Phillip Capital Management

OUTLOOK 2025

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2nd January 2025

Dear Valued Client

As we begin 2025, the investment landscape is marked by excitement, trepidation and uncanny echoes of previous stock market bubbles. The rapid advancement of Artificial Intelligence (AI) is transforming industries, creating new opportunities and the next frontier of Agentic AI – systems capable of independent action and learning. However, we urge caution as the optimism surrounding AI may not meet investors heightened expectations on tangible returns on investments. Already, some of the biggest customers of Nvidia have acknowledged the possibility that AI will not advance as quickly as expected. Simply, they have used up most of the digital text available on the internet. In short, they have run out of data to improve their AI systems!

US stock markets have moved far ahead of American exceptionalism. America's 70% share of global stock market indices is far greater than its 30% share of the global economy. Four decades ago, US stock markets constitutes just 30% of global stock market indices. For comparison, at its peak, in December 1989, Japanese stocks had a total market value of about US$4 trillion, 1.5 times the value of US stock market and close to 45% of the world's stock market capitalization! It was Japanese exceptionalism then as exemplified by the Toyota Way of Just-In-Time production.

The Warren Buffet indicator tells a similar story of US stock market extremes. The indicator compares the stock market value to the gross domestic product of the country. At around 200% now, the US stock market is significantly overvalued. In 2007, before the Great Financial Crisis this indicator was at 105% and 138% before the 2000 Internet bubble burst. For comparison, this indicator was at 100% at the peak of the Japanese bubble in end 1989, 120% for China's peak in 2007 and currently at around 60%. For now, momentum is a powerful force propelling the US market but it is important to remember that markets are cyclical since time immemorial.

Little wonder that Warren Buffet has been selling US stocks and holds more than US$325 billion in cash or about 25% of the portfolio, higher than before the global financial crisis.

Chinese stocks are deeply unloved and under owned – the complete opposite of US stocks. In late September 2024, Chinese stocks soared after Beijing unleashed stimulus measures to revitalize the economy. Investors had given China such a wide berth that stocks jumped 40% in just a few days as funds rushed in. Imagine what will happen if investors rush for the exit at the same time from the US stock market if recession hits, geopolitical shocks occur or Trump policies shift. For China, it doesn't need much good news to drive the market up. Among others, upside could come about from the relaxation of hukou rules in mid-sized cities and unleash the huge domestic demand potential from urbanisation which has slowed since the pandemic. Additionally, Beijing still has fiscal dry powder to respond to Trump's tariff plans as they become clearer.

On a similar note on the unloved, the renewables sector has become attractive after having derated significantly as the era of ultra-low-cost borrowing ended and the ESG investment boom fades. The sector is increasingly cost-competitive and is still growing strongly providing opportunities for the patient investor. For example, the global average cost for offshore wind has fallen to US$81 per megawatt hour, down from US$137 in 2018. That compares favourably with US$72 for coal-fired power plants and US$83 for gas – fired power plants, respectively – unthinkable just a few years ago. Growth in renewables used to be

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based on climate targets but now it has a strong economic underpinning.

2025 will also be marked by the strong US dollar and emerging market (EM) pain. If Trump follows through on tariffs, the US dollar is expected to strengthen. In 2018, after the US imposed tariff on half of everything it imported from China at a 25% rate, the renminbi fell 10% versus the dollar – almost a one-for-one offset. The currency of the country subject to tariffs falls to offset the hit to competitiveness. Commodity prices will also fall as a tariff war will be negative for global growth, adding to depreciation pressure on the currencies of commodity exporters. EM currency pegs will be vulnerable to devaluation and interest rates in EMs will have to be raised. Tariffs are just one manifestation of deglobalization and re-industrialisation of the West, shifting growth from EMs back to the US.

Gold will still add value in 2025 and beyond. It has been a universal store of value for over 5,000 years. Today, gold remains the principal alternative to fiat currencies (such as the USD) and as inflation devalues fiat currencies, gold appreciates. Since 1970, the US dollar has lost 98% of its value as compared to gold. Put in another way, gold has appreciated by more than 8% p.a., easily beating US Treasuries. From 1970 to 1981 (stagflation), gold averaged 26% p.a. Between 1982 and 2007 (stable monetary policies and moderate deficits), gold appreciated just 1.8% p.a. The 2008 global financial crisis ushered in 15 years of ultra-loose monetary policies, quantitative easing and extreme deficits and gold jumped by 8% p.a. In 2022, inflation had again surged to levels not seen since the early 1980s. The vast amount of money created since 2008, the enormous debts, deglobalization, the evolving geopolitical tensions globally, point towards a decade of higher gold prices.

To navigate the investment landscape in 2025 and beyond, investors will need to understand history, psychology and anthropology. History doesn't repeat itself but it often rhymes. So, familiarize yourself with the 1930s protectionism, the 19th-century robber barons or Tudor royal courts from the 15th-century. Those periods provide valuable insights into current challenges and opportunities. History will rhyme again!

Thank you for investing with us. We look forward to serving you for many years to come.

I wish you and your loved ones a Happy and Prosperous New Year.

Yours sincerely,

Jeffrey Lee

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