RESEARCH INSIGHTS

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Investment Trends
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Key Themes for 2025

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Investors look to steady an unbalanced world

As we enter 2025, one market dynamic dominates: the acute divergence between the United States and other major markets. Electoral outcomes across the globe in 2024 have reshaped political landscapes, and nowhere has this recalibration been more consequential than in the U.S. Its new proposed policy regime, marked by promises of technology-fueled growth and potential tariff barriers, is likely to expose investors to a macro- and financial environment without parallel in living memory.

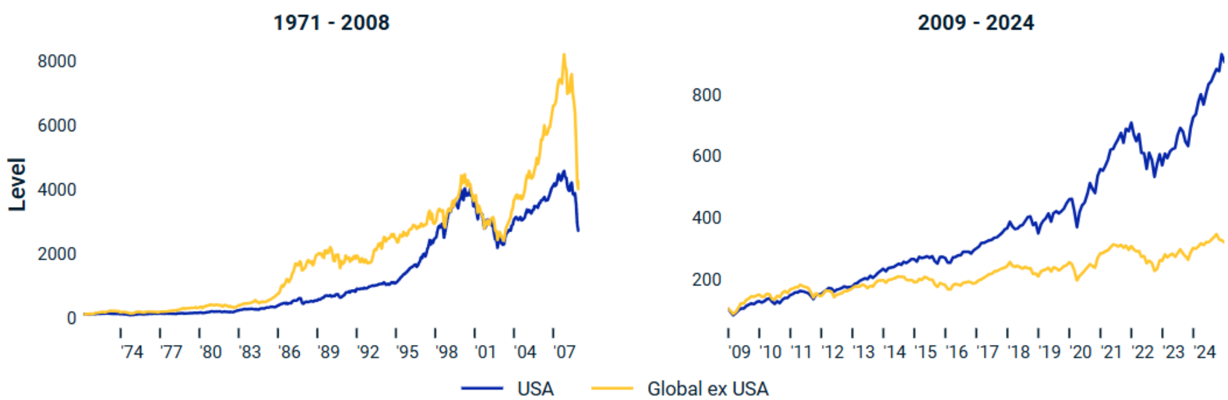
These developments have placed the U.S. firmly at the center of global market narratives, and this is most clearly reflected in equity markets. By the end of 2024, the U.S. share of global equity market capitalization approached an historically high 70%.

The ‘new normal’ that never came to pass

For half a century, investors have analyzed stock markets through regional, sectoral and factor-based frameworks. MSCI global equity indexes, which marked their 55th year in 2024, provide a long historical lens through which we can view these patterns. They reveal that the U.S. market’s lead has not been a permanent fixture. In fact, despite intermittent surges, the U.S. often trailed international markets — until the aftermath of the 2008 global financial crisis.

In the wake of the crisis, many had anticipated a “new normal,” where emerging economies would lead, and advanced economies would struggle against the headwinds of deleveraging and policy constraints. Instead, from early 2010 onward, U.S. equities have consistently outperformed their international counterparts across every rolling three-year period, often by double-digit margins. In 2024, U.S. equity markets outperformed the rest of the world by 17%.

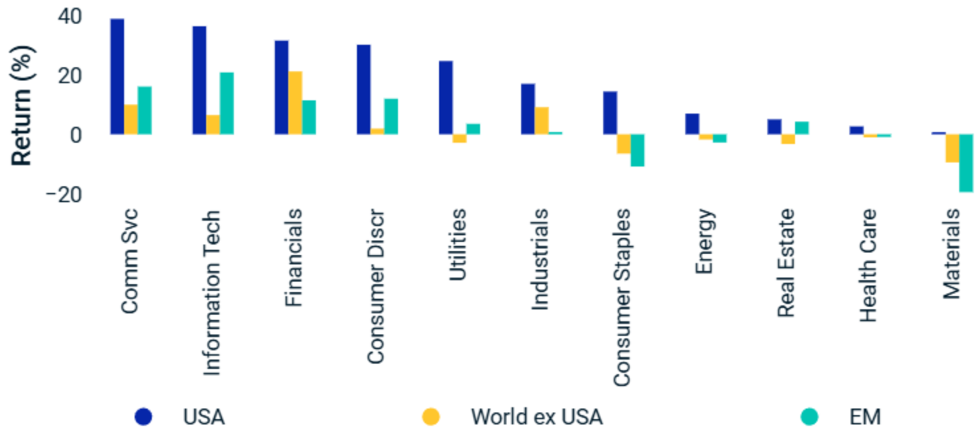
US equities soared ahead of international markets since 2009



Returns are gross in USD from Dec. 31, 1970, through Dec. 31, 2024. Global ex USA uses the MSCI World ex USA Index returns prior to 1988 and the MSCI ACWI ex USA Index returns thereafter.

Last year’s sector returns further emphasize U.S. dominance. U.S. equities not only outpaced in AI-adjacent sectors — technology and communication services — but also led developed (MSCI World ex USA Index) and emerging markets (MSCI Emerging Markets Index) across every other sector.

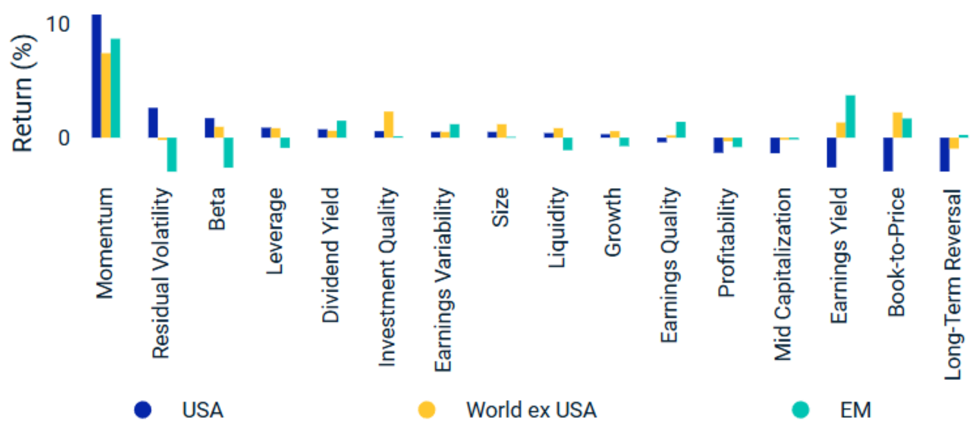
US outperformed other developed, and emerging markets, across every sector in 2024



Returns are gross in USD from Dec. 31, 2023, through Dec. 31, 2024. Sectors are defined using the MSCI Global Industrial Classification System (GICS®). GICS is the global industry classification standard jointly developed by MSCI and S&P Global Market Intelligence.

A similar pattern emerges in systematic style factors. Momentum — buying the recent winners — led all factors across the major markets in 2024. Nowhere was this shift more pronounced than in the U.S. Following the U.S. election, high-momentum stocks rose further still, again underscoring investors' risk-on appetite for U.S. assets.

Momentum outperformed all styles globally, with its strongest gains in the US



Returns are from Dec. 31, 2023, through Dec. 31, 2024, and use the MSCI Global Investable Markets Equity Model.

This pattern of regional divergence appears elsewhere. We see it in the industry makeup and returns of private assets, in Asia's pivotal role in the energy transition and in tariff-related geopolitical risks. It also emerges in the contrasting growth expectations for U.S. equities versus other market segments, and in the trajectory of interest rates.

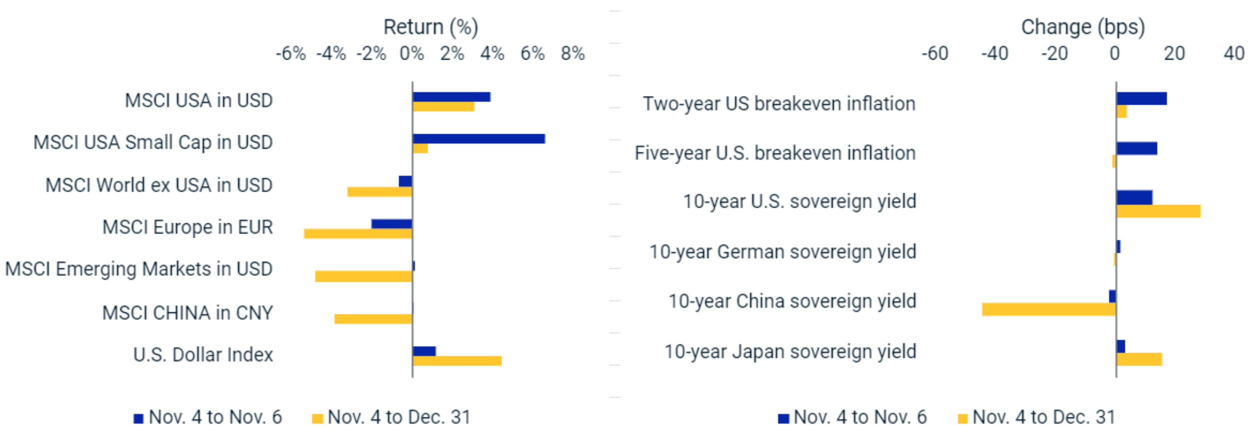
In the pages ahead, we will explore these dimensions, offering a perspective on the forces that will shape investment risks and opportunities in 2025.

1. US policy could further deepen economic divergence

The post-election market reaction has underscored the regional divergence in economic trajectories that was already evident prior to the vote. U.S. economic growth for 2024 is expected to have exceeded expectations from one year ago.[1] Other major economies face tepid growth and related challenges, such as political uncertainty in Germany and France and deflationary pressures in China on the back of its weak property sector. In addition, U.S.-centric tariffs introduce further uncertainty for global economies.

In the aftermath of the U.S. elections, U.S. equities rallied broadly, while the rest of the world lagged. The gap between 10-year Treasury yields and their German and Chinese counterparts widened, while the U.S. dollar index appreciated.

Post-election market returns underscore US economic strength relative to other regions

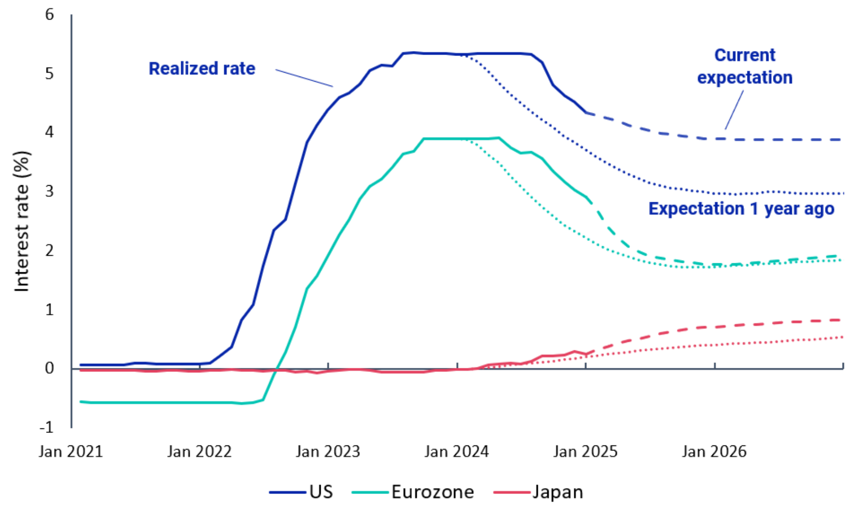


Market returns between Nov. 4, and Nov. 6 and Dec. 31, 2024, respectively.

Differences in economic outlooks are also reflected in diverging monetary policy expectations. Compared to market-implied expectations at the end of 2023, the major central banks delivered part of the rate cuts expected in 2024, albeit later in the year (dotted lines in the exhibit below). Looking forward, however, expectations for further Federal Reserve cuts have been trimmed since last year, with only two further cuts priced in. This pushes expectations for terminal rates roughly 90 basis points (bps) higher than this time last year. By contrast, in the eurozone, on the back of economic headwinds — potentially further exacerbated by future trade tensions — investors expect about four to five cuts in 2025. Meanwhile, after decades of deflation, the Bank of Japan is expected to gradually raise rates. These monetary policy expectations would also be consistent with another strong year for the U.S. dollar against other major currencies such as the euro.

1 According to the median estimate in the FT-Booth survey, economists expected 1.5% US real growth for 2024 in December 2023. As of Dec. 19, 2024, the Conference Board forecasts U.S. GDP to expand by 2.7% in 2024.

Diverging monetary policy rate expectations



Market-implied expectations are based on forward rates implied by MSCI overnight index swap curves as of Dec. 29, 2023, and Dec. 31, 2024.

Trade tensions may fuel inflation risks and policy uncertainty

The question for investors is how the optimism around U.S. exceptionalism that has left its footprint on market returns will play out this year. Higher tariffs, coupled with potential retaliation from trading partners, may dampen global growth and could drive inflation higher in the U.S., while the inflationary effects of U.S. tariffs on other regions would be more ambiguous.[2]

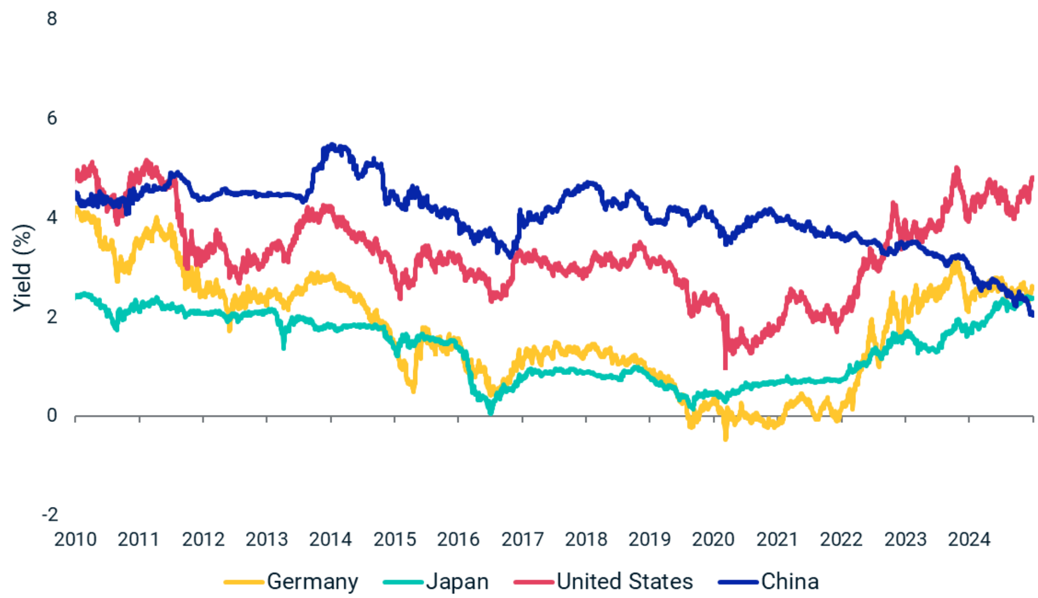
During the previous trade war in 2018–2019, the Federal Reserve adopted a more accommodative stance to mitigate potential slowdowns, but today's inflation dynamics differ. According to economists polled in the FT-Booth Macroeconomist Survey, inflation may be stickier, and we may see fewer rate cuts in 2025 than currently anticipated.[3]

In the eurozone, the dominant impact of tariffs would likely be to weaken business sentiment and influence long-term investment decisions, adding to existing economic challenges, consistent with the drop in yields in the eurozone since the U.S. election. Meanwhile, China faces deflationary pressures. Its decoupling from global trends is striking: The country's 30-year sovereign yields have dropped below those of Japan (see exhibit below). In this environment, tariffs and their drag on exports could further intensify deflationary concerns.

2 Warwick McKibbin, Megan Hogan, and Marcus Noland, "The International Economic Implications of a Second Trump Presidency," Peterson Institute for International Economics, September 2024.

3 Colby Smith and Eva Xiao, "Economists trim Fed rate cut estimates of fear of Trump inflation surge," Financial Times, Dec. 15, 2024.

30-year sovereign yields have fallen in China while rising elsewhere



30-year sovereign bond yields between Jan. 3, 2010, and Dec. 31, 2024. MSCI Fixed Income Curves.

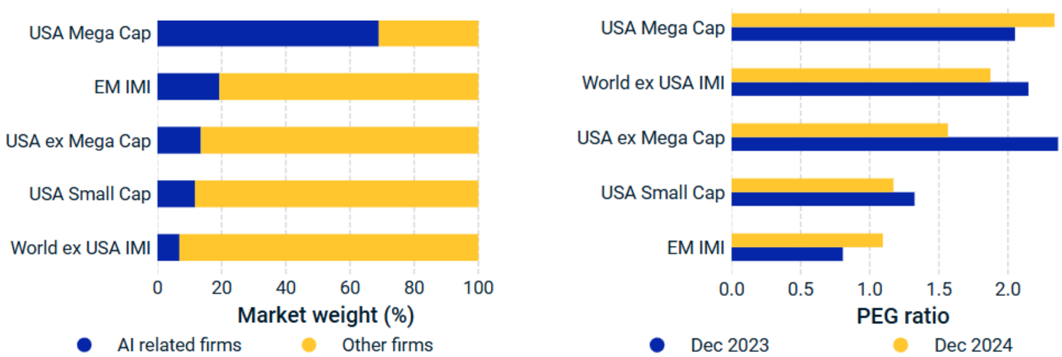
2. Technology and trade will shape equity markets

Shifting our focus from broad macroeconomic themes to equities, technology-driven growth — particularly in AI — continues to shape market narratives.

This is especially evident in the structure of the U.S. equity market. A handful of mega-cap stocks — fewer than 40 names, including the widely followed "Magnificent 7" — accounted for over 30% of global equity capitalization, as of Dec. 31, 2024. According to the MSCI Thematic Exposure Standard, AI-related firms comprised over 60% of this segment's weight, propelling its returns to almost 40% last year, more than twice that of other segments. Smaller U.S. stocks and international equities have AI exposure too, but at lower levels.

This disparity helps explain the valuation premium assigned to U.S. mega caps: At 32 times earnings, they traded at more than twice the multiples of emerging market (EM) and developed stocks ex U.S. peers, as of the end of 2024. The rationale for this premium is tangible. AI-related companies are expected to deliver earnings growth more than 30% higher than the broader market in 2025, establishing what could be called an "AI growth premium."

AI drove 60% of US mega-cap weight, but earnings expanded elsewhere



Capitalization weights are as of Dec. 31, 2024. AI-related stocks are based on the MSCI Thematic Exposure Standard and the MSCI ACWI IMI Robotics & AI Index. Earnings multiple and short-term forward earnings growth based on MSCI Fundamental Data Methodology.

This prompts a question: Is the premium still attractive? One way to gauge this is through the price/earnings-to-earnings growth (PEG) ratio, which balances growth expectations with price.[4] By this metric, the largest U.S. stocks have become more expensive than they were at the start of last year, partly due to moderating earnings forecasts and substantial expenditures fueling the AI arms race. In contrast, growth expectations outside the mega-cap cohort — both in U.S. stocks and developed equities ex U.S. markets (anchored by Europe and Japan) — have expanded.

Take note of the tariff trade

Alongside technology, geopolitics has deepened the regional divide, as the prospect of tariffs becoming a signature U.S. policy compounds uncertainties previously heightened by the COVID-19 pandemic and the Russia-Ukraine war.

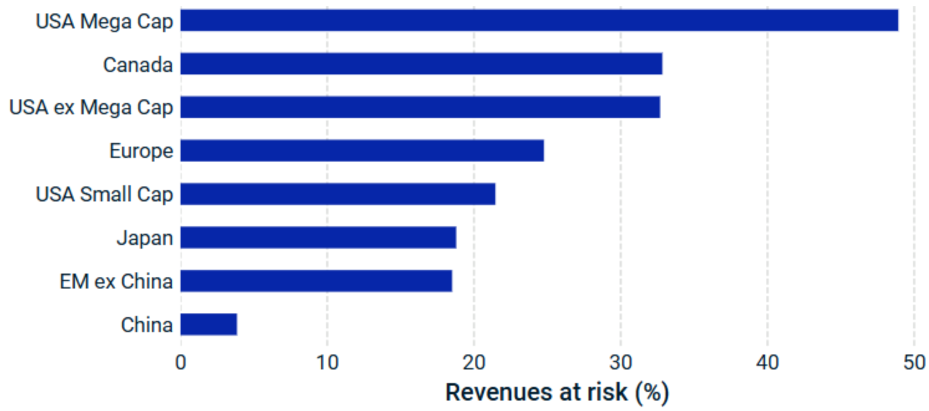
Traditional measures of trade risk, such as trade's share of national income, offer one view of policy sensitivity. A complementary view emerges from corporate revenue data. MSCI Economic Exposure figures suggest that roughly 20% of global corporate revenues may be policy-sensitive, evenly split between U.S. firms selling overseas and global firms selling into the U.S.

At first glance, U.S. mega-cap technology firms may seem especially vulnerable if trade barriers rise, given their high share of foreign revenues. However, their digital, services-based business models — combined with a history of resilience to regulatory changes — suggest they may be more insulated from policy risks than industries reliant on physical and capital goods.

For example, U.S. semiconductor firms' revenue exposure to China fell sharply following the export controls introduced under the 2022 U.S. CHIPS and Science Act, illustrating the potential for policy shifts to reshape revenues.

4 The PEG ratio is considered fairly priced at 1 by convention, as popularized by Peter Lynch (One Up on Wall Street, 1989). Unity reflects a balance where the current P/E ratio aligns with the expected growth rate.

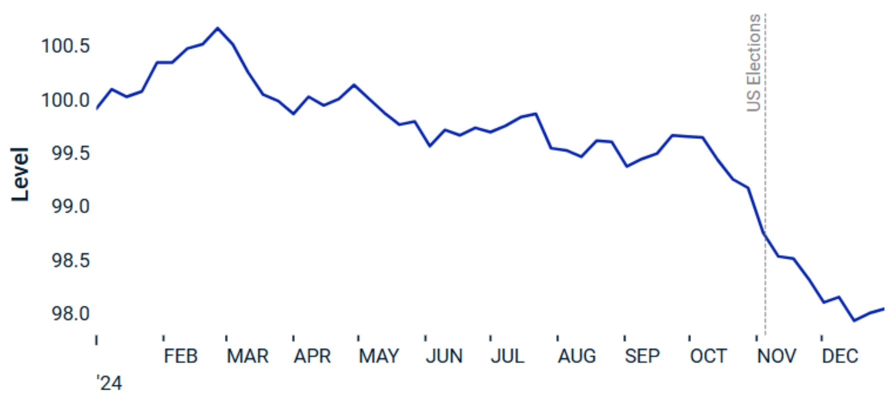
The largest US firms have the highest share of foreign revenues



MSCI Economic Exposure data as of Dec. 31, 2024. "At risk revenues" are non-U.S. revenues for U.S. firms, and U.S. revenues for non-U.S. firms.

Investors anxious about trade flows may be well-advised to consider risks to the smaller emerging markets, which include India, Korea, Mexico and Taiwan. The EM ex China region has a much higher revenue exposure to the U.S. than Chinese firms. Moreover, investors may already be pricing in added risk for export-oriented firms. MSCI's newest emerging-markets equity risk model shows that EM ex China companies heavily reliant on developed-market exports declined throughout the fourth quarter, notably so after the U.S. election, reflecting their sensitivity to shifting U.S. policies.

Exporters in smaller emerging markets declined throughout the fourth quarter of 2024

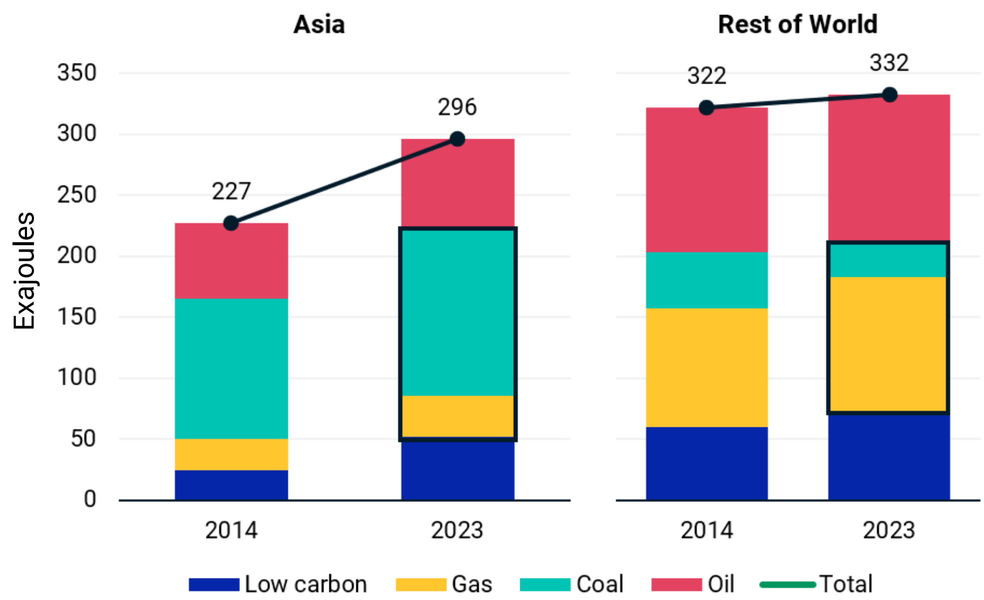


Returns are for 2024 calendar year for the developed markets economic exposure factor from the MSCI Emerging Markets Equity Factor Model.

3. Asia sets the pace of the energy transition

While the U.S. is the focus of the world's attention in financial markets, the locus of real-world activity continues its gradual shift east. In fact, Asia is on the brink of consuming as much energy as the rest of the world combined — underscoring the region's pivotal role in the global energy transition (see below). Over the past decade, Asia's consumption of all major energy sources — coal, oil, gas and low-carbon sources such as renewables, hydro and nuclear — has increased. In the rest of the world, by contrast, energy consumption remained flat, with gas replacing some use of coal in the overall mix.

Asia's energy consumption is nearing the rest of the world's combined



Source: MSCI ESG Research, Statistical Review of World Energy, as of November 2024. Note: Low carbon includes renewable power, hydroelectric, nuclear, biologic and geologic sources.

China in the driver's seat

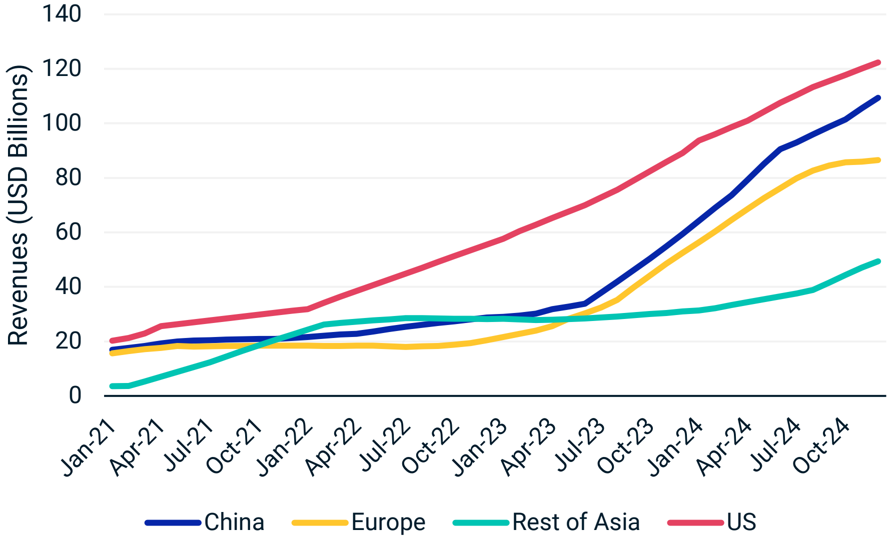
China has been a major contributor to Asia's increased energy consumption. The country's aggressive push towards renewable energy has seen significant investments in solar and wind power, alongside a steady increase in natural gas usage. Whether Asia, especially China, starts swapping coal out, and gas and renewables in, rather than just adding more of everything to meet rising demand, will be a major factor in the energy transition's trajectory.

Even for investors with little direct geographic or sector exposure to Asian energy markets or commodities, the ripple effects of these trends are far-reaching, and will continue to be felt through products and supply chains.

Transportation provides an important case-study. China's thirst for oil to fuel a rise in driving activity (and petrochemical manufacturing) made up half of the increase in global oil demand over the past 10 years. But the rapid growth of Chinese electric vehicles (EVs) has changed the way the world's largest country drives, threatening the future of oil demand growth and propelling the rise of a new industry. Chinese firms have earned more from selling EVs than firms in Europe or in the rest of Asia. Only U.S. firms, in aggregate, earned more, and Chinese companies have closed that gap sharply in the last 18 months.

Exports of Chinese EVs began to grow in early 2024, with governments in the U.S. and Europe responding with tariffs. If China sustains its rise as an EV powerhouse, it will influence the strategies for American, European and other Asian auto companies as they decide how fast they can (or cannot) afford to up the pace of their own EV manufacturing.

EV revenues have grown fastest in China, with a recent surge in the rest of Asia



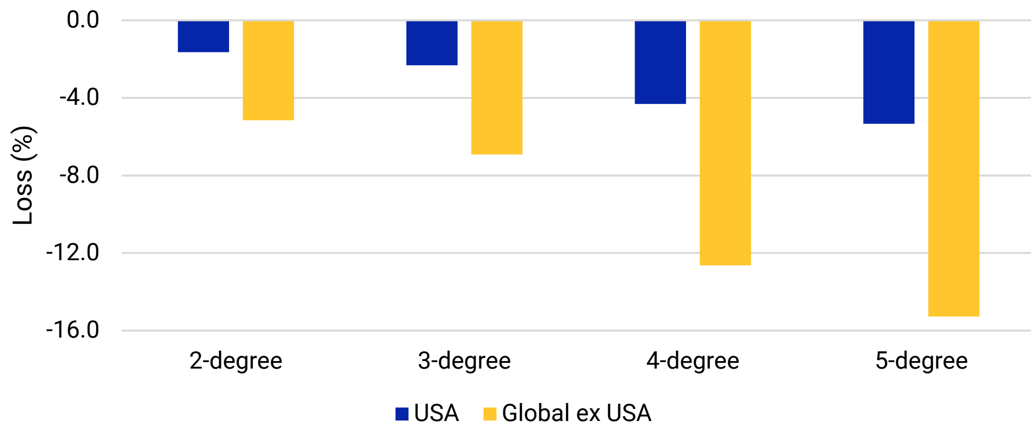
Note: Includes companies that were constituents of the MSCI ACWI Investable Market Index (IMI) across the period. EV revenues are shown as 12-month trailing averages, and were derived from multiplying total company revenues by the share of revenues firms derive from EVs, as determined by MSCI ESG Research's Sustainable Impact Metrics methodology. Revenues are then aggregated by each firm's primary country of exposure (i.e., where the majority of the revenues were made). Source: MSCI ESG Research, Barra Portfolio Manager, as of January 2025.

Geopolitical tensions could hinder collective responses to climate change more generally, by disrupting the flow of essential raw materials, technologies and capital required for a low-carbon transition. Nations prioritizing self-sufficiency over international cooperation may result in more fragmented and vulnerable supply chains, which would make decarbonization goals more expensive and harder to achieve. In turn, these disruptions would exacerbate the physical and economic impacts of climate change.

Progress addressing climate change could be further hampered by the fact that investors don't seem to agree about the pace of the global energy transition, which makes it more difficult to determine what is and is not priced into the market. A survey conducted by the MSCI Sustainability Institute in October 2024 found that roughly half of respondents expect that emissions will peak within the coming decade while the other half said they expect emissions to rise indefinitely. The survey found that the average investor expects a rise of 2.8°C, which could indicate that markets have priced in little policy action.

Regardless of their views, investors may want to take note of the fact that the MSCI Climate Value-at-Risk (CVaR) Model suggests that more extreme warming scenarios could lead to substantial equity losses due to asset damage and business interruption. Interestingly, aggressively valued, tech-heavy U.S. equities were an outlier, exhibiting relatively lower sensitivity to physical climate risks as a percentage of their market cap.

More extreme warming scenarios may lead to higher equity losses from physical risk



Source: MSCI ESG Research. MSCI's Physical Risk Climate Value-at-Risk Model indicates the potential financial losses relative to company and security's valuation due to the physical impacts of climate change. USA is MSCI USA IMI Index. Global ex USA is MSCI ACWI ex USA IMI Index. Data as of Dec. 31, 2024.

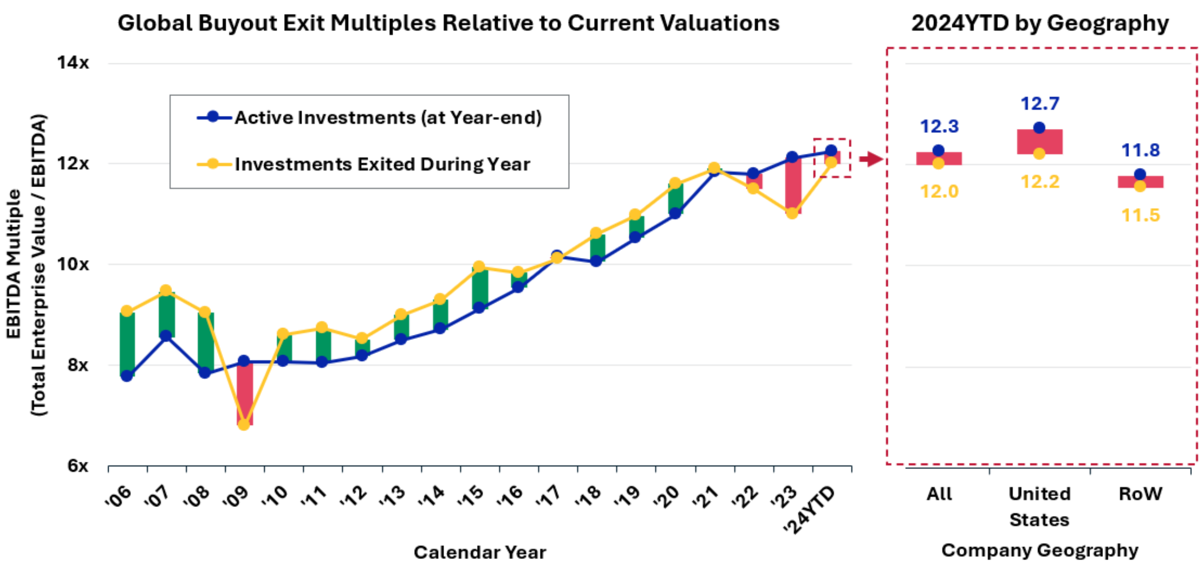
4. Private markets appear poised to turn a corner ... slowly

The years since 2021 have been challenging for investors in private assets, as rapid changes to interest rates caused them to reassess their underwriting of assets and how they view their allocations in a multi-asset context.

While these adjustments were quickly priced into listed markets, private assets incorporated this new information with their usual lag. The bid/offer spread widened in certain strategies with asset valuations becoming more uncertain, leading to stalling of transactions. In buyouts, investments exited since 2022 have done so at a lower valuation multiple (total enterprise value / EBITDA) than those investments still held by funds. While the pricing gap has narrowed to just 0.3x as of Sept. 30, 2024, this type of gap has not been observed in buyout investments since 2009. And if we look at the gap between private and public equity valuations since 2022, we see no compelling change.

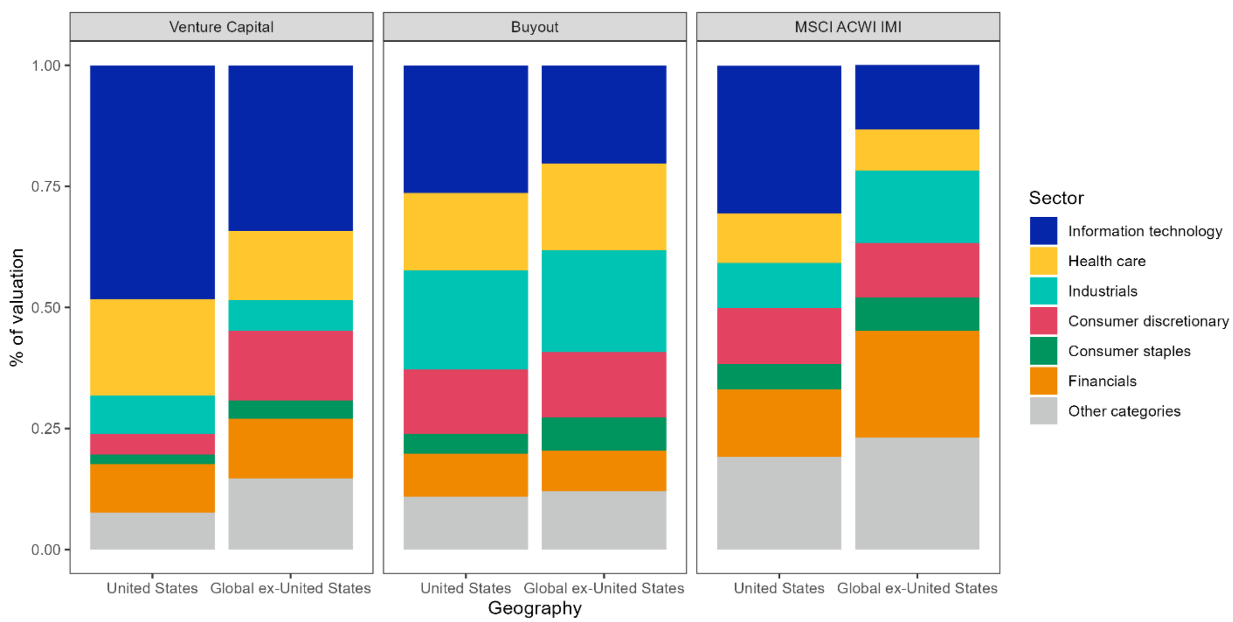
As with other trends we've observed, when we further explore this buyout pricing gap by geography, we see that it is more driven by U.S-based investments (a 0.5x gap) with the rest of the world (a 0.2x gap) faring better (see below).

Buyout exit multiples relative to current valuations



While private capital is a global industry, there are important sectoral differences within the private-equity universe across different regions of the world. U.S.-focused private-equity funds lean more towards investments in information technology (IT) — and this concentration exists within both venture capital (49% of U.S. fund holdings vs. 34% in other regions) and buyout (27% of U.S. fund holdings vs. 20% in other regions), as of Sept. 30, 2024. Surprisingly, this relative concentration in information technology companies is no greater than in public markets: in the MSCI ACWI IMI, 30.5% of U.S. market cap was in IT, versus just 13.3% for the rest of the world, as of Dec. 31, 2024.

Relative sector composition of US vs. the rest of the world



Venture capital and buyout data as of Sept. 30, 2024 (latest-available data). MSCI ACWI IMI data as of Dec. 31, 2024.

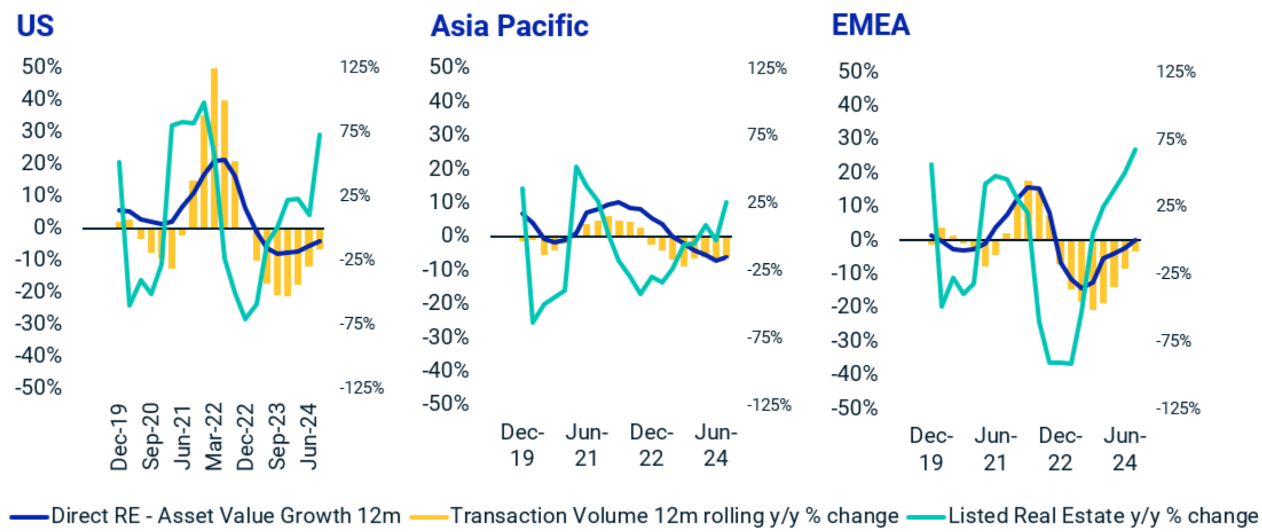
Getting the read on real estate

In global real estate, the lag between public and private markets has been particularly evident since the onset of COVID-19. Listed-market price movements clearly led underlying real-estate transaction activity and private valuation movements through pandemic-induced market weakness, the post-pandemic boom and the subsequent market correction that started in mid-2022.

Private valuations corrected most strongly in EMEA, but 12-month rolling asset value growth had just broken into positive territory by Q3 2024, while the U.S. and APAC continued to see price falls. And that is despite the U.S. illustrating a similar profile and timing to EMEA in both volumes and in the listed markets.

While underlying transaction volumes and private valuations continued to slide in Q3 2024, 12-month rolling listed real estate price returns have rebounded strongly. This provides a positive indicator that volume and valuation may revert to growth over the course of 2025.

Private real estate valuations corrected most rapidly in EMEA



Even when private-market metrics eventually return to positive territory, however, the benefits will likely be felt more directly by investors ready to deploy new capital, unencumbered by legacy positions. Those with marked-down assets looking to exit may need to weather an extended hangover period.

While not out of the woods, there are reasons fueling investor optimism in 2025 that the current stasis in some parts of private markets will ease. The pricing gap in buyout investments continues to close, private capital funds are sitting on over USD 2 trillion in dry powder as of Sept. 30, 2024, public equity multiples have recovered from their 2022 lows, and a new U.S. administration is expected to bring a more accommodative SEC. Further, private capital returns for the first three quarters of 2024 were generally positive, and early indications from the Q4 dataset indicate a rise in both capital contributions and distributions for private equity funds — a strong close to the year.

Key asset-allocation decisions lie ahead

Over the past decade and a half, global investment patterns have shifted decisively, with the U.S. increasingly outpacing other major markets. Yet history suggests this advantage cannot last indefinitely. While technology-driven U.S. mega caps have dominated, growth has broadened elsewhere, and private assets also face resetting valuations and evolving capital flows. Meanwhile, Asia's rising energy demand and China's renewable push present fresh avenues for potential growth, even as shifting trade policies expose market vulnerabilities.

These overlapping forces — spanning technology leadership, the energy transition, private asset growth and U.S. policy shifts — carry significant implications for investors' most important decision: asset allocation. Determining how much to commit to U.S. assets will be a key decision for both the largest institutions and individual wealth managers in the year ahead.

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