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1Q25: Thoughts to Expand on

AI: From Hype to Hard Numbers

Artificial intelligence continues to redefine industries, but in 2025, the focus shifts from promise to performance. Goldman Sachs estimates that AI could boost global labor productivity by 1.5% annually over the next decade, potentially adding 7% to global GDP. However, the human cost is worth consideration: Paraphrasing David Solomon – "AI could accomplish in minutes tasks that traditionally require teams of five to six people weeks to accomplish, threatening jobs in finance, operations, and beyond.

For investors, the story is one of winners and losers. Companies that harness AI to drive efficiency and revenue will stand out, while overhyped players may face harsh corrections. Attaching the AI/ML label to operations that invariantly remain stagnant is akin to attaching the ".com" moniker that saw company valuation balloon in the early 2000's.

Trump's NATO Shift Sparks a European Defense Boom

Geopolitical tensions and shifting alliances are driving a defense spending surge. Global military budgets reached $2.24 trillion in 2023, with Europe set to lead the charge in 2025. Donald Trump's return to the White House has renewed pressure on NATO allies to shoulder more of the financial burden, with the U.S. signaling reduced contributions. This is forcing European governments to boost their defense budgets and prioritize military modernization.

The ripple effects are profound. Defense contractors, aerospace firms, and cybersecurity providers stand to benefit as spending accelerates. For investors, Europe's defense sector offers significant opportunities, while infrastructure and private markets linked to military resilience could deliver long-term gains. With markets quick to price all conceivable factors, it's no surprise Rolls Royce was a top LSE performer in 2024. (As someone new to European equity markets, it was news to me that Rolls Royce the listed stock is not the Rolls Royce of cars that easily comes to mind; that is a brand name owned by BMW. Here rolls Royce refers to to the Aerospace and Engineering company)

Growth Splits the Globe: A Story of Divergence

The global economy is set to expand at a modest 2.9% in 2025, but the headline figure hides a tale of divergence. The U.S. is expected to outpace Europe and many emerging markets, buoyed by fiscal stimulus and resilient consumer demand. Europe, grappling with structural challenges, and China, contending with uneven domestic recovery, are likely to lag. Trump (and Elon) have a hand to play in all this but more to be discussed later.

Investors would do well to take a selective approach. U.S. equities, particularly mid-cap growth stocks and sectors like renewable energy, appear attractive. Meanwhile, caution is warranted in regions where recovery remains fragile. Identifying the right geographies and industries will be critical to navigating the uneven landscape.

Valuations Demand Earnings to Do the Heavy Lifting

Equity markets enter 2025 with high valuations leaving little room for error or further speculation. The S&P 500's forward P/E ratio sits at 19.6x, well above the historical average, forcing investors to shift focus to earnings growth. Companies with strong fundamentals, pricing power, and sustainable margins are likely to shine.

xRate Cuts Breathe New Life into Fixed Income

Cooling inflation is paving the way for central banks to pivot toward looser monetary policies in 2025. The Federal Reserve and the European Central Bank are signaling rate cuts, reversing the tightening trend of recent years. This creates a ripe environment for fixed-income assets. Additionally, with the UK's new Labour government facing new pressures and a stark divergence from how the expected their rturn to power, there is an expectation for the Bank of England to drastically accelerate the rate reductions. Current projections of GDP growth of 1.3% notably fall short of the promise to make the United Kingdom the fastest growing economy in Europe this year.

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