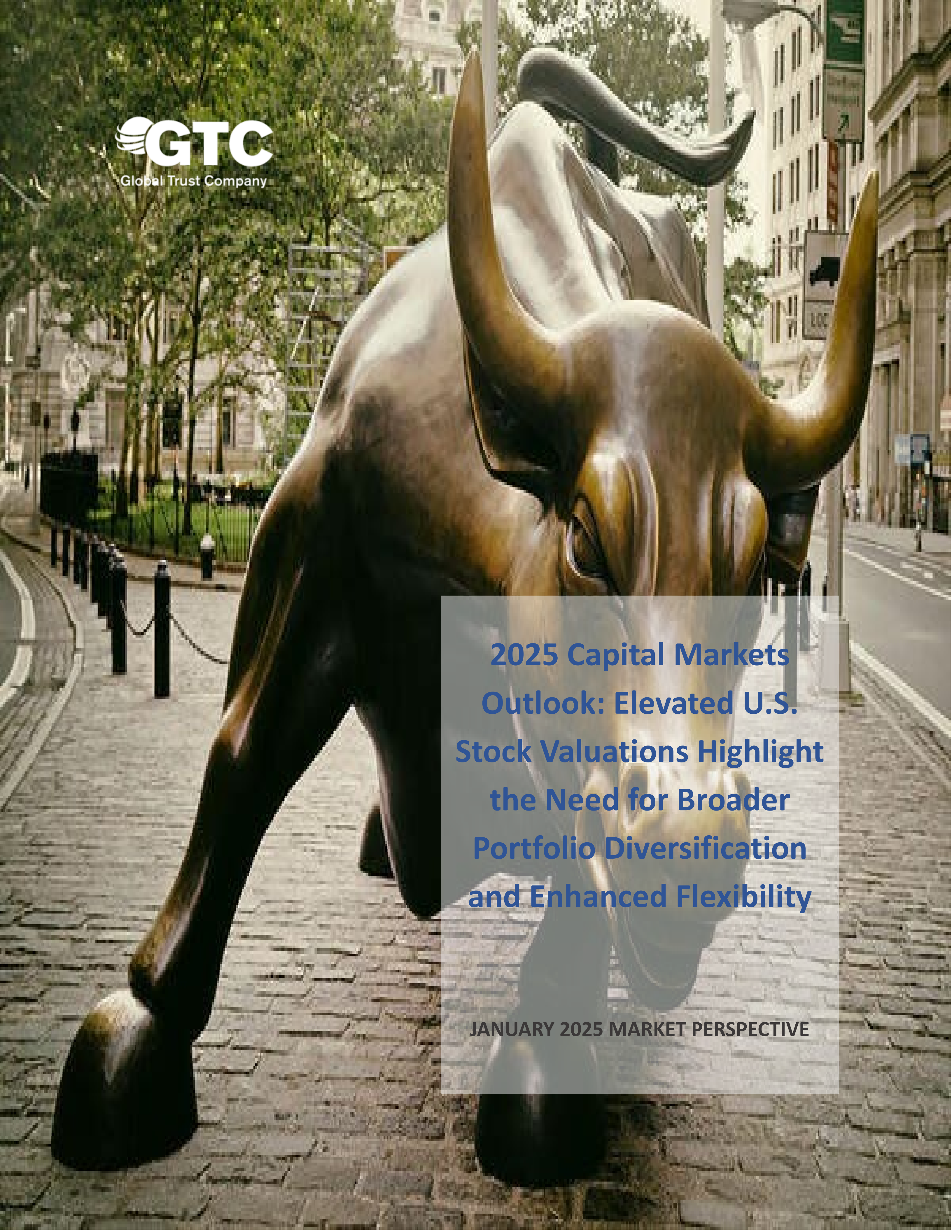


Global Trust Company

2025 Capital Markets Outlook: Elevated U.S. Stock Valuations Highlight the Need for Broader Portfolio Diversification and Enhanced Flexibility

JANUARY 2025 MARKET PERSPECTIVE

2025 Capital Markets Outlook: Elevated U.S. Stock Valuations Highlight the Need for Broader Portfolio Diversification and Enhanced Flexibility

Key Takeaways

- ✓ **Higher rates favor fixed income:** Rising interest rates offer improved yield opportunities, providing both return and downside protection.
- ✓ **Diversification is crucial:** High equity valuations necessitate global diversification across asset classes, regions, and sectors to mitigate concentration risks and optimize returns.
- ✓ **Alternative investments enhance returns:** Real assets, private equity, and private credit offer diversification benefits and attractive return potential.
- ✓ **Adopt a flexible strategy:** A dynamic portfolio allocation approach enables investors to respond effectively to changing market conditions and capitalize on short-term opportunities.
- ✓ **Long-term focus remains essential:** Despite short-term volatility, maintaining a disciplined, long-term investment strategy will be critical for achieving sustained growth and stability.

As we step into a new economic era shaped by shifting monetary policies, technological advancements, and evolving global geopolitical dynamics, investors face a landscape of both challenges and opportunities. This *Perspective* aims to provide insights into the future of capital market returns, with a focus on how sophisticated investors can navigate this environment effectively. Key themes will include the implications of higher interest rates on fixed income, the necessity of diversification amid lofty stock valuations, the increasing importance of alternative investments, and the value of remaining flexible and dynamic in portfolio management.

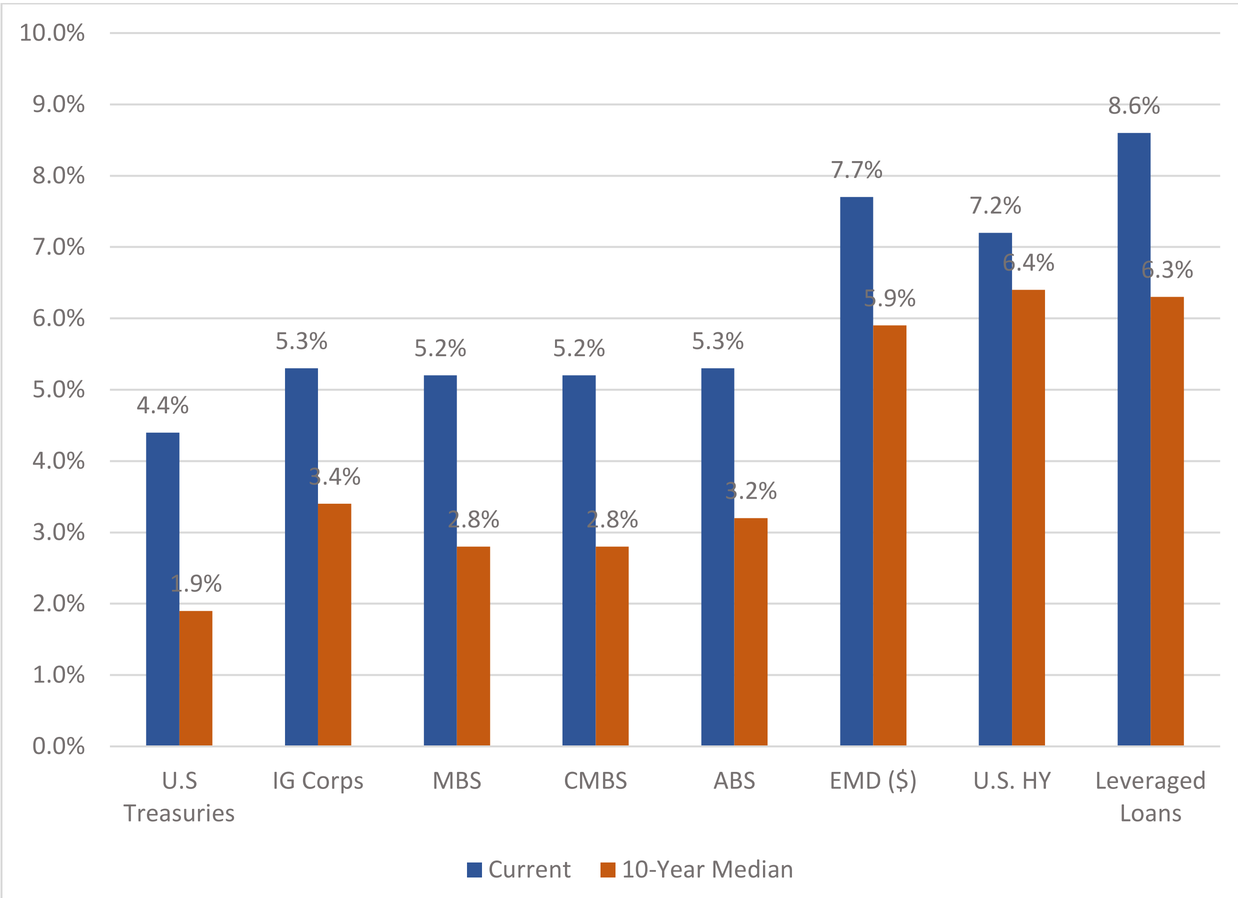
Higher Rates: A Boon for Fixed Income

Recent years have witnessed a significant shift in monetary policy, with central banks around the world raising interest rates to combat inflationary pressures. This monetary tightening has driven bond yields to levels not seen in over a decade. While the initial reaction was market volatility, this environment now presents a favorable outlook for fixed income investments.

Higher yields mean investors can now access more attractive income streams without taking on excessive credit risk. Government bonds, particularly U.S. Treasuries and investment-grade corporate bonds, offer compelling opportunities. Emerging market debt, particularly from countries with sound fiscal policies, also presents an attractive option for income-seeking investors looking for higher yields and potential currency appreciation.

Moreover, as inflation expectations stabilize, the real returns on fixed income are projected to be robust. Allocating to bonds not only provides steady income but also offers downside protection in the event of equity market volatility, reinforcing their role as a cornerstone of balanced portfolios.

Exhibit I: Yield-to-worst across fixed income sectors



Source: J.P. Morgan Asset Management. As of 12.31.24

Lofty Stock Valuations Demand Diversification

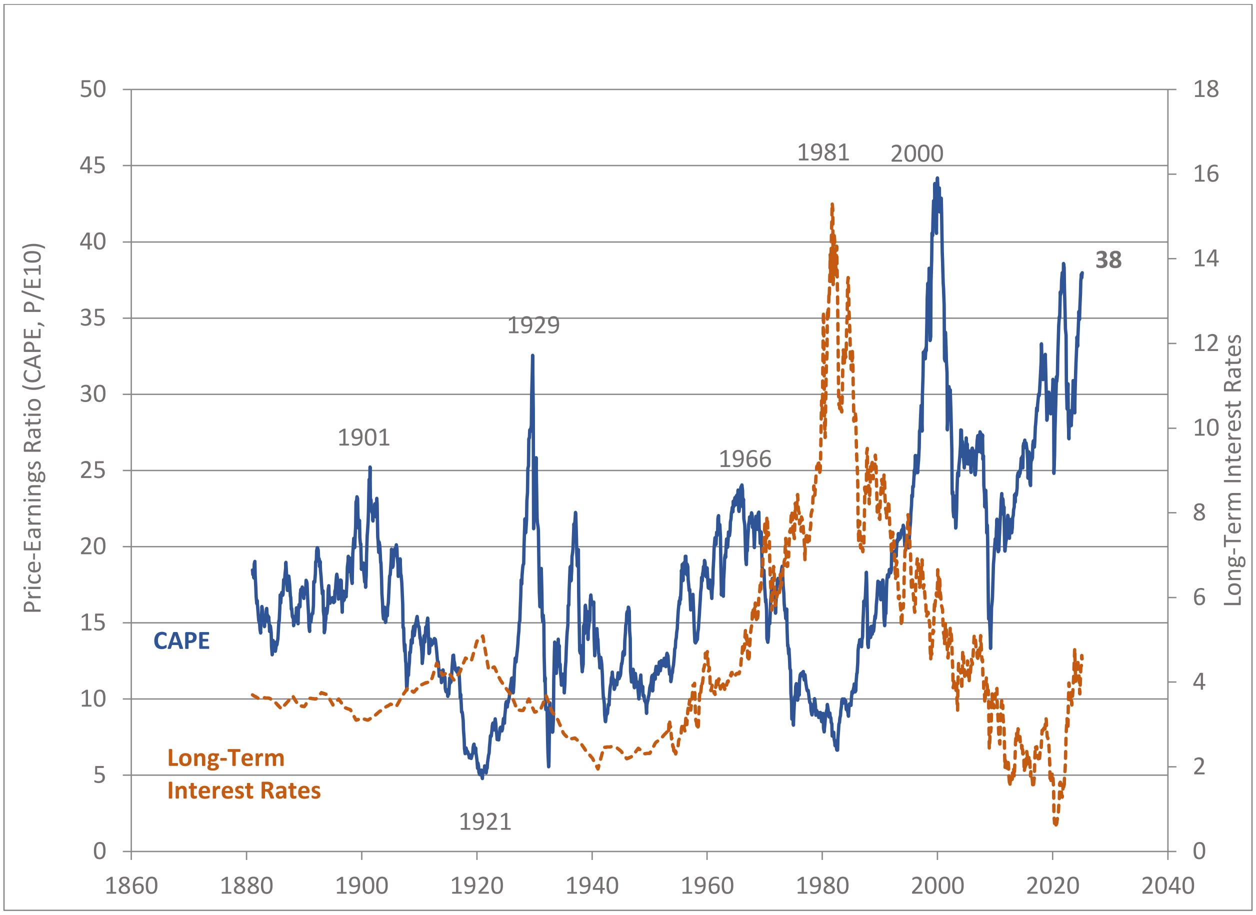
U.S. equity markets are currently experiencing historically high valuations. Metrics such as the cyclically adjusted price-to-earnings (CAPE) ratio are at levels comparable to previous market peaks, such as the dot-com bubble and post-pandemic rallies. These elevated valuations raise questions about the sustainability of future returns, especially as economic growth projections remain modest.

A renewed focus on diversification can mitigate risks associated with these lofty valuations. Allocating capital to non-U.S. equities—particularly in developed markets such as Europe and

Japan—offers the potential for attractive returns, supported by favorable valuations and stronger dividend yields. Emerging market equities, despite recent underperformance, continue to offer compelling growth opportunities, driven by favorable demographic trends and technological adoption.

Sectoral diversification within equities is also critical. While technology and large-cap growth stocks have driven much of the recent market rally, sectors such as financial, industrials, and energy present attractive long-term growth potential.

Exhibit II: Cyclically adjusted price earnings ratio (CAPE)



Source: Robert J. Schiller, Yale School of Management

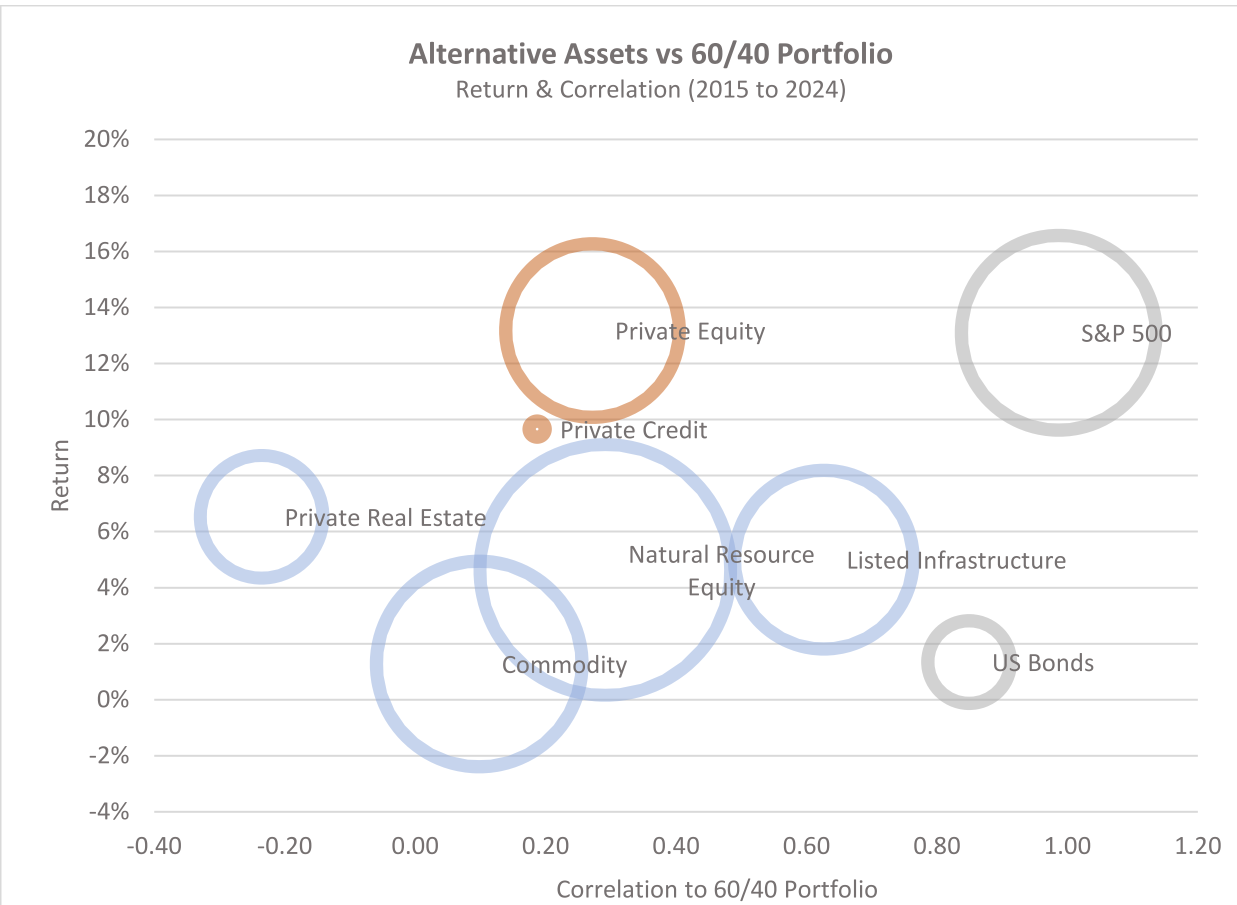
The Role of Alternative Investments

As traditional asset classes face heightened valuation risks and yield compression, alternative investments are increasingly essential in constructing resilient, high-performing portfolios. Real assets—such as infrastructure, commodities, and real estate—provide not only inflation protection but also uncorrelated returns that can stabilize portfolio performance during market volatility.

Infrastructure investments, in particular, stand to benefit from increased government spending on energy transition projects and digital infrastructure. Commodities offer a hedge against geopolitical risks and supply-chain disruptions, while real estate investments can provide stable cash flows and capital appreciation potential.

Private markets, including private equity, private credit, and venture capital, are also gaining traction among retirement plan investors. These markets offer higher potential returns due to their illiquidity premium and reduced correlation with public equity markets. Investors can unlock opportunities in high-growth sectors like technology, and healthcare.

Exhibit III: Diversifying beyond traditional stocks and bonds



Source: eVestment

Flexibility and Dynamism: The Keys to Modern Portfolio Management

The current economic environment demands a more agile approach to portfolio management. A static, one-size-fits-all asset allocation strategy may no longer be sufficient in an era marked by rapid technological change, evolving geopolitical landscapes, and shifting macroeconomic dynamics.

Being dynamic involves continuously monitoring market conditions and adjusting portfolio allocations in response to evolving risks and opportunities. Tactical asset allocation strategies, which involve making short-term shifts in asset allocation to exploit market inefficiencies, can enhance returns without sacrificing long-term investment goals.

Factor-based investing also offers a systematic approach to capturing market anomalies and managing risk. Factors such as value, momentum, quality, and low volatility have historically offered diversified return streams that can complement traditional asset class exposures.

Regular portfolio rebalancing ensures that allocations remain aligned with investment objectives, particularly during periods of market volatility. By systematically adjusting exposures, investors can lock in gains from outperforming assets while maintaining the risk profile of their portfolios.

Conclusion

Navigating the evolving landscape of capital markets requires a nuanced understanding of global economic shifts, market valuations, and asset class dynamics. Higher interest rates present favorable conditions for fixed income, offering both income generation and downside protection. Elevated stock valuations underscore the importance of diversification across geographies, sectors, and asset classes.

Alternative investments, particularly real assets and private markets, provide attractive opportunities for enhanced returns and risk mitigation. Finally, maintaining flexibility and adopting a dynamic investment strategy will be key to optimizing portfolio outcomes in this ever-changing market landscape.

Investors who embrace diversification, stay informed, and remain agile in their portfolio management strategies will be well-positioned to thrive amid the uncertainties and opportunities of the years ahead.

Exhibit IV: Global Trust Company 10-year estimated capital market return forecast

Asset Class	10-year estimated total return (%)
U.S. Cash	3.5%
U.S. Core Bonds	4.9%
High Yield Bonds	6.0%
Emerging Market Bonds	6.1%
U.S. Equity	6.4%
International Equity	7.6%
Emerging Market Equity	7.6%
Public Real Estate (REITs)	6.5%
Inflation-Protected Securities (TIPs)	4.4%
Commodities	5.9%
Private Real Estate	6.1%
Private Credit	8.7%
Private Equity	10.0%

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