Ninety One

Investing for a world of change

Quality earnings are more predictable than the market

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How would you assess the performance of the global equity market in 2024?

There wasn't much evidence of the market broadening out in 2024, with the Magnificent Seven again performing strongly. While there was some deepening in terms of the performance of a wider range of stocks within the US, many geographies elsewhere were left behind. For instance, the performance of Chinese or European stocks hasn't really lived up to expectations of capital being more readily distributed. However, we certainly don't think that a broadening out of returns is something that investors should lose sight of. The new US administration is likely to be more volatile than other jurisdictions where there is more continuity, which is more predictable.

How do you think the new Trump administration will influence markets in 2025?

The idea of a continuation of US exceptionalism, which results in continued outperformance of US-listed stocks, seems to be a general theme that many market commentators are backing. It's an idea that has some degree of merit, because the US economy is growing robustly and it's certainly exercising its dominance in terms of policy decision making, which is geared towards reinforcing that degree of dominance. We think Trump has learned from his first term, so the decision makers are being put into place to continue that growth agenda.

That said, we don't think it's going to be a risk-free reward in terms of 2025 because tariffs are not necessarily just geared towards improving the US's fortunes and weakening everybody else. Other nations will have their right to reply, so geopolitical tensions are certainly going to ensure that the wheels of commerce aren't greased as neatly as they have been in the past. Therefore, there could be some friction for investors to be mindful of, and this will occur when markets are at elevated valuation levels, with high expectations for companies to deliver a level of performance that justifies current valuations. Any surprises to the downside could therefore be punished.

The S&P 500 has delivered consecutive years of double-digit returns. Do you expect the US to maintain this market leadership?

Following such strong economic growth and earnings growth, inevitably interest rates have started to be reduced because economic risks are rising, and inflation is falling. Both of those are ultimately negative drivers for top line performance for most companies. So, the idea that 2025 is going to see acceleration in top line growth in revenue for businesses and the commensurate margin improvement and performance doesn't really gel with what one would see in terms of the shape of the evolution of the economic forces.

Therefore, we would expect earnings growth, all else being equal, to be slower in 2025. Then, the question becomes: how much more would the market want to pay for an ebbing rate of earnings growth with risks rising on that front? While we would not be overly pessimistic or bearish, investors should just bear in mind that to expect another double-digit return means that the stock market must continue to re-rate off these elevated levels. If earnings growth slows to single digits – as we expect – the remainder has to come from increasing dividend streams or a stock market re-rating, which would again mean stocks becoming more and more expensive. Who is going to keep paying for that?

Do you think that geopolitical risk is going to be important for markets as we enter 2025?

Much of this depends on how draconian the US tariff regime is. However, investors should bear in mind that since Trump first introduced tariffs during his first presidential term, we've seen an ever increasing tightening of them by the Biden administration, both in terms of magnitude and scope of industries being covered. Therefore, there has already been a distinct move in that direction, and the new administration may be emboldened as there doesn't appear to be any tangible evidence of a negative impact on the US economy. However, the response of other nations is important in terms of determining the degree to which the US can keep on pushing.

Ultimately the tariffs affect critically important industries. For instance, the semiconductor industry is one which the US doesn't have the sole power of controlling, as these businesses are not all on its own turf. The leaders are domiciled in Europe, Taiwan and other parts of the world. So, if the US wants to recreate a semiconductor ecosystem by putting up tariffs, there could be a lot of collateral damage that could occur, and the US could end up undermining its own progress. Therefore, the new administration must think carefully about certain industries. Others are maybe more obvious, like electric vehicles, where there are very clear competitive threats and different pricing regimes and a desire to protect the domestic industry, which has massive multiplier effects. However, as mentioned above, some industries are not easy to recreate in a single geography.

How do you think about the risks and the opportunities for quality investing in 2025?

If we look at our portfolio holdings, the underlying growth that those businesses produced in 2024 exceeded our expectations and is comfortably in the double digits in terms of actual bottom line earnings per share growth. However, the expectations of growth were stronger in other parts of the market last year. So, the question is: to what extent do those high growth expectations translate into reality? We are comfortable with the trajectory of our businesses, even if growth rates were to slow. We believe a portfolio containing compelling growth numbers – and more certainty around that growth – coupled with attractive valuations is well placed for 2025. So, we are encouraged by the environment for quality. Investors who execute correctly on buying businesses that have realisable growth – not the promise of growth - on reasonable valuations, with low funnels of uncertainty should benefit in this environment.

General risks. All investments carry the risk of capital loss. The value of investments, and any income generated from them, can fall as well as rise and will be affected by changes in interest rates, currency fluctuations, general market conditions and other political, social and economic developments, as well as by specific matters relating to the assets in which the investment strategy invests. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Past performance is not a reliable indicator of future results. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

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