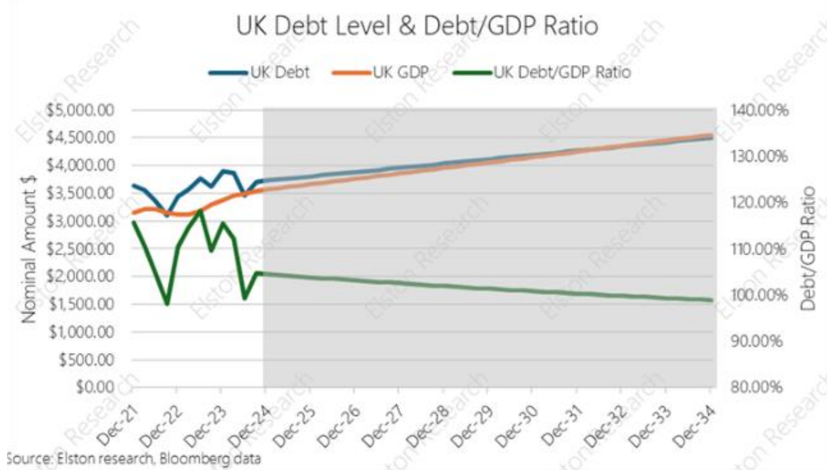
Fig.1. US economic growth is dominating



Debt indigestion: government debt is in fine balance

Government debt is spiralling in the US and the UK. But with projected economic growth, aggregate debt levels remain (just) digestible. But any upgrade to borrowing or downgrade to growth could destabilise this fine balance and rattle the bond market. Lower bond yields (higher bond values) mean more confidence in the bond market. Higher bond yields (lower bond values) mean less confidence in the bond market. The start to the year has already seen the fine balance in the bond market get rattled. We can expect periodic bouts of bond market volatility as Trump's economic plans get unveiled.

Fig.2. UK Government debt levels



Inflation: down but not dead

Inflation has moderated from its peak but remains above the 2% target, which now acts as a "floor" rather than a cap. Wage growth, energy volatility, and trade frictions are persistent factors keeping inflationary risks alive.

We recommend portfolios maintain exposure to inflation-resilient assets, such as short- to medium-term inflation-linked bonds, yield-focused equities, and real assets. Diversified alternatives will continue to provide low-correlation opportunities to hedge against inflation surprises.

The primary concerns are around geopolitical risk – gas transit issues in Ukraine, Russian energy sanctions, the Middle East conflict and China/Taiwan supply chains all risk creating further inflationary pressure if escalated or unresolved.

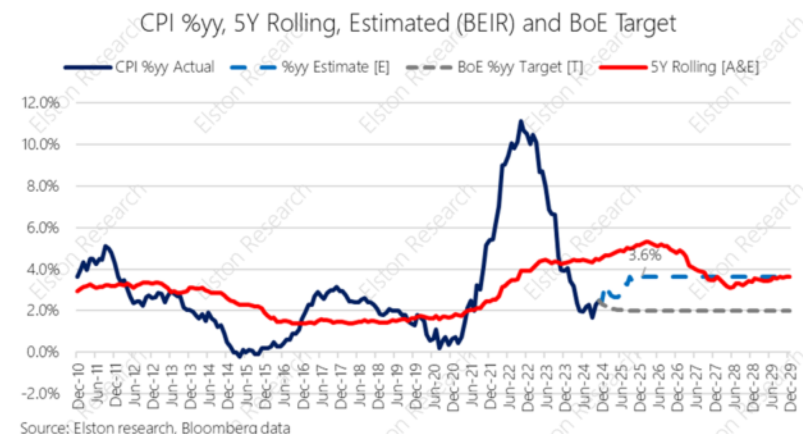


Fig.3. Zombie inflation: the shock is over, but inflation pressure remains

Conclusion

Markets did indeed turn a corner in 2024, with economic growth, earnings and equity market returns outperforming expectations. As we move into 2025, our approach continues to emphasise an adaptive approach to navigate market risks, rather than leaving portfolios in cruise-control. This categorically does not mean trying to time the markets. What it does mean is trying to steer away from potential hazards along the way.

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