Value Partners
Since 1993

December 2024

2025 Market Outlook

Navigating Cross-currents:

Identifying opportunities amid conflicting forces in 2025

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Contents

Review of Market Performance 4

Asia Investment Outlook:
Key Investment Themes 6

Asia Investment Outlook:
Equities 12

Asia Investment Outlook:
Fixed Income 14

Summary:
Asset Allocation Views 2025 16

Review of Market Performance

Although inflationary and recessionary concerns in the US abated in 2024, investors continued to grapple with various uncertainties affecting global markets, including the US Fed's rate-cut path, the outcome of the US presidential election in November, escalating geopolitical concerns in the Middle East, and growth concerns in China.

Nevertheless, Asian financial markets proved to be resilient during the year, although performance was uneven across different markets (Figure 1).

Figure 1: Performance of Asian equities and fixed income markets

Key indices	YTD performance (end-Nov 2024)
MSCI AC Asia ex-Japan	11.79%
MSCI China	16.29%
MSCI China A Onshore	12.64%
MSCI Taiwan	28.84%
MSCI Korea	-17.36%
MSCI ASEAN	12.18%
MSCI India	14.57%
JPM Asia Credit Total Return Index	6.57%

Source: Bloomberg.

Within the equities markets, China's performance came as a positive surprise to many investors. Various supportive measures announced during the second half of the year, which targeted monetary policy, the property market, and capital markets, largely surpassed expectations and overshadowed ongoing economic concerns.

Meanwhile, Taiwan's market remained strong, boosted by its technology leaders as they continued to see robust demand for artificial intelligence (AI)-related hardware and applications. However, the same could not be said by its tech-heavy counterpart, South Korea, indicating that investors may have put too much hype on the AI theme. In addition, South Korea's highly anticipated "Value Up Program" stalled during the year, leading to some disappointment for investors.

In Southeast Asia, although the markets were largely impacted by uncertainties in the US, especially how the greenback affected local currencies, most markets remained resilient, supported by strong domestic demand and favorable demographics. Similarly, India continued to deliver positive returns as its long-term growth story remained intact despite the already high valuations relative to its regional peers.

Meanwhile, there was also a constructive tone within Asia's fixed income markets. Asian investment grade bonds continue to have solid credit profiles, backed by corporates' strong balance sheets and cashflows, as well as good access to funding. At the same time, the high yield market benefited from easing monetary policies, given the lower funding costs and refinancing options. The market has structurally changed and has become more diversified as the weighting of Chinese properties within the high yield sector has reduced significantly in the past few years.

Overall, despite the various market and economic uncertainties of 2024 continued to linger worldwide, Asia's financial markets remained robust. However, as some of the key concerns in 2024 may have diminished, new challenges and risks are on the horizon. Vigilance will continue to be essential in this evolving landscape, where emerging economic and geopolitical factors could impact financial markets. Staying alert and adaptable will be key to navigating this new era.

Asia Investment Outlook:
Key Investment Themes

1) Trump 2.0 – A boon or bane for Asia?

Following Donald Trump's win as the US president, we expect his policies to revolve around trade policy uncertainty, including higher tariffs on imports, deregulation, and tax cuts. These could lead to higher inflation and higher-for-longer interest rates in the US, as well as a stronger dollar.

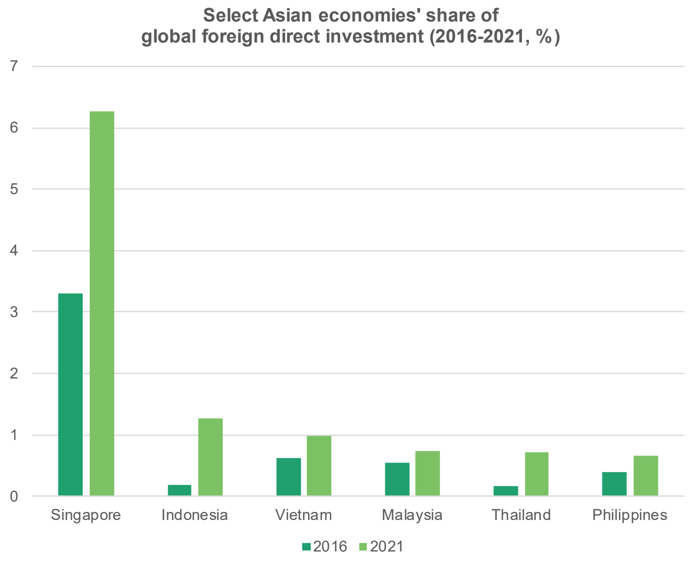
We outline below several key scenarios under this environment:

A boon for Asia:

For China, although Donald Trump's tariffs would negatively impact the country's sizable export segment, Chinese policymakers could exceed expectations on fiscal and monetary stimulus in 2025, especially given the government's clear messages in 2024 in boosting the economy. These measures shall aim at offsetting the impacts of Trump's tariffs and help the domestic economy. This has happened before during Trump's first term as president when the China-US trade frictions started in 2018. At the time, Chinese policymakers rolled out measures to support weak exports and domestic demand.

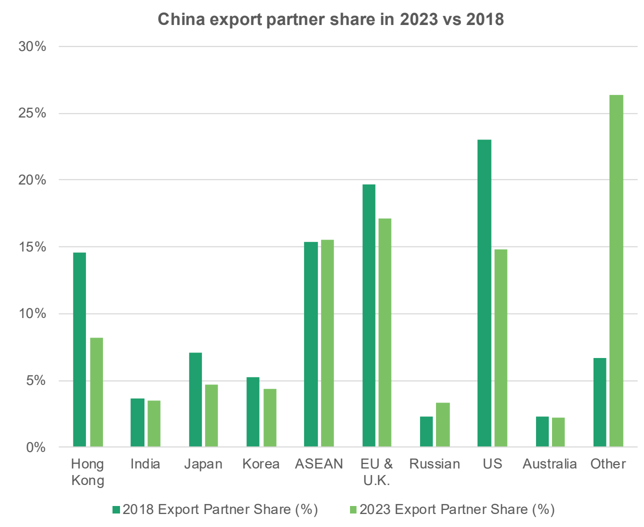
At the same time, Trump's assertive position towards China may accelerate the supply-chain diversification or the "China-plus-one" strategy (e.g., adding manufacturing bases in other countries besides China). This could potentially be positive in Southeast Asia, where certain markets have competitive production and labor costs (Figure 2). In addition, China's export exposure to various markets has become more diversified, with more than 40% of exports going to other emerging markets, including Asia (Figure 3). Hence, the impacts of the increase in tariffs might not be as harsh as many had thought.

Figure 2: Many ASEAN economies have become hot destinations for investments



Source: CLSA, UNCTAD, March 2023.

Figure 3: China's exposure to other markets have become more diversified



Source: CEIC data.

Alternatively, Trump may come to the table to negotiate trade, such as the US-China Phase One trade deal signed in 2020, which allowed both countries to grant various tariff exemptions on select goods. A surprise deal like this should be a positive surprise for the market.

A bane for Asia:

Another scenario that investors should monitor is that in addition to hard tariffs imposed on China, Trump also slaps tariffs on goods produced from other Asian countries that have China as part of their supply chain or value-added. Export-oriented economies, which make up a large portfolio of the Asian equity market, would suffer under this scenario as investors cut back on valuations of the market.

Additionally, Trump's tariff policies would lead to higher inflation in the US and, therefore, a stronger US dollar, which tightens the room for further monetary stimulus by central banks in Asia.

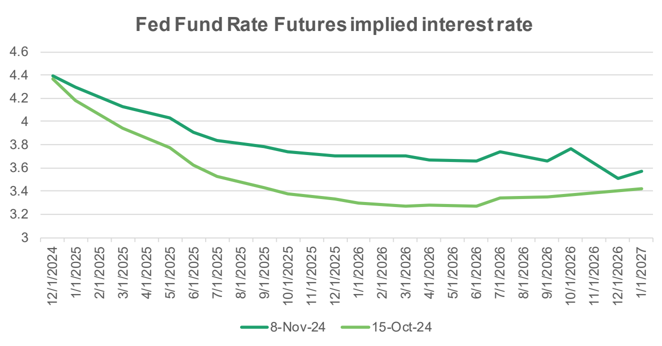
Although the higher degree of uncertainty may lead to more market volatility in 2025, opportunities remain in the Asia market. Market valuations remain cheap relative to many other markets, especially in the US, and global investors continue to be under-allocated in the region. While a strong policy response from Asia to offset any negative impacts from policy changes in the US warrants a cautiously optimistic outlook for Asian assets, a strong focus on security selection could generate good returns and at the same time manage risks.

2) Monetary policy – a waning tailwind

Monetary policy was seen as a tailwind for Asian markets in 2024, especially following the US Fed's larger-than-expected 50 basis point rate cut in September. This should give Asian central banks room to ease monetary policy to support their economies, and the weaker US dollar and lowered interest rates in the US should also lead to more inflows into Asia.

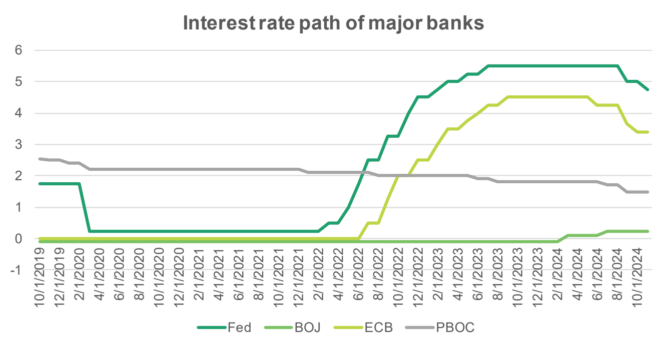
However, although inflation has moderated, it is expected that Trump's policies could be inflationary, limiting the room for the Fed to materially loosen further. Additionally, the strong US economic and inflation data has added uncertainty to the extent of the rate-cut path, with investors already cutting back their expectations on rate cuts for 2025 (Figure 4).

Figure 4: Expectations for Fed Fund Rate Futures have changed following Trump's win



Source: Value Partners, Bloomberg, as of November 2024.

Figure 5: Interest rate path of major banks (%)



Source: Bloomberg.

We note that this waning tailwind scenario does not lead to an all-out gloomy outlook for Asia. Inflation dynamics across Asian economies are different, and several factors may offset the impact of higher-for-longer rates in the US. For example, economies that are more exposed to commodity prices, particularly importers, should see a counter-balancing effect if oil prices drop (Trump may push oil prices down to control inflation, as he has done previously during his first term). Meanwhile, although rising tariffs might put pressure on export-oriented economies, some of them might be more willing to allow their currencies to weaken in an attempt to offset this impact. This might allow a little more room for Asian economies to be more flexible on their monetary policies versus a situation where central banks would focus on managing the depreciation of their local currencies.

Meanwhile, companies in Southeast Asia, especially those in the Philippines and Indonesia, are less impacted by trade-related policies as they have less revenue exposure to the US compared to other markets, given their focus on catering to their respective domestic consumers. Sectors within Asia that are also heavily dependent on domestic growth, such as telecommunications, financials (especially insurance), and utilities, are also most likely immune from trade policy uncertainties.

At the same time, we believe the path of a rate cut, albeit with a slower pace, shall remain supportive for the Asian fixed income market.

We continue to be constructive for Asia Investment Grade (IG) bonds, given their attractive all-in yield. Asia IG bonds' yield of 5.4% at the index level remains high on a historical basis (Figure 6). They remain a good choice for both income and diversification in the portfolio, with low underlying credit risks.

The overall loosening monetary landscape shall also support risky assets. Asian HY (High Yield) corporates will benefit from lower funding costs, as well as easier onshore and offshore refinancing options, which should strengthen their credit profiles (Figure 7). With a stabilizing credit outlook, improved sector diversification, and expectations of lower default rates, we see some room for Asia HY credit spreads to tighten. Attractive carry and spread compression shall keep total returns at decent levels. Our themes on credit selection remain with those issuers demonstrating their ability to improve their credit profiles via earnings growth and deleveraging. We are constructive on selective issuers in Japan, Hong Kong, Indonesia and India.

Figure 6: Asia IG bond offers attractive yield, portfolio diversification with low underlying credit risks

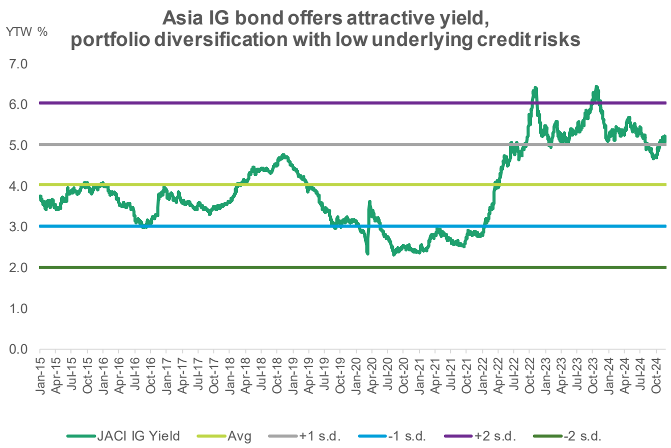
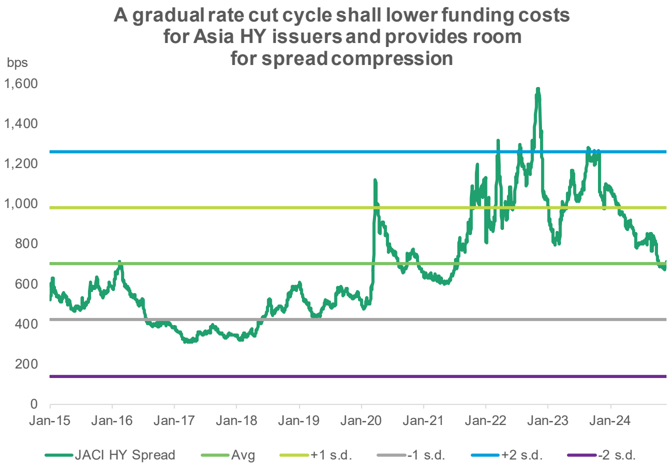


Figure 7: A gradual rate cut cycle shall lower funding costs for Asia HY issuers and provides room for spread compression



Source: JPM, Bloomberg.

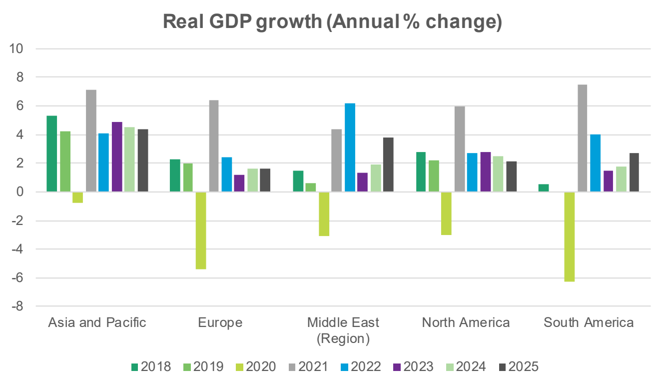
3) Economic growth – sustained growth from fiscal expansion, but risk of deceleration remains

Economic growth in Asia should remain supported. Despite a slowdown in Europe, the US economy remains robust, supported by consumer spending, a strong job market, and solid wage gains. In addition, the expected fiscal expansion through tax cuts under Trump's administration should further support the US economy.

In Asia, although the Chinese economy has been a key concern in the past few years, we expect that fiscal expansion, together with other targeted measures towards consumption and the real estate sector, will come into effect in the coming quarters and support the economy. China will likely continue to target a relatively ambitious growth target of about 4-5% in 2025, and with the potential impact of the expected tariffs from the Trump administration, policy support could expand further. We expect the focus of the stimulus will come from the fiscal side, as any significant expansion in monetary policy could lead to a deprecation of the renminbi, increasing the risks of capital outflows.

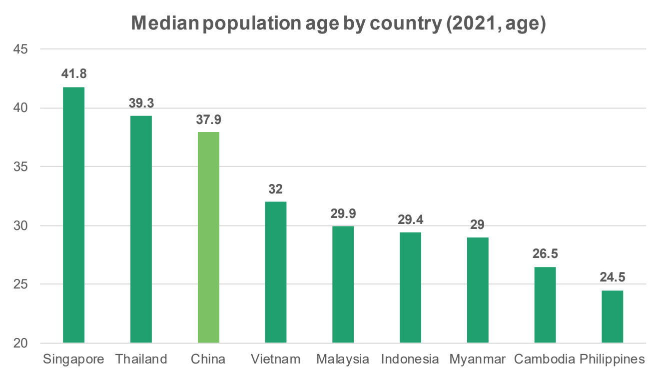
Overall, economic growth in Asia remains robust compared to the rest of the world (Figure 8). The long-term prospects remain intact in the region, especially in markets where domestic demand is strong and demographics remain attractive, such as in Southeast Asia and India (Figure 9).

Figure 8: Economic growth in Asia remains robust vs the rest of the world



Source: International Monetary Fund.

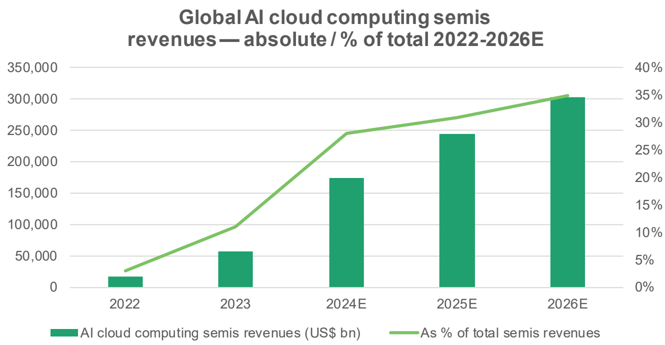
Figure 9: Southeast Asia markets continue to have favorable demographics



Source: CLSA, UNCTAD, March 2023.

Separately, we view the growth support coming from AI-development, which was a key driver globally in 2024, will likely slow, especially going into the second half of 2025 (Figure 10). Other growth drivers will, therefore, have to take the baton, or else we are likely to see some deceleration.

Figure 10: AI cloud computing revenues are expected to moderate in the coming years



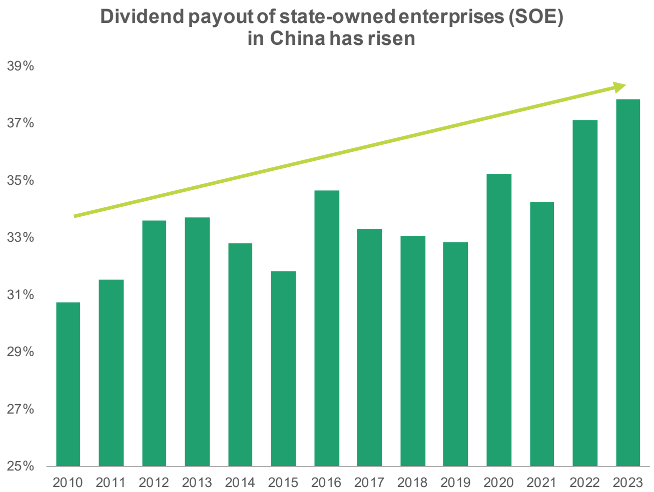
Source: SIA, UBS estimates.

4) Bracing for volatility – embrace value and dividends; actively manage duration and credit risks

In an environment of higher-for-longer rates in recent times, value as a style has performed better, and we expect the same in the impending market landscape despite the rate-cut cycle has begun in 2024. The high probability of tariffs and trade tensions also calls for focusing on domestically focused sectors, which are likely better shielded against volatility caused by geopolitical risks and events. For example, in terms of markets, ASEAN companies, especially those in the Philippines and Indonesia, are less impacted by trade-related policies as they have less revenue exposure to the US compared to other markets, given their focus on catering to their respective domestic consumers. Sectors within Asia that are also heavily dependent on domestic growth, such as telecommunications, financials (especially insurance), and utilities, are also most likely immune from trade policy uncertainties.

We would like to note that equity dividend strategy remains relevant when investing in Asia. The dividend strategy in China, in particular, is supported by the structural trends and reform policies. These include Chinese investors diversifying their portfolios away from property investments towards alternative income sources, government policies aimed at enhancing overall shareholder returns (such as measures that promote dividend distributions), and the ongoing development of the country's private pension industry. Collectively, these are anticipated to provide robust support for dividend investing in China in the decades to come.

Figure 11: Dividend as a theme will continue to be in favor for domestic China



Source: Value Partners, Bloomberg, as of August 2024.

Asia Investment Outlook: Equities

As the current market environment and risks have varying impacts on markets, we have listed down our more detailed out for the various equities markets in Asia:

China/Hong Kong

While the direction of government support toward the economy remains clear, the next round of stimulus is expected to be announced in 2025. We believe more stimulus will support growth, consumption, and stabilize the property market in the first half of 2025. That said, investors will likely be defensive in the near term amid rising concerns of heavy tariffs on China.

We expect Hong Kong-listed equities, particularly those that are rate-sensitive, to be under pressure in the near term, given the uncertain US rate-cut path for 2025. As a result, A-shares will be favored more over offshore-listed equities, although their valuations are more expensive.

Overall, the Chinese equity market will gradually recover in 2025 as earnings will likely bottom with a lower base effect. A deal coming out from Trump and Chinese president Xi Jinping, such as in the case in Trump's previous term, should also be an upside surprise for the market.

Taiwan

We remain constructive about the tech-heavy market of Taiwan, as the AI/chip cycle is expected to continue to grow – at least in the first half of 2025. Although valuations are at the higher end, companies are supported by strong fundamentals. While tariffs from the US will have some impact on Taiwanese exporters, the more important concern is restrictions on exporting to China, as most of the tech companies in Taiwan have higher exports to China than to the US.

South Korea

South Korea will likely be range-bounded as its auto exports may be affected by US tariffs. In addition, the memory cycle outlook remains challenging, as the cycle seems to be nearing its peak. Also, with the Fed pushing out the likelihood of further rate cuts, it will become more difficult for South Korea to cut interest rates to support its economy.

Japan

The strong US dollar helps Japanese equities as the Japanese yen will weaken. However, the potential tariff threat may offset this effect. The weak support of the Prime Minister (although being re-elected) may cause policy uncertainties on tax and economic reforms. That said, the Bank of Japan (BOJ) will be more cautious in hiking interest rates.

South Asia (ASEAN + India)

Countries with strong domestic growth, such as India, will be more muted from the tariff threat. However, with the uncertainty in the US rate cut path, Southeast Asian countries that need to cut interest rates to support their economies would find themselves in a more difficult situation if US rates stay higher for longer. On the other hand, more and more Chinese companies may start some manufacturing activities in Southeast Asia in order to avoid potential tariffs.

Asia Investment Outlook: Fixed Income

Below is our more detailed outlook for the various fixed income markets in Asia:

China

The easing stimulus might not be a direct game changer for the economy, but the combined forceful monetary and fiscal policies may help avoid further growth downside. The housing destocking cycle is also a long-drawn process that requires coherent and effective cooperation between the local government and banks, as well as sizable financial support to normalize high inventories, which currently stand at 30 months versus a healthy norm of 15 months. The path to reflation, to a large extent, will hinge on the speed of execution.

The possibility of a rate cut in China remains high in 2025, given slow growth and deflationary pressures. With the US Fed's pivot, we believe the People's Bank of China (PBOC) could ease monetary policy further, but there may be an upside on the Chinese government bond (CGB) yield, given the rising funding needs for fiscal stimulus in the medium term. The general low rate set-up should benefit Chinese investment grade corporates by allowing them to obtain cheaper onshore financing. Credit spreads of their offshore bonds trended lower for most of 2024 and are on the tight side given the limited dollar bond supply.

Japan and Australia

Australia has very robust institutional and policy frameworks that mitigate potential risks of economic and financial stability. Key banks' common equity tier 1 (CET1) ratios, which compare a bank's capital against its assets, are well above the regulatory requirement, leaving plenty of buffer to withstand any stress.

In Japan, the BOJ's normalization of monetary policies should be positive for banks' profitability, on top of their strong asset quality and stable capital. Megabanks have limited exposure to US commercial real estate and have a strong buffer against regulatory minimums.

Japan and Australia investment grade bonds help expand the Asia bond universe and provide diversification benefits. In addition, their solid fundamentals support technicals.

Macau

Macau gaming operators have maintained good earnings performance since the border reopening. At the operators' level, most have recorded positive free cashflows as capex has stabilized, which should facilitate further deleveraging. We expect higher visitor arrivals and tourism activities going into 2025, further supporting operators' earnings profiles.

While we view bond valuations for Macau gaming bonds are demanding, the improving fundamental trends and limited bond supply make the sector a good carry and diversification play within the Asia high yield universe.

India

Strong economic growth and a stable macro backdrop create a goldilocks phase for India. Broad policy continuity and a softening of oil prices on slower global growth are tailwinds. India should be relatively less exposed to US tariff risks, given that it is less export-oriented and more domestically focused.

The space is dominated by non-bank finance companies (NBFCs) and renewables. NBFCs will continue to play an instrumental role in fulfilling India's credit needs. Although NBFCs' overall funding costs are modestly rising, the robust credit demand will support the sector's profitability and loan growth. This, together with adequate capitalization, shall help offset asset quality headwinds in certain loan sectors and more stringent regulatory controls, the latter of which shall help provide a more healthy operating environment going forward.

We are largely neutral on Indian high yield bonds, given their fair valuations and potentially more bond supply. Any consolidation in this space would present some investment opportunities.

Indonesia

We believe Bank of Indonesia has some room to cut its policy rate further, given the lower inflation outlook and the need to boost economic growth. Indonesia's consumption growth maintains its positive momentum. The country continues to promote loan growth, which is expected to reach 10-12% for the full year of 2024. We believe this creates a positive backdrop for offshore bond issuers as they can benefit from lower onshore funding costs and have alternative funding channels for refinancing.

We stay constructive on Indonesian high yield bonds, given strong onshore bank support, good carry, and scarcity value.

Summary
Asset Allocation Views 2025

Asset class	Action	6-12 month views
Equities		
US	▶	• Donald Trump's policies will likely focus on tariffs, deregulation, and border control before tax cuts, as the Tax Cuts and Jobs Act of 2017 will expire in December 2025. As these policies are inflationary, the US Fed will likely pause interest rate cuts in the first quarter to at least monitor developments in the new administration. • Hence, interest rates are expected to be maintained around the current levels for some time, favoring value more to growth, as value sectors benefit from the steepening yield curve and regulation. • With high valuations, the US market is expected to be ranged-bound in the first half of 2025 as investors monitor the impacts of policies.
Europe	▼	• The potential tariffs from Trump will add pressure to European economies, given their already weak situation. • Additionally, Trump will likely demand Europe to increase their funding support to Ukraine. Political instability will also continue to drag sentiment.
Japan	▶	• A strong US dollar supports Japanese equities as the yen weakens. • However, potential tariffs may offset this effect.
North Asia (ex-Japan)	▲	• The Chinese government is very clear that it will support the economy, with expectations of more stimulus in the first half of 2025. • Earnings are likely bottoming with a lower base effect, and the Chinese equities market may see a gradual recovery in 2025. • In Taiwan, the AI/chip cycle will continue to grow at least in the first half of 2025, and companies are supported by strong fundamentals. • In South Korea, however, the market may be negatively impacted by the challenging memory cycle outlook.

▲ *Add exposure* ▶ *Remain the same* ▼ *Reduce exposure*

Source: Value Partners, November 2024.

Asset class	Action	6-12 month views
South Asia	▶	• Markets with strong domestic growth are more muted from tariff threats. • However, the uncertainty in the US rate-cut path does not bode well for Southeast Asian markets that need to cut interest rates to support their economies. • On the positive side, more Chinese companies potentially look at Southeast Asia as a manufacturing base to avoid potential tariffs.
Other emerging markets	▼	• Geopolitical risks remain highly uncertain, given the escalating situations in the Middle East, Russia, Ukraine, and North Korea. • In the near term, the strong US dollar and lower oil prices will not be favorable for emerging markets.
Bonds		
Asian investment grade	▶	• Asia IG's solid credit profile is backed by corporates' strong balance sheets and cashflows, as well as good access to funding. They are also well-positioned to navigate any economic turbulence. An expanded APAC bond market in the IG space, including Japan and Australia, offers even more country diversification benefits, and tends to exhibit a more stable credit profile. We like Asian financials, Japanese lifers, and Indonesian quasi issuers. US Treasury is the key driver for performance, given the tight credit spreads.
Asian high yield	▶	• With a stabilizing credit outlook, improved sector diversification, and expectations of lower default rates, we see a good value proposition in Asian HY bonds heading into 2025. Attractive carry and spread compression are drivers for bond performance. We are selective on issuers in Hong Kong, Indonesia, and India, which are relatively less exposed to trade-related risks.
Emerging markets bond	▼	• Geopolitical risks remain highly uncertain, given the escalating situations in the Middle East, Russia, Ukraine, and North Korea.

▲ *Add exposure* ▶ *Remain the same* ▼ *Reduce exposure*

Source: Value Partners, November 2024.

Asset class	Action	6-12 month views
Alternatives		
Real estate	►	• As global growth will likely be resilient in 2025, real estate prices should remain stable, and the risks surrounding commercial real estate should be contained. • However, a slower interest rate-cutting cycle will dampen the relative attractiveness of the asset class.
Gold	▲	• Gold prices will likely consolidate in the near term as money flows from gold to cryptocurrencies amid expectations of deregulation on crypto by Trump. • However, in the longer term, heightened geopolitical risks will continue to support the outlook for gold as it remains a safe-haven asset. • In addition to geopolitical risks, investors are concerned about the de-dollarization trend as BRIC countries are developing a new payment system.
Base metals	►	• Base metals could be a hedge against Trump's inflationary policies. However, a strong US dollar may offset some of this effect. • Investors would need to be selective on base metals. Those with balanced demand and supply, such as copper, are preferred. • A slower demand from China in 2025 is a key risk factor to monitor.
Oil	▼	• The outlook for oil is negative under Trump with deregulation, as he is expected to push the oil price down to control inflation–an action he has done during his first term.

▲ *Add exposure* ► *Remain the same* ▼ *Reduce exposure*

Source: Value Partners, November 2024.

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