



NCM Core Global/Core International

# Equity Strategies

## NCM Monthly Commentary for January 2025



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As at January 8th, 2025

Cumberland Investment Counsel Inc., affiliate of NCM Asset Management Ltd.

### 2024 Review

2024 marked another year of solid returns for global equity markets. The S&P 500 rose 25% on a total return basis, following a 26.3% increase in 2023. The last time this benchmark index generated 2 consecutive years of 20%+ returns was in 1998. The strong returns in the U.S. were driven by a handful of large companies known as the Magnificent Seven (Amazon, Apple, Alphabet, Meta, Microsoft, NVIDIA, and Tesla). On a collective basis, these 7 companies accounted for over half of the return for the S&P 500. Excluding the Magnificent Seven, the remainder of the index returned approximately 10% in 2024. Outside of the U.S., the Tokyo Stock Exchange generated a total return of just over 20%, while the Euro Stoxx 600 index delivered a total return of nearly 10%. The key factors that drove global equity markets higher during 2024 included strong corporate earnings, interest rate cuts from central banks around the world, and significantly reduced fears about a global economic recession.

CHART 1

Index	Geog. Region	Currency	Price change	Total return with dividends
MSCI World	Global	US\$	17.0%	19.2%
S&P 500	US	US\$	23.3%	25.0%
Stoxx Europe 600	Europe	Euro	6.0%	9.6%
Tokyo Stock Exchange	Japan	Yen	17.7%	20.4%

Source: Bloomberg

The leadership of U.S. stocks in a global context can be explained by a resilient economy and strong corporate earnings. The U.S. economy is a consumer led economy, and the consumer has been supported by several positive developments including rising inflation-adjusted incomes, low unem-

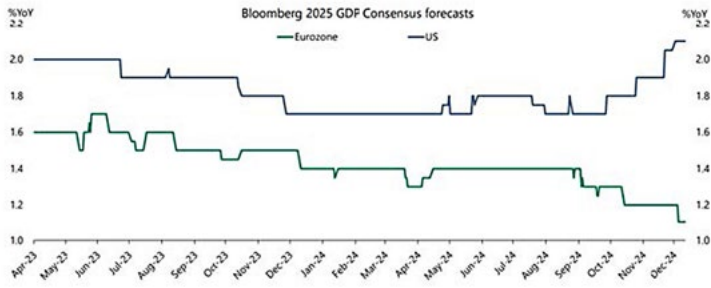
ployment, and a surge in asset prices for stocks and housing. These factors have supported the spending of middle to upper income households. Recent data points have showed ongoing strength in consumer spending and balance sheets remain in good shape. The effective interest rate on mortgage debt outstanding is only 4% and the debt to disposable income ratio is sitting near multi-decade lows. Overall, the U.S. consumer is in really good shape and is well supported by rising asset prices and low debt levels. The U.S. economy is also being supported by various secular trends including reshoring, electrification, and artificial intelligence. In addition, the economy is getting a lift from several fiscal policies including the CHIPS Act, Inflation Reduction Act, and the JOBS Act.

*“Overall, the U.S. consumer is in really good shape and is well supported by rising asset prices and low debt levels.”*

The European economy is not enjoying the same tailwinds as the U.S. economy. There are several structural issues that continue to negatively impact this region of the world. High energy prices, ongoing struggles in the region’s largest economy (Germany), and the knock-down impact of the weakness in China are some of the key factors that continue to weigh on Europe’s economy. High energy prices have hampered Germany’s manufacturing sector and its economy faces deep structural problems. The upcoming election in February could serve as a positive catalyst if it leads to hope for pro-growth policy changes. Reforms are needed to lower energy prices, increase labour supply, and spur innovation. Even if this materializes, it will take time for new policies to be implemented. In the meantime, there is a wide divergence in the economic prospects between Europe and the United States as shown in Chart 2 on the next page.

CHART 2

**Strong divergence between the US outlook and the outlook for Europe**



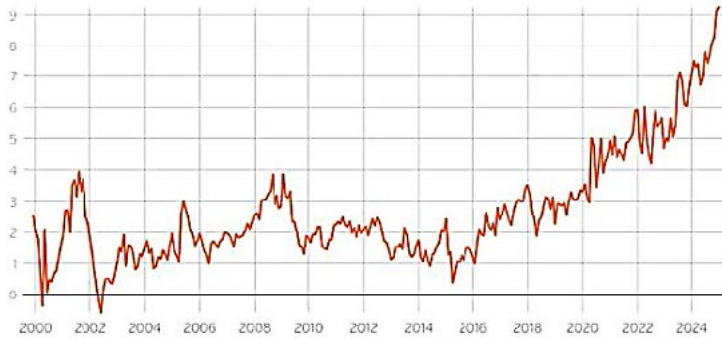
Source: Bloomberg, Apollo Chief Economist

Over the last 4 months 2025 consensus GDP forecasts have improved in the U.S. and have deteriorated in Europe. Given all of the forementioned issues, is Europe a complete basket case that should be avoided from an investment perspective? We do not believe so. First and foremost, it can be argued that many of the economic headwinds in Europe have been discounted in the stock market. For example, the Price-to-Earning ratio premium of the US relative to Europe is at its widest level in the last 25 years as can be seen in Chart 3 below.

CHART 3

**U.S. valuation premium to European stocks reaches record high**

S&P 500 price-to-earnings premium to Europe's Stoxx 600



NOTE: Data to Dec 31, 2024. | By Naomi Fovnick | Source: LSEG

Second, just because a company is headquartered in Europe, it doesn't mean that its entire business is generated in Europe. We own many European-domiciled companies that derive substantial portions of their business from outside of Europe. Given the significantly brighter prospects in the US relative to Europe, we have tilted our European-based investments towards companies that generate large percentages of their revenue from the U.S. and other parts of the world with better growth prospects.

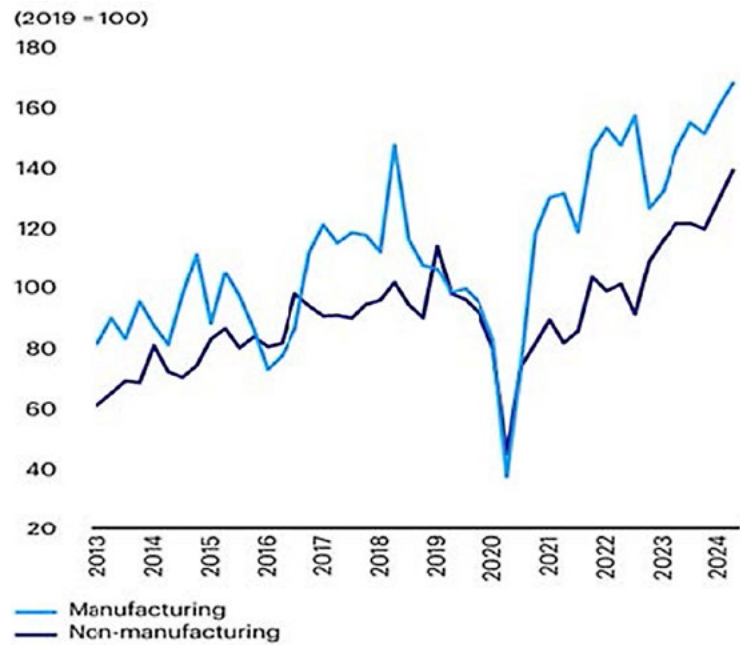
Outside of the U.S. and Europe, we continue to be encouraged by what we are seeing in Japan. This economy has returned to steady economic growth after experiencing decades of deflation and economic stagnation. The govern-

ment has implemented several reforms including measures to improve corporate governance, policies to address its shrinking labour force, and incentives to encourage consumers to invest their savings into the stock market. In addition, the economy is being viewed as a safe haven by many countries and companies around the world. Billions of dollars are being deployed into Japan as companies re-engineer their supply chains in the aftermath of COVID and the war between Russia and Ukraine. Although economic prospects look encouraging to us, stock prices in Japan have moved sideways for the past 9 months on the back of a strong Yen. Given that Japan is an export-oriented country, there is concern that a strong Yen will create a headwind for Japanese stocks. We do not share this view because we believe that company fundamentals matter the most for stock market returns. A tight labor market and healthy wage increases have enabled pricing power for companies in Japan, which has allowed them to generate higher profitability. This is illustrated in Chart 4 below.

CHART 4

**Japanese companies' profit continues to rise robustly with higher pricing power**

Japanese companies' pre-tax profits



Source: CEIC, Data represents macro-level company profits as compiled by Japan's Ministry of Finance. Quarterly data as of October 25, 2024.

Bringing it all together, we have a cautiously optimistic view for the global economy. While some parts of the world are experiencing lacklustre growth (i.e. Europe), there are other countries that are expected to generate decent levels of growth. According to the OECD, there are more countries that are expected to experience accelerating economic growth than decelerating growth in 2025. Furthermore, there is not even 1 major economy that is expected to fall into a recession in 2025 as shown in Chart 5 on the next page.

CHART 5

Growth in most non-US economies expected to accelerate in 2025



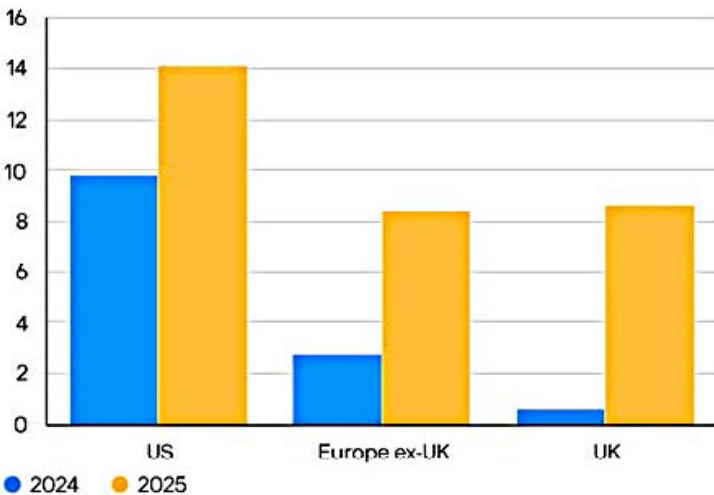
Source: Charles Schwab, Organization for Economic Cooperation and Development data as of 12/1/2024.

The bottom line is that global economic growth is modest but this is happening in a backdrop of falling inflation and interest rate cuts from global central banks. We believe this will be supportive for corporate earnings. On a historical basis, global central banks typically cut interest rates when the economy is weakening and when the outlook for corporate earnings is deteriorating. In the current cycle, central banks are cutting interest rates at a time when the U.S. economy is stable and earnings are accelerating as seen in Chart 6 below.

CHART 6

Consensus estimates for earnings per share growth

% change year on year



Source: FTSE, IBES, LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. US: S&P 500; Europe ex-UK: MSCI Europe ex-UK; UK: FTSC All-Share. Past performance is not a reliable indicator of current and future results. Data as of 12 November 2024.

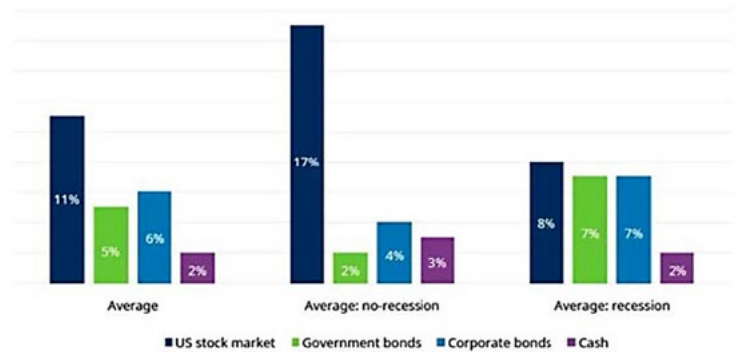
As seen in the chart, earnings are expected to accelerate in 2025 relative to 2024 for the U.S., Europe (excluding the UK), as well as the UK. And this is happening as rates are being cut. We view this as a favourable backdrop for global equities. Looking back at nearly 100 years of data, one can see that

U.S. stocks have significantly outperformed bonds and cash when rates fall and the economy avoids a recession. This can also be seen in Chart 7 below.

CHART 7

Stocks have beaten bonds and cash when rates fall

Average 12-month real returns from the date of first cut, since 1928



Source: Schroders

In terms of the risks to our outlook, we would highlight tariffs, immigrant deportation, and a resurgence in inflation. Tariffs are a key risk given that Donald Trump has threatened a tariff of at least 60% on imports from China, a 25% tariff on goods from Mexico and Canada, and a 10-20% across-the-board duty on imports from virtually all other countries. If enacted, the proposed tariffs would push the U.S.'s effective tariff rate up roughly sevenfold to 21%, according to analysts at Fitch Ratings. This would represent the highest level since the 1930's. Donald Trump has also vowed to crack down on illegal immigration and deport undocumented immigrants. If Trump moves forward with these proposals, it could create a significant shock to the U.S. labor market given that unemployment is already low and there is very little growth in the workforce in terms of native-born Americans. Taken together, tariffs and immigrant deportation have the potential to reignite inflation. While inflation has been getting closer to Federal Reserve's target of 2% target, it seems stuck around the 2.5-3.0% level as the last mile of inflation is proving difficult to bring down. Shelter costs remain stubbornly high and so are prices for many services. Surging power demand from artificial intelligence (AI) and data centers could lead to higher electricity bills for consumers. If inflation were to rise due to all of the forementioned factors, it would very likely force the Fed to stop cutting rates and potentially raise them instead. Goldman Sachs economists calculate that the proposed tariffs could cause core PCE inflation to rise to 3.1% by early 2026. This compares with a pre-election forecast of 2% core inflation by early 2026. At the end of the day, we believe cooler heads will prevail. Our rationale for saying this is that Donald Trump has surrounded himself with a team of market savvy individuals. Furthermore, Mr. Trump prides himself on a steady economy and a strong stock market. It seems unlikely that he would pursue an agenda that would jeopardize all the good things that are currently happening in the economy and the stock market.

## Portfolio Review

During the fourth quarter, we established several new positions in our Global and International portfolios. In our Global strategy, we established new positions in Booz Allen and Eli Lilly. In the International strategy, we initiated new positions in BEA Systems, Deutsche Boerse, Diploma, Experian, and Trane Technologies. A brief description of each new holding can be found in the Appendix.

## Outlook for 2025

In terms of our outlook and as we described, we continue to have a cautiously optimistic view. First, the global economy continues to show signs of resilience and concerns about an economic recession have faded. Second, central banks around the world have begun the process of cutting interest rates which should provide support to the global economy. Third, corporate earnings have been steady and are set to accelerate into 2025, as both inflation and interest rates continue to fall. For all these reasons, we have a favourable outlook for global equity markets.

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## APPENDIX A

### Company descriptions for new positions added to the Global Strategy

#### Booz Allen Hamilton Holding Corporation

Booz Allen Hamilton Holding Corporation is a premier government services consultant. The company employs over 35,000 people, who provide civil and military government services to the federal government. Booz Allen's consultants are well known for their ability to tackle sensitive and high-priority areas such as cybersecurity, intelligence, defense, and spending efficiency projects. The company is an industry leader and has historically outgrown the defense budget and peers by 2% to 4% per year across market cycles. The company has invested in artificial intelligence, cybersecurity, and other advanced technologies in order to stay ahead of peers and remain an important partner in providing mission-critical solutions. Booz Allen has historically outgrown its peers by 2% to 4% per year and has delivered mid-to- high single-digit organic revenue growth. The company also uses M&A to accelerate growth and to bring new capabilities to the firm. Booz Allen is a very cash generative business and the company has a strong track record of efficient capital allocation.

#### Eli Lilly

Eli Lilly is the largest pharmaceutical company in the United States, with leading positions addressing diabetes, obesity, and recently Alzheimer's disease. With Mounjaro for diabetes and the recent approval of Zepbound for obesity, Lilly is set up for substantial growth over the next 5 years. The immense market potential for weight-loss treatment is underscored by the fact that over 40% of Americans are considered obese. Coupled with the urgent need for Alzheimer's therapies for an aging population, we believe its innovative therapies have the potential to improve millions of lives while also driving significant value for investors in the years to come.

## APPENDIX B

### Company descriptions for new positions added to the International Strategy

#### BAE Systems

BAE Systems is one of the world's largest aerospace and defence companies. The company's business spans all domains of the global security market, from air and space, to land, sea and cyber domains. BAE is the largest defence contractor in both the UK and Australia, and is also a top 10 defence prime contractor in the United States. The company's backlog is at record levels as European defense budgets have been rising in response to the Ukraine situation with many NATO countries raising their spending commitments. The company has demonstrated a strong track record of growth, and it maintains a strong balance sheet supporting capital return to shareholders including acquisitions, dividends, and share buybacks.

#### Deutsche Boerse

Deutsche Boerse is a diversified exchange operator that offers a large suite of products and services. The company operates through 4 segments including 1) Data & Analytics; 2) Trading and Clearing; 3) Fund Services; and 4) Securities Services. Data & Analytics offers stock market index-based products (STOXX® and DAX®) as well as ESG and governance research for institutional investors and companies. Trading & Clearing offers trade execution and clearing capabilities across several verticals including equities, commodities, currencies, and derivatives. Fund Services provides fund processing and fund distribution solutions for global banks, wealth managers, and custodians. Securities Services offers post-trade services like settlement, custody, collateral, and liquidity management. Deutsche Boerse is a very cash generative business and has been a strong allocator of capital over the years.

## Diploma

Diploma is a decentralised distributor operating globally across three main end markets including Controls, Seals, and Life Sciences. Diploma distributes specialized products that are critical components in their customers' value chains, which have a low-cost relative to their overall spend. In addition to providing these products, the company also provides expertise and support, allowing customers to tap into Diploma's extensive product knowledge and application expertise. A key characteristic of Diploma's business model is its decentralised structure, with several companies in its portfolio operating independently. Diploma distinguishes itself in the distributor sector by providing a higher degree of advice and customisation. This added value allows Diploma to command higher margins, as clients are typically willing to pay a premium for the specialised services and bespoke solutions.

## Experian

Experian - As one of the largest information services companies in the world, Experian is well positioned to benefit from major structural tailwinds associated with the collection and use of consumer and business data. The growth in the market for big data and analytics, identity protection, decisioning, and healthcare data is expected to drive future demand for Experian's services through the cycle. In recent years, Experian has made significant investments into new product innovation and new sources of data to exploit untapped market opportunities. This has allowed Experian to win market share from competitors. The company's operating model is highly cash generative, which has enabled the company to simultaneously invest in its core business, make acquisitions, and return cash to shareholders via dividends & share buybacks.

## Trane Technologies

Trane Technologies is involved in the design, manufacture, sale and service of heating, ventilation & airconditioning (HVAC), as well as transport refrigeration technologies. Trane became a stand-alone company in 2020, after separating from its parent company, Ingersoll Rand. The company operates under the two major brands of Trane (HVAC) and Thermo King (Transport Refrigeration). We believe that Trane is a key beneficiary of several industrial mega trends including AI-driven proliferation of data centers, US reshoring, and greater energy efficiency.

The company has been on the leading edge when it comes to innovation, which has been driven by a relentless rate of reinvestment into the business. This has allowed the company to push the envelope on energy efficiency and also drive improved paybacks for its customers.

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