



OUTLOOK

2025

TIME TO DELIVER

 **BARCLAYS** | Private Bank

Contents

Foreword	3
2025: time to deliver	4
Can the US stay in top gear?	5
Eurozone: a mild recovery?	7
Is China having its 'big bazooka' moment?	9
UK: a new paradigm?	11
A time for selectivity and quality amid shifting tides	13
Adapting to the yield cycle	18
Is AI (b)reaching its limits?	22
Material E, S and G factors in 2025	27
Is 2025 the time to decarbonise your portfolio or the planet?	33
Making sense of things	37
Multi-asset portfolio allocation	40
Key dates	41

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Foreword

Welcome to our “Outlook 2025”, the investment strategy update from Barclays Private Bank. In the following chapters, we look at what the growing pace of rate cuts by US and European central banks might mean for bonds and equities in 2025.

With around half the world heading to the polls this year, we also examine just how much of an effect election results could have on prospects for financial markets.

And beyond our in-depth asset class and financial market analysis, we highlight AI's potential impact on portfolio returns, and what investors should position themselves for in 2025, given climate change and specific ESG risks.

As always, we hope you enjoy the articles, and we thank you for entrusting us with your investments.

Jean-Damien Marie
Global Head of Investments, Private Bank & Wealth Management



In memoriam
Henk Potts
1973-2024



2025: time to deliver

For all that investors have had to digest in 2024, many equity markets performed well. With the US election out of the way and inflation, and interest rates, heading lower, will 2025 be just as fruitful?

What a last 12 months. A contentious US election, plus many more votes to boot, continued tensions in the Middle East and on trade, and central banks in rate-cutting mood.

While the period might have offered a few answers, many questions have opened up. Can the US Federal Reserve deliver a 'soft landing'? How much of a difference will China's stimulus package really make? Will companies match the elevated earnings' growth expectations? Is artificial intelligence (AI) actually going to boost productivity much?

The strong equity market performance and further tightening in credit spreads seen in 2024 suggest that investors are banking on a scenario where most of these questions are answered in the affirmative. The result of this optimism is that some of the returns initially expected to materialise in 2025, may have already occurred. In this context, and with a global economy that is unlikely to generate much better gross domestic product growth, a period of lower returns probably lies ahead.

OPPORTUNITIES IN 2025

That said, there are always opportunities, for those who know where to look. Whether it's a broadening of the equity rally, or 'carry' and relative-value trades in fixed income markets, most of the action will likely take place in specific sectors or companies, rather than at the index level, in 2025.

Risks are numerous, though. Politics and geopolitics won't suddenly create less noise, and central banks are walking a tightrope in trying to land their respective economies softly, without falling into recession. Investors will need to stay nimble, broaden their universe and embrace diversification.

Then there is AI, perhaps the term of the year for investors. The coming months will be critical for delivering on the hype, and its effect on companies' results. In a typical cycle for emerging technology, such as this one, the peak of inflated expectations is usually followed by a trough of disillusionment. To avoid this, companies will have to show clear signs that AI is delivering on its promises. Those that don't, will suffer the consequences.

NAVIGATING THROUGH THE TURBULENCE AHEAD

In such a difficult environment, investors should rely on clear frameworks to guide their investment decisions. It all starts from appropriate planning. When it comes to execution, the key is to avoid succumbing to our biases, and to remain focused on the 'big picture'. Here, a precise analysis of environmental, social and governance (ESG) factors should prove useful.

"With a global economy that is unlikely to generate much better gross domestic product growth, a period of lower returns probably lies ahead"

Every year is challenging for investors, and 2025 won't be any different. Uncertainty has rarely been so high, and wide-ranging. Unfortunately, there is no choice but to embrace it. In this outlook, we don't offer scenario analysis or probability-weighted outcomes. These are of little use in the real world. Instead, find out more about our insights on the global economy, as well as the investment opportunities and themes for the coming year.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist



Can the US stay in top gear?

The US economy continues to outgrow other developed markets, aided by a vibrant tech sector and rate cuts. While many suggested before the election that more tariffs, as promised by Trump, would be inflationary, might US prices fall faster than expected in 2025?

SLOWER BUT STILL STRONG

Once again, the US economy powered ahead in 2024. Indeed, the country is on track to expand the economy by 2.7%, in real terms, this year. By contrast, the consensus among economists expected just 1% growth, back in November 2023.

Sure, 2024 hasn't been plain sailing, with market sentiment swinging between a 'soft landing' and a 'hard' one. While this debate is likely to resurface before long, the combination of supportive fiscal policy and retreating interest rates should underpin more of the same: we pencil in GDP growth north of 2% in 2025, as a base case. Importantly, though, 2024's drivers of growth (the government and consumer spending) are anticipated to slow, with investment spending doing some of the heavy lifting.

One reason for this shift in the growth mix is that US consumers appear to be running on fumes, in particular at the lower end of the income distribution. Indeed, the savings rate remains relatively low (at 4.8%), pandemic-related excess savings have been depleted, and real income growth, although still positive, is likely to slow.

TARIFF UNKNOWNNS

Beyond that, the outlook is rather clouded. Indeed, with a change in leadership at the White House, there could be important policy changes. Whether it's tax cuts, deregulation or new tariffs being imposed, they could all significantly alter the US growth trajectory. It's important to remember that any impact may not be felt in 2025, though.

When it comes to tariffs, president-elect Trump was pretty clear, saying 'tariffs' is "the most beautiful word in the dictionary"¹ and, if he follows through on his promises, much higher import duties could be on the way in 2025. If so, their ultimate impact will depend on the scope and range of them, and any retaliation that may ensue.

US economic forecasts, year on year (%; F =Forecast)

	US		
	2023	2024F	2025F
GDP growth (%)	2.9	2.7	2.1
CPI inflation (%)	4.1	2.9	2.3
Unemployment rate (%)	3.6	4.0	4.1
Gross public debt (% of GDP)	122.7	123.4	125.2
Private consumption (pp*)	2.5	2.6	1.9

* Percentage point (pp)

Source: Barclays Investment Bank, November 2024

Companies, in their ability to pass on and absorb those additional costs, and consumers will also be key deciding factors.

Importantly, though, any tariffs-related inflation shock should be short-lived. Similarly, just as how companies and consumers adjusted after the 'trade war' in Trump's first administration, we would expect the US economy to "move on" within a few quarters, following the announcement of new tariffs.

THE POSSIBLE ROLL BACK OF POLICIES

Another key unknown is the future of existing stimulus packages, such as the Inflation Reduction Act. While some committed capital has already been spent, the majority of it remains to be allocated. Of that, only around a quarter, representing a few hundred billion US dollars, based on some estimates, is likely exposed to a possible roll back.

This is significant, when compared to the large US tech companies' expected investments in artificial intelligence next year alone (close to \$200 billion). However, it is relatively small in the context of US net domestic investments (close to \$1.5 trillion²). Yet, this could have an impact on the country's economic outlook, especially if additional tariffs are implemented.

¹The Guardian, Trump vows to impose tariffs as experts warn of price hikes and angry allies, 15 October 2024

²The St Louis Fed, Net domestic investment database, October 2024

RATE CUTS STILL ON THE AGENDA

In the meantime, the US Federal Reserve (Fed) will probably keep banging away about it being focused on the data, and the data alone, in setting policy. On that note, the uncertainty around US trade relationships could lead to a short-term boom in activity, to pre-empt higher tariffs. Unfortunately, the subsequent hangover may not be pleasant, resulting in lower growth from late 2025.

Meanwhile, employment may slow in the immediate aftermath of the election. Indeed, companies may prefer to adopt a 'wait and see' approach, further compounding the recent declines in in real-time measures of demand for workers. Beyond that, a stricter stance on immigration may 'artificially' support employment, by preventing the labour force from expanding, but also put upward pressure on wages. Overall, however, the Fed is likely to lower interest rates further, at least initially.

“The country is on track to expand the economy by 2.7%, in real terms, this year [2024]”

MORE QUESTIONS THAN ANSWERS

In this highly uncertain environment, economists and investors alike should remain open-minded, acknowledging the wide range of possible economic outcomes. Importantly, as was seen in Trump's initial presidential term, the most obvious consequences of the election result (in this case, the "doomsday" predictions of some, and hopes by others that the oil sector will outperform) may not happen. With that in mind, and while everyone seems convinced inflation will rise; it's tempting to assume that it may, in fact, fall faster than expected in 2025.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist



Eurozone: a mild recovery?

Growth in the bloc, while on the up, might remain subdued. But with the economy on the mend, inflation at last under control and interest rates heading in the right direction, the outlook appears brighter.

Eurozone economic growth is going through a soft patch. Gross domestic product (GDP) is expected to increase by just 0.8% in real terms (that is, after adjusting for inflation) during 2024. However, this subdued performance hides much divergence between countries in the bloc.

In the 'south', Spain stands out, with growth on par with a racy US economy. Meanwhile, core areas, namely Germany and France, have seen a more muted performance, with the former contracting for the second consecutive year, held back by a languishing manufacturing sector. China's economic struggles are partly to blame, but so too is the political uncertainty that followed the inconclusive French election.

Importantly, though, the eurozone's inflation dynamics have been heading in the right direction, down. This allowed the European Central Bank (ECB) to be among the first of the main central banks to start cutting interest rates in 2024. With wage pressures abating, this trend should continue in 2025, with the deposit facility rate likely to be in the vicinity of 2% before the end of that year, closing in on the terminal rate, which we estimate to be just below that figure.

SOME GREEN SHOOTS

At face value, with inflation seemingly under control, this puts the eurozone in a potentially very strong position heading into 2025. In fact, we've seen supportive data, in regards to monetary development, for September, confirming an upturn in household credit creation with an uptick in credit flows to non-financial corporates.

This combination of low inflation, lower rates and a low base, could drive a significant improvement in GDP growth – albeit absolute expansion is likely to remain subdued – of around 0.7% in 2025, in our base-case scenario.

Europe economic forecasts, year on year (%; F = Forecast)

Europe			
	2023	2024F	2025F
GDP growth (%)	0.5	0.8	0.7
CPI inflation (%)	5.4	2.4	1.9
Unemployment rate (%)	6.6	6.4	6.6
Gross public debt (% of GDP)	87.8	88.0	89.6
Private consumption (pp*)	0.7	0.8	0.8

* Percentage point (pp)

Source: Barclays Investment Bank, November 2024

Labour market dynamics, as captured by our Macroeconomic Momentum Indicators, have picked up of late, substantiating the economic recovery. Despite large German auto manufacturers looking to cut jobs, even the traditionally more sensitive measures, such as under-employment, eased in 2024.

While labour-market momentum supports consumption, many key economies are not as reliant on consumer spending for growth as, for example, the US economy is: German and French household expenditure only accounted for 51% and 54% of GDP in 2023, respectively, while it was 68% for the US.

The economy's openness works as both a strength and a weakness. In 2024, it was a weakness. But, in 2025 the European 'renaissance' could be further strengthened by the bloc's outsized exposure to China. That is if that country's stimulus plans bear fruit and reignite its economy, of course.

POLITICS TO SPOIL THE PARTY?

The real risk for the eurozone is a political one. Whether it is domestic politics frustrating the recovery, or geopolitics putting pressure on an economy that remains very open to the world, the region's economic fate is heavily influenced by policymakers. The immediate risk here is driven by the election of Donald Trump, again, in the US. Furthermore, the conflicts in Ukraine and the Middle East remain pressing issues that could disrupt the outlook for the bloc.

Domestically, France's outlook is clouded by an inconclusive snap election, called by President Macron in June. Meanwhile, in Germany the coalition government refuses to remove the country's fiscal brake, and this is unlikely to change until the federal election in September 2025.

FISCAL STRAINS

As a result, France and Germany may not be able, or willing, to support eurozone growth as much as they would like, or need to. On that note, a key factor to watch in 2025 will be the outcome of the German election. Similarly, the Italian government is still trying to take the country out of the European Union's (EU) Excessive Deficit Procedure (EDP), a fate that could be achieved in 2026, at the earliest. Finally, and although its fiscal situation improved in 2024, Spain's debt-to-GDP ratio remains above 100%, giving the country limited room for manoeuvre.

Therefore, any real fiscal support probably lies in the hands of the EU. There are still very significant Recovery Fund (NGEU) disbursements expected over the next couple of years, and, as highlighted in September by the former ECB President Mario Draghi's report on the bloc's competitiveness¹, additional investments are required. Unfortunately, this may not be enough to overturn the contractionary stance of European fiscal policy in 2025.

"Low inflation, lower rates and a low base, could drive a significant improvement in GDP growth – albeit absolute expansion is likely to remain subdued – of around 1% in 2025"

WEAK GROWTH, BUT STILL INVESTMENT APPEAL

In this context, and as an investor, it's difficult to get overexcited about the eurozone's prospects. Yet, everything has a price. Furthermore, below the surface, the bloc remains an attractive hunting ground for active managers. As such, our focus is on select idiosyncratic opportunities, both in public and private markets, in 2025.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

¹ European Commission, EU competitiveness: Looking ahead, 9 September 2024



Is China having its 'big bazooka' moment?

Chinese growth has slowed and the outlook does not look any brighter, weighed down by a troubled property sector and worsening demographics. Will a flurry of policy interventions turn the economy around?

The Chinese economy has slowed in 2024 and is forecast to grow by 4.8%. The outlook for 2025 is not bright, with gross domestic product (GDP) expected to expand by only 4%. At the heart of the troubled outlook is the consumer, who has seen their savings slashed since the bursting of a housing bubble in 2022, in turn hitting confidence and propensity to spend.

TROUBLED HOUSING SECTOR

Chinese household wealth has been slashed by 30% of late, with rising debt levels and stubbornly low levels of inflation (forecast to be 0.4% in 2024 and 0.8% for 2025). Japanification is a term often used by economists these days in relation to the country, due to the similarities between its economy of today, and the Japanese one after the bursting of its property bubble in the 1990s.

One economist, Takatoshi Ito, came up with a measure for the extent of Japanification evident in an economy. Applying this to the current Chinese figures, suggests, ironically, that the country has just overtaken Japan, (see chart, p10).

FOLLOWING THE JAPANESE PLAYBOOK?

While the bursting of an asset bubble, debt-depressed consumers and deflationary risks indeed suggest similarities between China and Japan, there are also differences, both to the advantage and disadvantage of the former.

The leadership has the advantage of knowing the Japanese playbook, seeing how long the healing process can take, and understanding what extreme measures might be called for. It also has made technological advances in key worldwide industries (green tech and industrial digitisation).

China economic forecasts, year on year (% , F =Forecast)

	China		
	2023	2024F	2025F
GDP growth (%)	5.2	4.8	4.0
CPI inflation (%)	0.2	0.3	0.8
Unemployment rate (%)	5.2	5.2	5.3
Consumption (pp*)	4.3	3.2	3.0

* Percentage point (pp)

Source: Barclays Investment Bank, November 2024

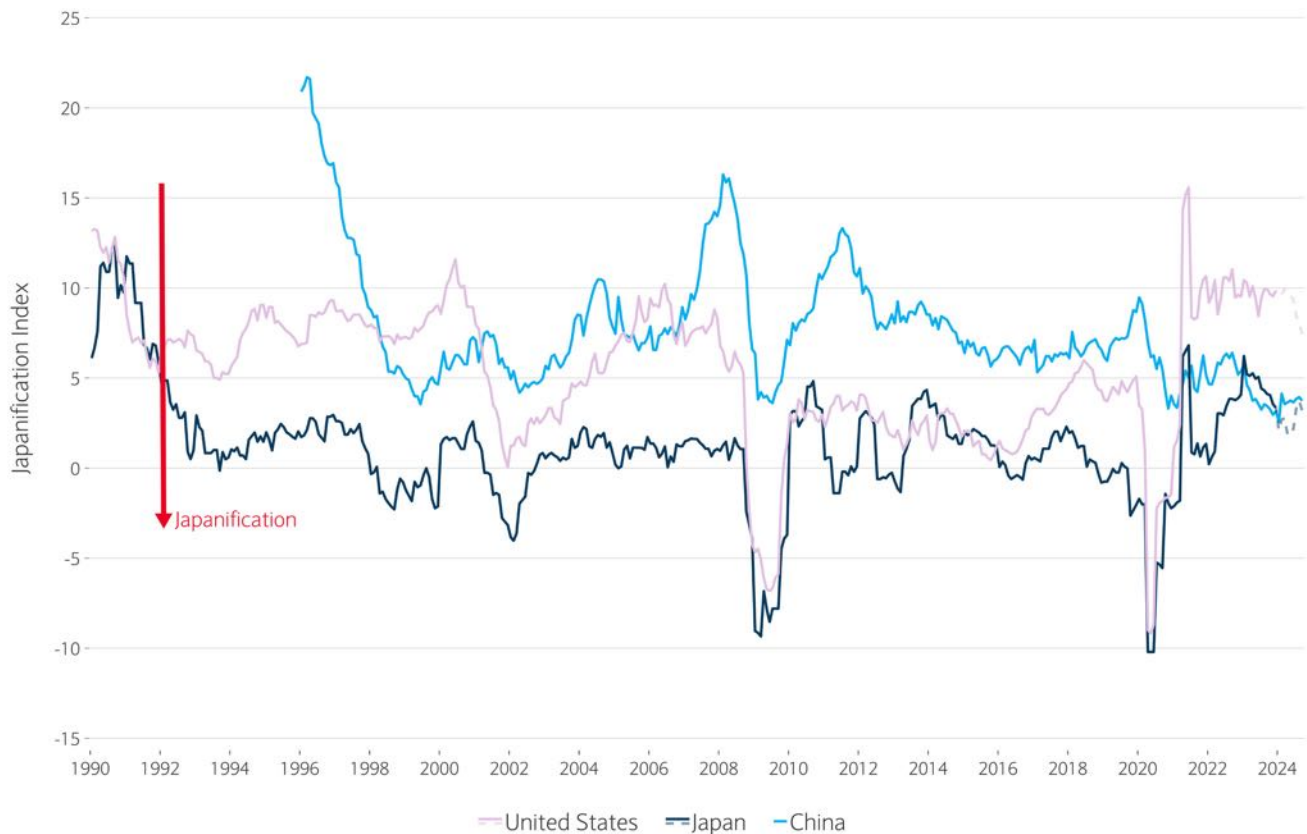
On the downside, the Chinese population is ageing much faster than the Japanese population of three decades ago. Household budgets are more strongly affected, due to property making up double the share of household wealth, than it did for Japan.

Moreover, the latter's crisis hit at a time of relative geopolitical calm, whereas China's bust is unfolding with considerable turmoil around the world, that could spark a flurry of trade impediments in 2025. With the re-election of President Trump, we deem further escalation of trade restrictions and tariffs very likely.

"A flurry of stimulus measures...leaves ample opportunity to up exposure to the area"

CHINA'S JAPANIFICATION SURPASSES JAPAN

The Japanification Index is a gauge for the macroeconomic trends that defined the drawn-out depression that the Japanese economy experienced after 1990²



Sources: Bank for International Settlements, US Bureau of Labour Statistics, International Monetary Fund, Japanese Statistics Bureau, OECD, United Nations, Barclays Private Bank, October 2024

CONCERTED FISCAL AND MONETARY POLICY EFFORTS

The good news is that the People's Bank of China is very much aware of the potential costs of doing too little, too late. The authorities unveiled in October that many measures from the counter-cyclical policy playbook were being considered or actioned, including recapitalising large Chinese banks, cash handouts to consumers plus a significant intervention in the housing market. As a first step, in November Beijing announced a fiscal package to tackle local government debt problems. At the same time, austerity initiatives for public servants were put in place, with long-term debt sustainability in mind.

While the stimulus measures may be encouraging for the country's short-term economic prospects, the long-term demographic outlook is depressing. China has one of the fastest-ageing populations, with the population aged over 65, ballooning from 12% of the total in 2020 to 20% by 2032, according to United Nations' estimates¹.

PLENTY OF INVESTMENT OPPORTUNITIES, DURING A TURBOCHARGED TRANSITION

Worrying demographic trends and significant trade tensions put the Chinese leadership under a lot of pressure to act. Demographics, in particular, puts a lid on how high Chinese growth can go in coming years – the figure is potentially no higher than 5%.

However, that does not make the country uninvestable. To the contrary: a flurry of stimulus measures and a re-orientation of the nation's industries leave ample opportunity to up exposure to the area. China has emerged as the world's leading producer in many high-tech sectors, including solar panels, lithium batteries and wind-power equipment – a position that will be very hard to wrestle from it, despite all the trade tensions.

Author: Lukas Gehrig, Zurich, Switzerland, Quantitative Strategist

¹United Nations, Department of Economic and Social Affairs, World Population Prospects 2024, October 2024

²Originally introduced by Japanese economist Takatoshi Ito, the Japanification index has been expanded by Barclays Investment Bank to include China by replacing the harder to estimate GDP gap (the difference between the real growth rate and the potential growth rate) by the working age population gap instead. GDP gap estimates for the US and Japan for 2024 are based on OECD forecasts.



UK: a new paradigm?

The UK might be finishing 2024 on a stronger footing than twelve months earlier. With domestic growth set to recover further in 2025, as inflation and interest rates recede, could the country become attractive again?

Despite all the UK political drama and uncertainty in 2024, the economy is forecast to grow by 0.9% over the year, leaping from the 0.3% recorded in 2023. That said, momentum faded recently. Uncertainty surrounding October's budget weighed on sentiment, for both companies and consumers, and wage growth appears to be cooling.

The silver lining is that the headline consumer prices index plummeted from more than 10% in 2023 to below 2% in the twelve months to September 2024. While a short-term blip was observed into the year-end, inflation is expected to stabilise, averaging 2.3% in 2025.

A 'PAINFUL' BUDGET?

Labour's first Budget since 2010 was much anticipated. The main surprise was the higher-than-expected spending splurge (around £70 billion), funded by increased taxation and borrowing. On the latter, the UK Debt Management Office announced a £19.2 billion jump in gilt sales for the year to April 2025, taking gross supply to £296.9 billion. Not only that, but £120 billion of additional borrowing could be needed over the next four years, based on projections, which has put upward pressure on yields.

Among the numerous new tax announcements, the increase in national insurance contributions for employers (up 1.2 percentage points, to 15%) was probably the most consequential. This could lead to lower wage growth over time, to compensate companies for the hit to their bottom lines. If this occurs, then consumption could suffer.

"The UK feasibly has a place in a well-diversified portfolio"

UK economic forecasts, year on year (%; F =Forecast)

	UK		
	2023	2024F	2025F
GDP growth (%)	0.3	0.9	1.2
CPI inflation (%)	7.3	2.5	2.3
Unemployment rate (%)	4.0	4.3	4.7
Gross public debt (% of GDP)	87.9	90.4	91.9
Private consumption (pp*)	0.7	0.6	0.7

* Percentage point (pp)

Source: Barclays Investment Bank, November 2024

On the growth side, the Office for Budget Responsibility (OBR) projects that the Budget's measures will have a limited immediate impact on structural growth. In fact, it specified that any positive boost to economic supply will come beyond its five-year horizon. For 2025, the OBR estimates that real growth could be lifted by 0.6%, thanks to a boost in demand as fiscal drag drops from -0.9% of GDP to -0.2% of GDP.

Interestingly, while the OBR anticipates growth of 2% in 2025, above their own estimate for a long-term potential growth rate of 1.7%, the Bank of England's (BoE) projections are slightly more cautious (1.5%). In addition, the central bank thinks it is "not sensible" (yet) to conclude that the rate path will be different, based on the Budget. Given all the unknowns, a base case of 1.2% GDP growth in 2025 seems reasonable.

MONETARY POLICY TO PROVIDE FURTHER SUPPORT?

The Bank of England is forecast to cut interest rates further going into 2025. The magnitude of cuts is unclear, though. Indeed, the UK government's decision to direct around two-thirds of additional borrowing towards day-to-day public services spending, rather than investments (one-third), could have inflationary consequences.

That said, we forecast that the Bank Rate will drop below 4% in the second half of 2025. If this happens, it could boost real disposable income, support investments and revive 'animal spirits' in the economy. Importantly, consumers still have a healthy level of excess savings, that could be called on if the macroeconomic uncertainty clears. As such, a rebound in activity could be on the cards in the later part of 2025.

Yet, the next year is still likely to be a challenging one for the UK economy, in the face of both cyclical (fiscal pressures and higher unemployment rate) and structural (low productivity and labour force participation) headwinds. Therefore, the optimists may have to look beyond 2025 for sunnier economic uplands.

"The Bank of England is forecast to cut interest rates further going into 2025. The magnitude of cuts is unclear"

A LAND OF PROMISE?

Encouragingly, investors may not need to be as patient as economists. Indeed, even if domestic growth remains subdued, investment opportunities abound. Whether it's via a cheap, and a largely export-driven equity market, or appealing gilt and credit markets, the UK feasibly has a place in a well-diversified portfolio.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist



A time for selectivity and quality amid shifting tides

Equities continued to hit fresh highs in 2024, despite much economic and geopolitical uncertainty. With the global economy slowing and the promise of more rate cuts in 2025, how should investors be positioned for the year ahead?

Please note: This article is more technical in nature than our typical articles, and may require some background knowledge and experience in investing to understand the themes that we explore below.

All data referenced in this article is sourced from LSEG Datastream unless otherwise stated, and is accurate at the time of publishing.

Warren Buffett once said: "It's only when the tide goes out that you learn who's been swimming naked." In today's market, this serves as a reminder of the importance of resilience and strong business fundamentals as investors navigate a slowing economy and uncertain world.

Looking ahead, it's essential to recognise that, while equity markets have been fuelled by the strong performance of a select group of high-growth, mega-cap tech companies, diversification and quality across all sectors remain key to enduring returns.

This year, we recommend looking beyond index-driven rallies to focus on quality companies that can deliver growth as the economy moderates and trade at reasonable valuations. By emphasising these attributes, one can identify opportunities in a market where disciplined stock selection is increasingly crucial, allowing an investor to capitalise on a more diverse range of sectors as the market broadens.

EQUITY INDICES ARE BACK NEAR ALL-TIME HIGHS...

With regards to 2024, it's been another good year for global equities, though progress has not been linear. Despite an 8% correction in the summer, which was quickly reversed, the MSCI All Country World Index is up 17% year-to-date at the time of writing, and 54% above its October 2022 lows.

This performance reflects (i) improved growth and inflation expectations globally, (ii) continued enthusiasm around the long-term impact of artificial intelligence (AI) on the economy, and (iii) the anticipation of a significant easing in monetary conditions in major economies.

... BUT A LOT HAS CHANGED UNDER THE SURFACE

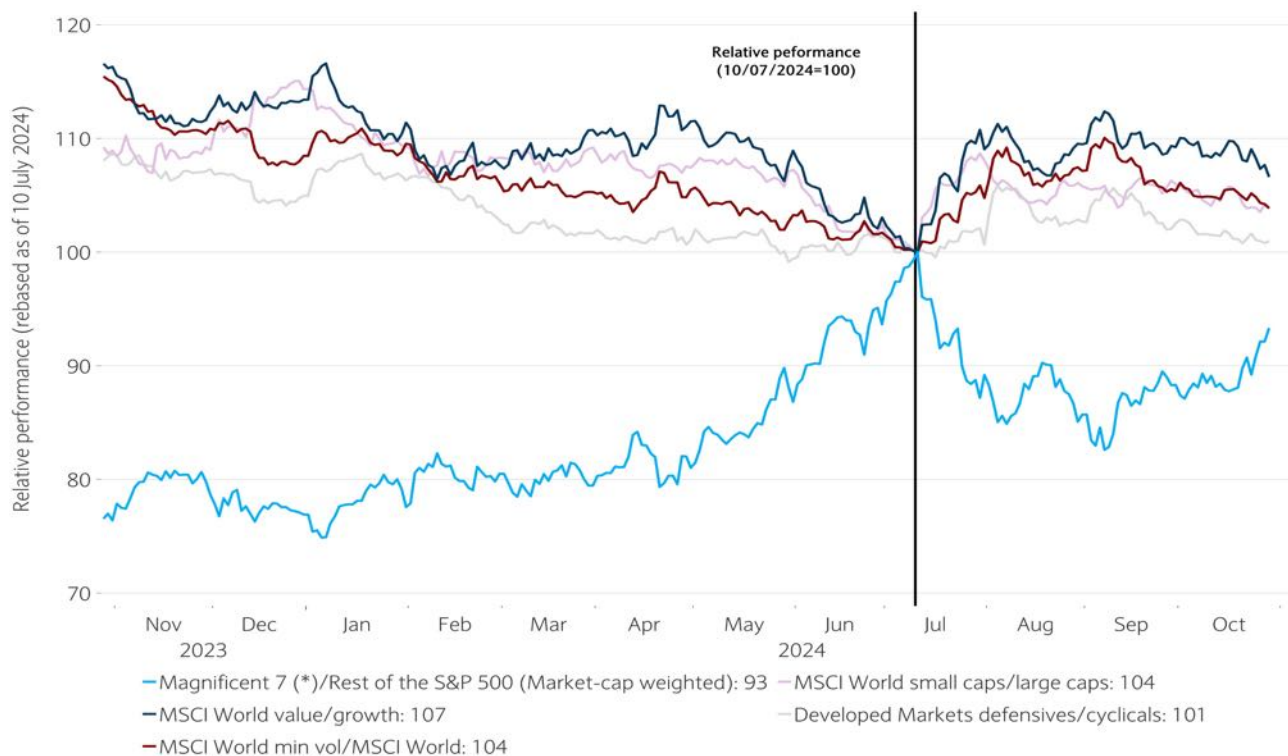
The summer sell-off was accompanied by a notable change in market leadership, as fears of a growth shock resurfaced. As in typical market sell-offs, the areas that had performed most strongly since the October lows were the ones which corrected the most. Capital flowed out of Big Tech into the rest of the market, with 'value' equities outperforming their 'growth' peers. Small caps outperformed large caps (especially in the US), defensive sectors beat cyclical ones, and low volatility stocks outpaced the rest of the market.

Since then, global equities have retraced their losses and made new highs, driven by improved economic data, receding fears of a growth shock, and investors' attention shifting back to central banks' easing. However, the leadership changes mentioned above have only partially reversed (see chart top of p14).

"Future equity market gains rely on companies' ability to deliver strong profit growth"

THE GREAT ROTATION

The brutal equity market rotation that accompanied the summer sell-off has only partially reversed, despite equities being back near all-time highs



* The Magnificent 7 stocks consist of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla

Source: Barclays Private Bank, October 2024

While equity markets remain highly concentrated, the recent broadening of market leadership is a welcome development. Encouragingly, 45% of S&P 500 companies have outperformed their index over the past six months, a significant improvement from just 20% in mid-July. Market breadth has also improved in Europe, with 52% of STOXX 600 stocks outperforming their index, compared to 38% in late June.

WHERE DO WE STAND TODAY?

Following the rally, global equity valuations look stretched by historical standards, seemingly discounting very little risk of a weakening in economic conditions. Global equities trade at 18.2 times forward earnings, 25% above their 20-year average, largely driven by the tech-heavy US market. In contrast, European shares trade broadly in line with their long-term average, while UK equities trade at a 5% discount (see chart on p15).

At the same time, analysts expect companies to grow earnings by 9% globally in 2024, and 13% in 2025. These estimates seem high, based on our macroeconomic outlook, and leave little room for disappointment. Our economists anticipate global gross domestic product (GDP) growth to slow to 3.0% in 2025,

down from 3.2% in 2024. Historically, this level of economic expansion, which is slightly below the long-term trend, has coincided with flattish earnings growth.

Finally, investor sentiment is no longer depressed, as it was back in October 2022, when only a small piece of good news was needed to trigger a rally.

WHERE DO MARKETS GO FROM HERE?

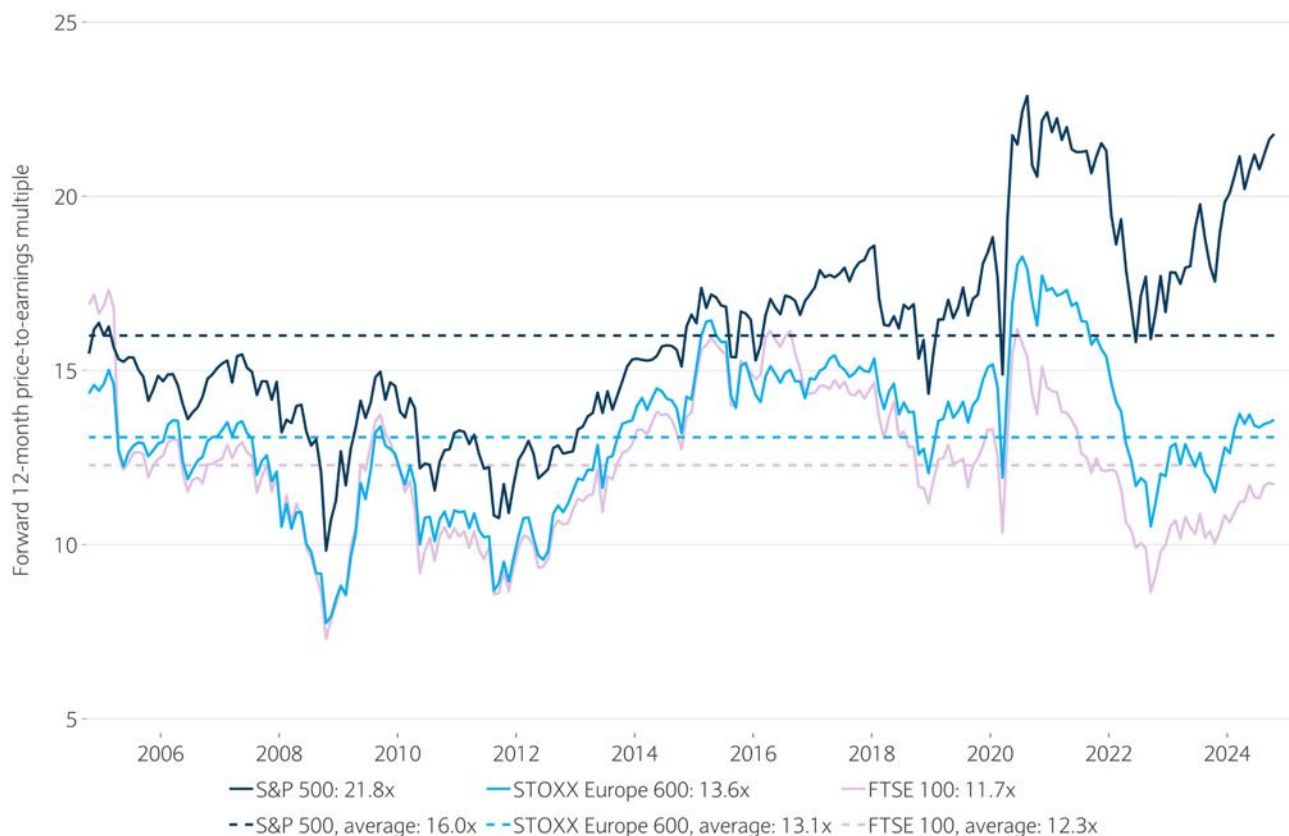
Ultimately, market direction will depend on the economic growth trajectory (and whether a recession is avoided) and the sustainability of the AI theme that has driven markets in the past couple of years. As discussed in [“The Great Unwind”](#), key indicators to monitor will be the US labour market and corporate earnings.

COMPANIES WILL NEED TO DELIVER ON HIGH EARNINGS EXPECTATIONS

The 35% rally in global equity prices since October 2023 has been primarily driven by valuation expansion, based on the MSCI All Country World index.

EQUITY VALUATIONS VARY SIGNIFICANTLY ACROSS REGIONS

Price to earnings (PE) multiples look stretched by historical standards in the US, but more reasonable in Europe and the UK



Source: Barclays Private Bank, October 2024

Corporate earnings reported during this period have risen by only 6%, while PE multiples have jumped by 27%, on the expectation of solid earnings growth in the future.

With valuations unlikely to expand much from current levels, future equity market gains rely on companies' ability to deliver strong profit growth, amid a highly uncertain economic and geopolitical backdrop. The good news is that expectations (and valuations) aren't necessarily excessive across the board.

IN THE NEAR-TERM, VOLATILITY IS LIKELY TO PREVAIL ...

With significant uncertainty around (geo)politics, the health of the US labour market, and ultimately, the path for interest rates, volatility is likely in the coming months. Corrections and sharp rotations within the equity market, similar to that seen in mid-2024, are possible. However, these could be seen as possible entry points.

... BUT OVER THE LONGER TERM, FURTHER OUTPERFORMANCE CAN BE EXPECTED

Indeed, global equities should continue to outperform bonds over the long term. While simple valuation metrics are not effective for timing investments, cyclically-adjusted PE ratios (CAPEs) have historically been reliable indicators of long-term returns.

At current levels, CAPEs suggest that global equities could return 6.4% annualised over the next decade (including dividends), with significant contributions from non-US markets. While this is below the 9.0% annualised returns of the past decade, it remains more attractive than the 4.3% yield currently offered by US 10-year Treasuries.

IN THAT CONTEXT, DIVERSIFICATION AND PRUDENT RISK MANAGEMENT ARE CRUCIAL

In this environment, maintaining a well-diversified portfolio across sectors, regions, and styles is essential for equity investors. With returns likely to be more muted going forward, a greater focus on yield generation and capital protection is essential. Option strategies and structured products can be useful tools in that respect.

WITHIN EQUITY PORTFOLIOS, A SELECTIVE APPROACH AND DEFENSIVE POSITIONING ARE WARRANTED

Given demanding valuations at the index level, selectivity is key. Most opportunities are likely to materialise under the surface, at the stock level or within specific sectors or geographies.

1. Favour quality stocks: At this stage of the cycle, we favour quality companies with strong balance sheets, that have shown resilience in previous downturns and trade at reasonable prices.

2. Prefer equally weighted over market cap weighted indices: For investors who need to maintain index-level allocations, we would lean towards equally weighted indices. Indeed, the equally weighted MSCI All World Country index trades in line with its 20-year average, based on forward PEs, while its market cap-weighted counterpart is at a 25% premium.

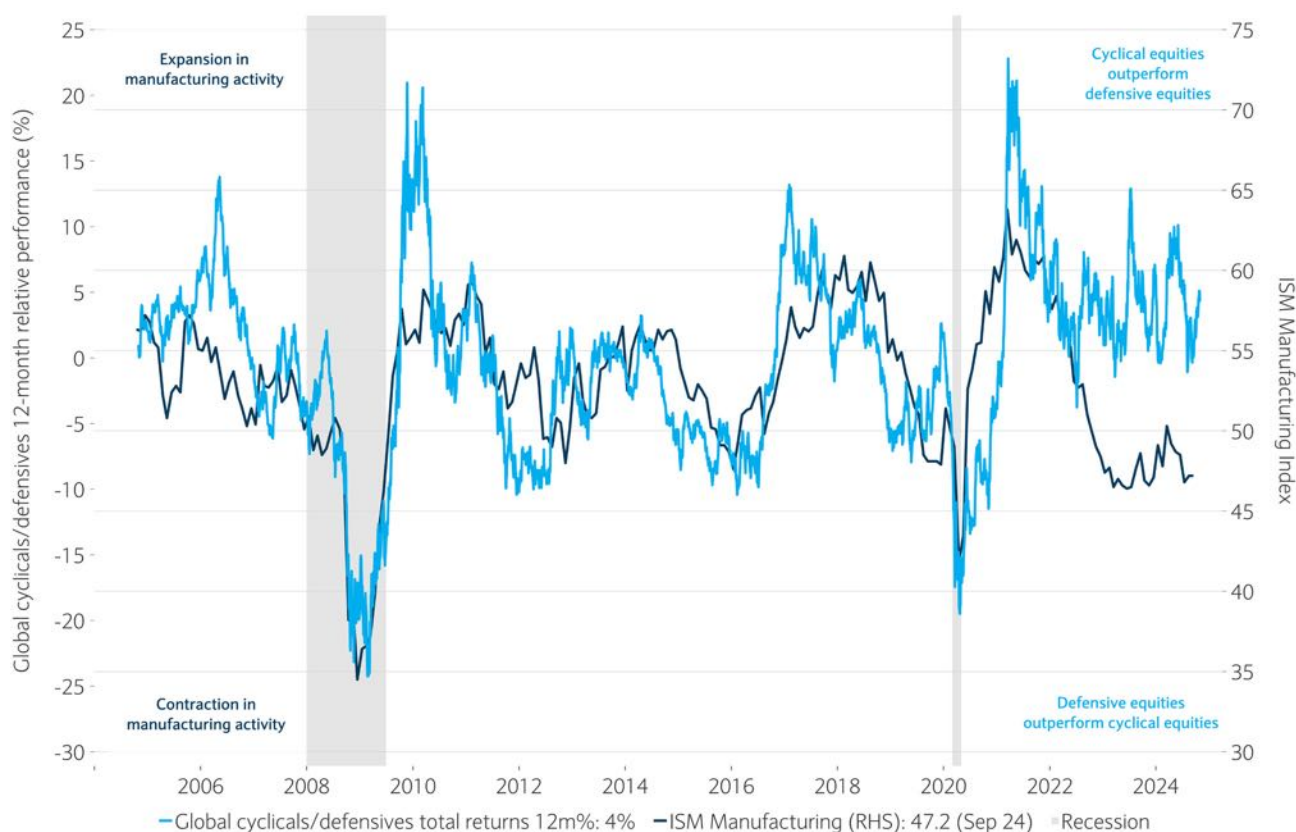
3. Favour defensive sectors and “bond proxies”: With global growth projected to slow below trend in the next couple of years and yields expected to decline, defensive sectors and so-called bond proxies could help to improve portfolio diversification.

In previous easing cycles over the past 50 years, defensive sectors consistently outperformed cyclicals, regardless of whether the economy entered a recession, as flagged in “[The economy matters more than the Fed](#)” (albeit past performance is never a guarantee of future performance). This aligns with the US central bank cutting rates in response to a decelerating economy.

Notably, the performance of cyclicals versus defensives in the past year has remained resilient despite the weakness in the global manufacturing cycle, and the underperformance of industrial metals versus precious metals (see charts, p16 and p17). Historically, defensive sectors have tended to outperform in such environments.

CYCLICAL EQUITIES HAVE BEEN RESILIENT RELATIVE TO DEFENSIVES, DESPITE ONGOING WEAKNESS IN THE MANUFACTURING SECTOR

Relative 12-month performance of global cyclicals vs defensives against the ISM Manufacturing index



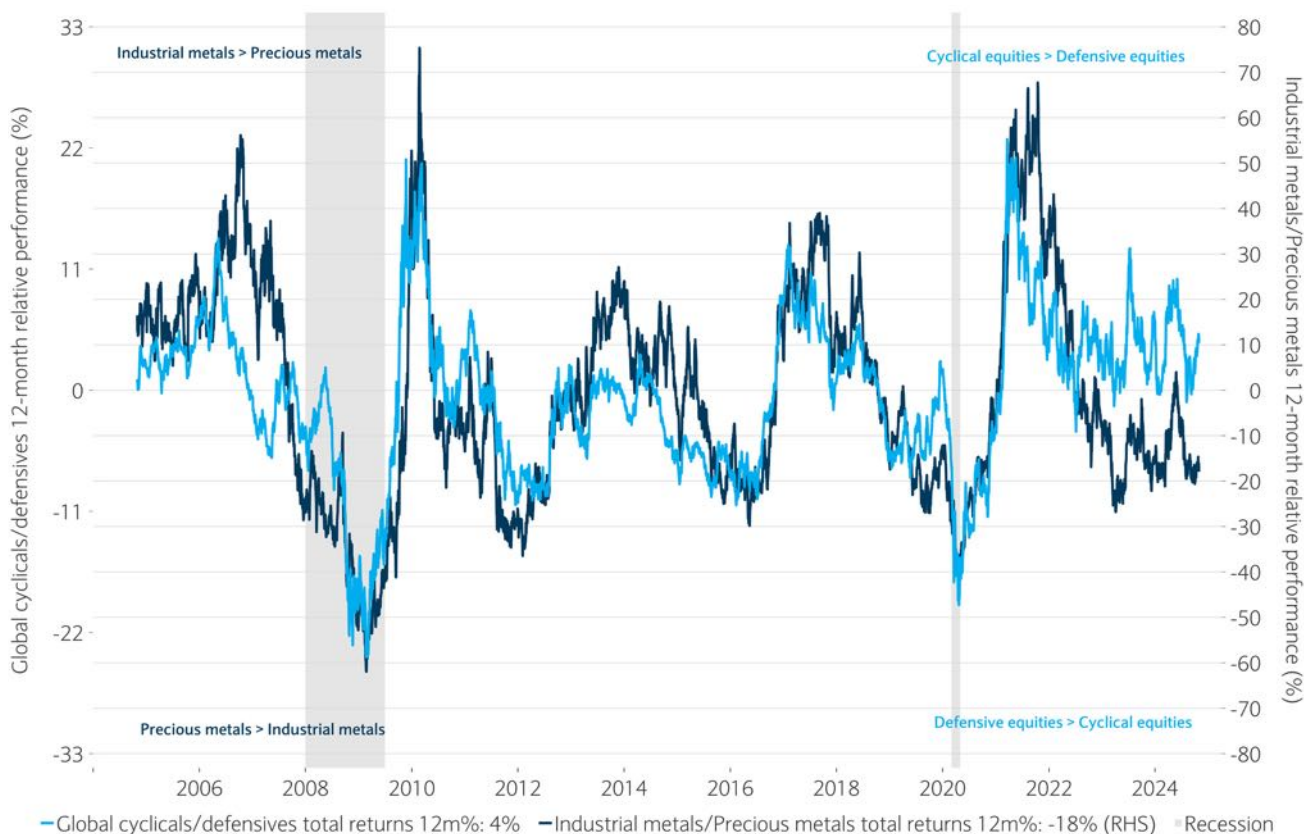
Source: Barclays Private Bank, October 2024

At the sector level, utilities and consumer staples appear best positioned globally, being negatively correlated with the business cycle and interest rates. They remain reasonably priced, especially in Europe, despite a significant rerating over the past year, and offer superior dividend yields. Additionally, more conservative earnings expectations offer less room for disappointment.

4. Maintain some exposure to deep value cyclicals as an upside hedge: In light of all the uncertainty, we recognise the need to account for scenarios that fall outside of our base case. With that in mind, there seems to be merit in maintaining some exposure to deep-value cyclicals that lagged in the recent rally.

THE RELATIVE PERFORMANCE OF CYCLICAL SECTORS VS DEFENSIVES HAS ALSO BEEN AT ODDS WITH INTERNAL PRICE DYNAMICS WITHIN THE COMMODITY COMPLEX

Historically, the outperformance of precious metals against industrial metals has tended to coincide with defensive sectors outperforming their cyclical peers



Source: Barclays Private Bank, October 2024

5. Regional preferences: We maintain a favourable view on UK large caps, due to their defensive tilt, undemanding valuations and attractive dividend yield. The FTSE 100 index has low exposure to the technology sector compared to global equity indices, making it a compelling option to capitalise on a broadening of market leadership.

Beyond the UK, Chinese shares may become investible again in the coming months, once clarity on the stimulus measures announced by the authorities in September emerges. The proposed initiatives were initially met with a 40% surge in the MSCI China index, but the rally subsequently faded as investors curbed their enthusiasm. Chinese shares remain attractively valued and largely overlooked, positioning them for a sharp rebound if fiscal stimulus finally starts working.

6. Thematic investing can also be considered: The election of Donald Trump raises the possibility of an increased focus on deregulation and less stringent antitrust laws. This could be positive for profit margins, but also for merger-and-acquisition activity. Separately, if new US tariffs are implemented on Chinese imports, this should benefit companies exposed to the onshoring of US supply chains. In any case, investors should consider a variety of strategies to better tackle a dynamic macro and micro landscape.

Author: Dorothee Deck, London UK, Head of Cross Asset Strategy



Adapting to the yield cycle

With yields potentially having passed their cycle peak, amid much uncertainty, what can bond investors do to adapt to this new world in the search for sustainable returns?

Please note: This article is more technical in nature than our typical articles, and may require some background knowledge and experience in investing to understand the themes that we explore below.

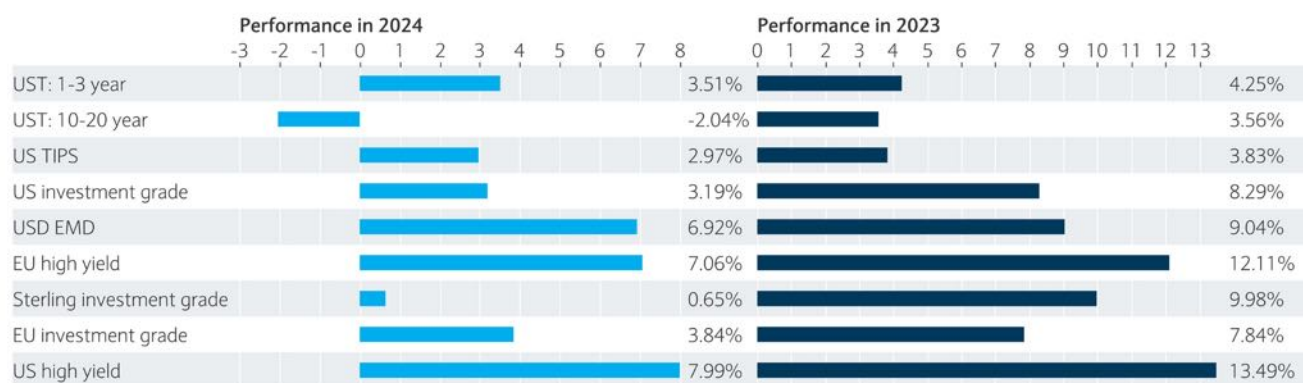
All data referenced in this article are sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

ANOTHER SOLID YEAR FOR FIXED INCOME

Bond markets have delivered solid returns in 2024, following a strong performance in 2023 (see chart). More importantly, this year saw important developments. First, with inflation back close to central banks' 2% target in most developed countries, a global interest rate cutting cycle has begun. Second, with short-end yields declining, the yield curve has 'uninverted', leaving longer-dated bonds yielding more than their short-term counterparts.

ANOTHER SOLID YEAR FOR BOND MARKETS

The performance of various bond markets so far in 2024, compared with last year



Sources: Bloomberg, Barclays Private Bank, October 2024

RATE DIVERGENCE

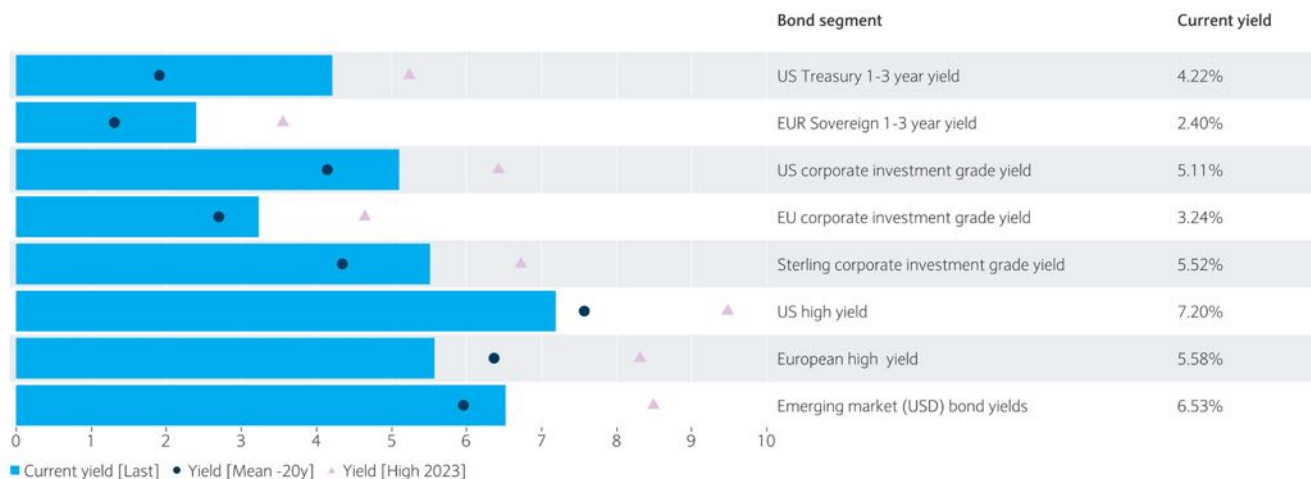
Historically, yields have reached their peak either before, or as, policy rates peak. As such, global bond yields should have passed their cycle highs. However, we would expect some divergence to emerge as we move into 2025.

Although, inflation in both the UK and the eurozone has returned to the 2% target, the outlook for growth in both areas seems fragile, potentially increasing the downward pressure on yields.

On the other hand, the US economy continues to power ahead and the risk of recession appears remote at this stage. This combined with additional inflationary pressures stemming from fiscal policies, could lead to further upward pressure on US yields and challenge the market's expectation that the terminal rate will be almost 4.0%. But for now, and until clarity emerges around the next president's policies, US yields are likely to tread water.

YIELDS MOSTLY ABOVE LONG-TERM AVERAGE

The yield in various bond markets relative to last year's peak and to the 20-year average



Sources: Bloomberg, Barclays Private Bank, October 2024

BRIDGING THE FISCAL GAP

As we've highlighted in our macroeconomic outlook, one key question for 2025 will be around US debt sustainability. With US government debt supply surging at a time when traditional large buyers, such as the US Federal Reserve (Fed) and other central banks, have reduced their exposure, the term premium is bound to move higher.

The premium investors demand to hold longer-dated bonds has already started to increase, and it may continue to do so for two main reasons. First because, mechanically, as the market prices in more cuts for shorter-dated debt (the short end), the yield curve tends to 'bull-steepen'. Second, as seen recently, when fixed income markets come under pressure due to shifts in supply and demand, yields tend to rise faster at the long end, compared to the short end (a so-called bear-steepening).

The bearish steepening could trigger additional volatility, as seen in 2016 or 2013, but usually does not persist for long. In this context, a neutral duration positioning seems warranted for the time being, with duration increased selectively and gradually during phases of volatility.

TIGHT CREDIT SPREADS

The last two years have been supportive for credit. This shouldn't come as a surprise as, historically, this segment prospered during phases of economic growth and inflation moderation (see [The right temperature for corporate credit?](#)).

But credit spreads are now as tight as they've ever been in the last 26 years, leaving little room for further compression. Given the richer pricing, the window for locking in yields seems to be closing quickly and a different approach may be needed.

In 2025, three investment themes stand out: diversification, carry and relative value. In terms of segments of the fixed income market that appear attractive, we would highlight the securitised credit market. This segment provides additional security through higher-quality collateral, is less exposed showing reduced exposure to rate shocks, and still provides a relatively high carry yield. The same is true of structured credit. An example would be higher-quality, AAA-rated, collateralised loan obligations (CLOs).

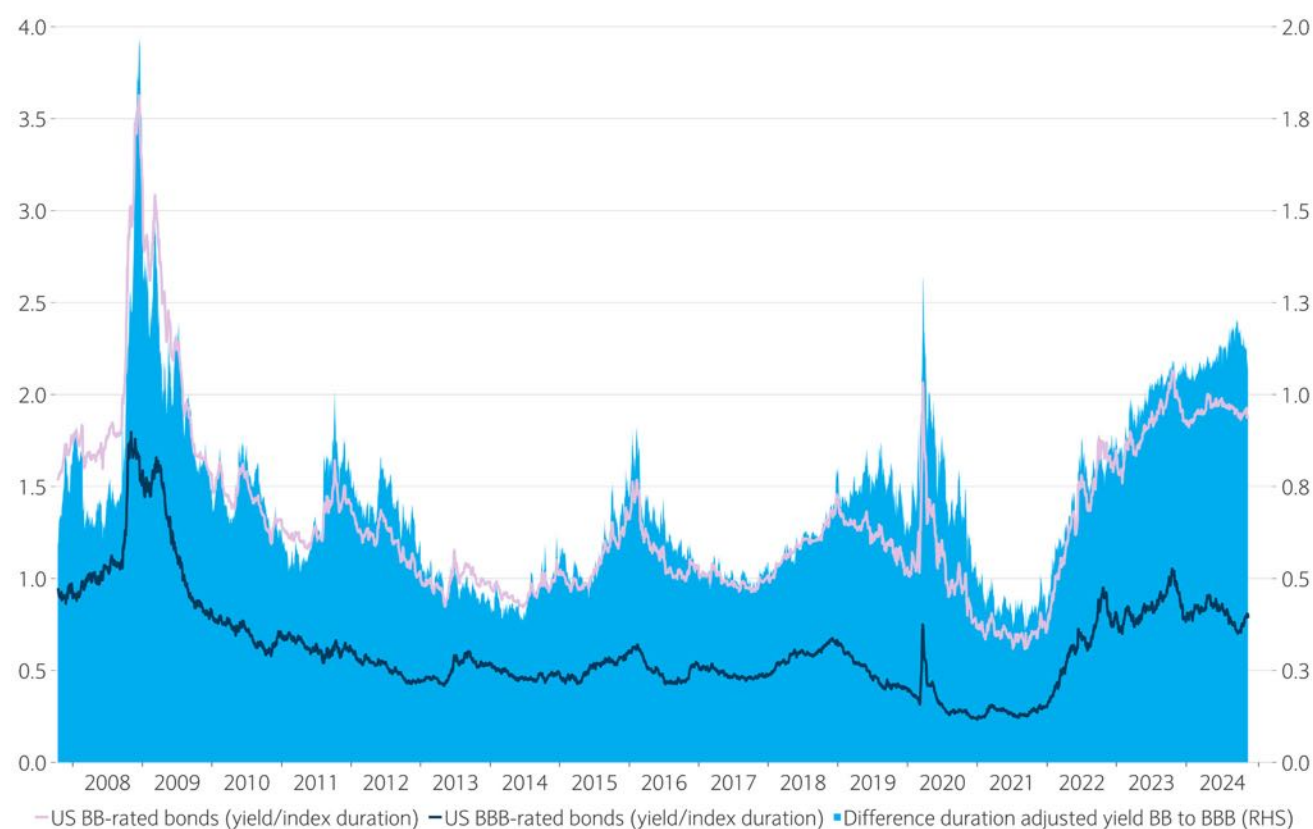
When it comes to corporate credit, we see select relative value opportunities within short-dated BB-rated bonds.

While the yield differential between BBB- and BB-rated indices narrowed in 2024, when adjusted for duration, the carry opportunity is clear (see chart). In fact, the latter bonds can now withstand a yield increase of 1.9% within one year (compared to 0.7% for BBB-rated debt) before they start losing money; a comfortable cushion and a carry opportunity.

That said, BBB-rated bonds can still offer value, especially as the yield curve gradually steepens. Currently, the roll-yield starts getting attractive three years out.

BB-RATED BOND YIELDS SURGE

Comparison of the yield per unit of duration for BB-rated bonds and their BBB-rated peers since 2005



Sources: Bloomberg, Barclays Private Bank, October 2024

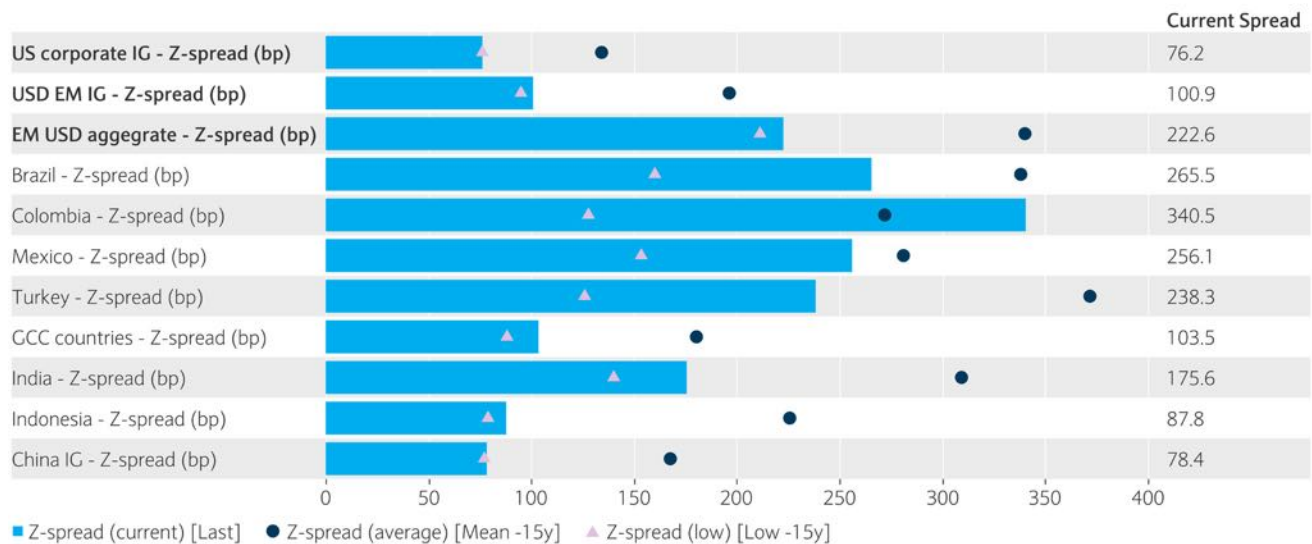
EMERGING MARKET BONDS AND IMPORTANCE OF DIVERSIFICATION

The market for 'hard-currency' (that is, bonds priced in US dollars) emerging market debt (EMD) has increased to \$17 trillion, from \$12.8 trillion in 2013, and is a segment that shouldn't be overlooked. Admittedly, the average EMD spread is relatively low, by historical standards, when compared with US investment grade bonds.

Yet, with an average monthly correlation of 0.6 over the last 10 years against USD corporate bonds, hard-currency EMD can aid portfolio diversification. Not only that, but the wide dispersion between countries' dynamics (see chart, p21) further bolster diversification and allow for substantial relative-value and carry opportunities.

EMD SPREADS BELOW THEIR 15-YEAR AVERAGE

EMD spreads by country and in comparison with US corporate bonds



Sources: Bloomberg, Barclays Private Bank, October 2024

The attractiveness of EMD might become even more obvious if bond yields in developed markets continue to moderate in 2025. In fact, in the last few months of 2024, inflows into emerging market- dedicated funds picked up, as investors were increasingly tempted by the region's yield advantage. With assets under management in this segment of the market 18% lower than in 2022, and with \$6.5 trillion sitting in US money market funds, the pent-up demand could be huge.

Of course, the increased funding pressures faced by China, on the back of its troubled property market, can raise concerns over possible defaults in EMD land. After all, the country is likely to account for two-thirds of the Asian debt defaults by volume in 2025, according to JP Morgan. To make the most of their exposure to hard-currency EMD, investors need to navigate carefully through issuer selection and emphasise the timing of investments.

CONCLUSION

The low-hanging fruit may have already been taken, but for those who know where to look, fixed income markets can still offer attractive pickings in 2025. The approach to investing should be less about chasing gains, and more about minimising losses, while avoiding having over-concentrated exposure to certain segments of the bond market.

In this context, a neutral duration stance seems appropriate, and investors should be on the lookout for rate volatility, as a signal to extend duration selectively. In the credit market, securitised credit could be a useful diversification tool, while relative value and carry options abound in the BB-rated segment. Finally, EMD provides a vast pool of opportunities for investors to improve a portfolio's risk-return profile.

Author: Michel Vernier, CFA, London UK, Head of Fixed Income Strategy



Is AI (b)reaching its limits?

Artificial intelligence brings great promises, stirs equally great fears and moves societies and markets in a way that little else has in a long time. Will it reshape the way economies operate within just a handful of years or will challenges economically, technologically and societally hinder its progress?

Economist John Maynard Keynes argued that the increase in technical efficiency was happening too fast, in order for the labour market to adjust. And, that was back in 1933. The first televisions had just entered homes, revolutionising information distribution, and automobiles were ever more prevalent in cities. He identified a new 'disease', technological unemployment, defined as "unemployment due to our discovery of means of economising the use of labour outrunning the pace at which we can find new uses for labour"¹.

In today's world, the promises of great productivity gains clash with Keynesian worries about job cuts and displaced labour. The time horizon over which these events might unfold, often found to be around ten years, suggests that much urgency is needed.

In this article, we argue that despite artificial intelligence's (AI) meteoric rates of adoption in recent years, it is still in its infancy, in terms of its ability to replace labour and to drive productivity gains. The challenges facing the broad implementation of AI across industries, range from its hunger for energy to the finer details around implementing it for job competency requirements that involve questions of trust. Moreover, while the technology is often discussed as being a global disruptor, research and implementation can vary from region to region.

THE RACE IS UNDERWAY

Keynes argued, unsurprisingly, that countries not at the vanguard of progress, would suffer relative to those that were. Indeed, through productivity increases, the speed of automation has been correlated very strongly with most measures for living standards, such as income per worker.

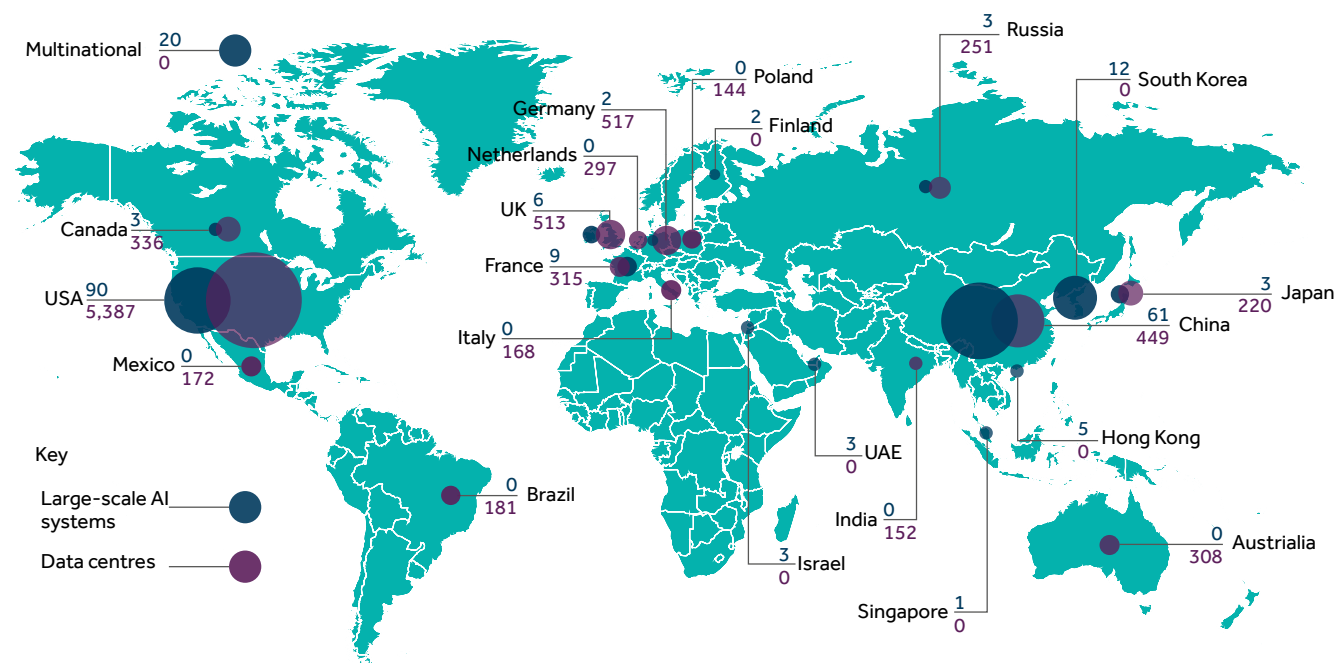
AI is interesting in this regard, because, while it may enable skill gaps to close and elevate workforces in developing economies, the race for dominance in AI capabilities is well underway. Indeed, large parts of the world may never catch up with the leaders.

"The key reason for the concentration of AI developments within just two economic heavyweights is the ever-expanding cost of training the systems"

¹ Keynes (1930): Economic Possibilities for our Grandchildren

IT'S A BATTLE ROYAL BETWEEN THE US AND CHINA

The map shows the number of AI systems identified by country, where AI models are defined as "large-scale" when their training compute is confirmed to exceed 10^{23} floating-point operations.



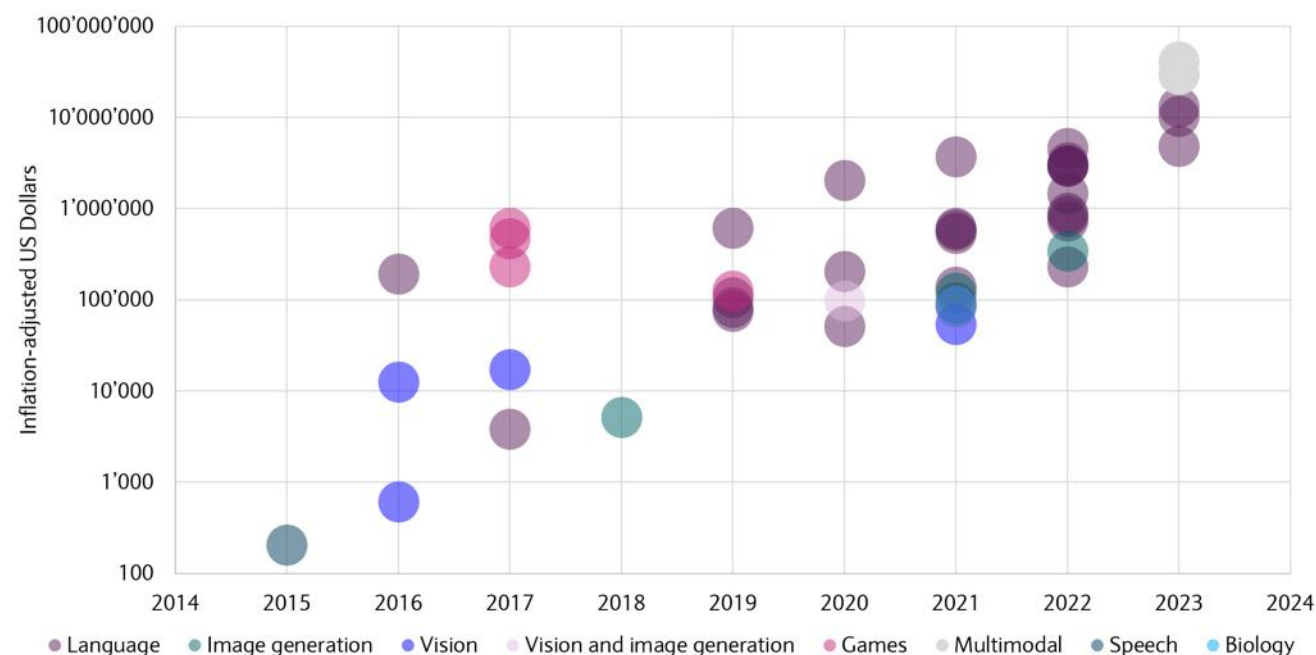
Sources: Our World in Data, Lightcast via AI Index (2024), Barclays Private Bank. Data accessed in September 2024

The key reason for the concentration of AI developments within just two economic heavyweights is the ever-expanding cost of training the systems. While the combined costs for hardware and energy usage were measured in the thousands

of dollars back in 2016, frontier models were easily consuming millions of dollars by 2023, and that was just for initial training runs. This limits the number of contributors to frontier research.

COSTS OF TRAINING AI SYSTEMS HAVE INCREASED

The combined costs in hardware and energy for training of AI models is expressed in constant 2023 US dollars. The hardware expenses are amortised and calculated by multiplying the training chip-hours by the reduced hardware cost, with an additional 23% for networking expenses



SIX NUCLEAR REACTORS TO TRAIN A MODEL

The process of training these models, involves trillions of data points and vast numbers of calculations to improve accuracy and performance. This, in turn, demands large-scale data centres packed with specialised hardware, consuming much electricity.

Recent estimates suggest that the computational demands of AI models have grown by over 260% per year, on average, over the last five years². This growth is expected to continue, as increases in model scale can contribute two-thirds of the performance gains of AI models.

However, this trajectory faces challenges, including the availability of high-quality training data, the scaling in production of the advanced chips needed and constraints on energy supply to data centres. Of all the constraints, power supply seems to be the most significant. If AI continues to scale at the current pace, it is estimated that by 2030 training a frontier model will require six gigawatts (GW) of power³, even after factoring in future efficiencies. To put that in perspective, six GW is equivalent to the output of around six nuclear power plants⁴.

“Some sectors may embrace full automation more quickly than others”

TEN GOOGLE SEARCHES FOR ONE CHAT GPT QUERY

Training is only a part of the equation though; once models are deployed, they require energy for ‘inference’ — the process of using trained models to provide results and solve problems. Whilst inference is far less energy-intensive than training, a single Chat GPT query is estimated to require 10-times the electricity of a google search⁵. Therefore, if Google were to power its entire search engine using AI models, it would consume 29.3 terawatt hours (TWh) per year⁶, equivalent to Ireland’s energy usage over the same period.

Data centres account for 2-4% of energy consumption in large economies today, but this is expected to double by 2030, making up 8% of US power demand⁷, driven by AI growth. The current geographical concentration of these data centres poses the biggest capacity issues, with datacentres already consuming over 10% of electricity in at least five US states and over 20% of electricity consumption in Ireland.

SCRAMBLING FOR ENERGY

The question, then, is not only how AI will continue to scale, but also how the energy infrastructure will keep pace. With construction of nuclear reactors alone taking around eight years for the most recently finished reactors and only twelve reactors having been connected to the grid over the last three years globally⁸, the bottleneck is real.

Meeting AI’s future power needs will require large-scale investments in energy generation, likely far beyond what is currently planned. Google’s recent agreement to purchase nuclear power, which will supply 200 megawatts (MW) by 2030, highlights both the industry’s awareness of this issue and the massive gap that remains.

OUTPUT BOOST OVER THE NEXT DECADE: 1% OR 100%?

Near-term physical limits to AI capabilities aside, gauging its impact on economies is difficult. It’s easy to extrapolate too far in the euphoria of the moment. By contrasting the complexity of tasks that are up for automation with present and future capabilities of AI, estimates can be derived for how much the technology may substitute labour and drive raw productivity gains. Furthermore, the shift may also generate new ways in which labour might be employed, an important concept in Keynes’ thoughts on technological progress.

Extremely optimistic estimates for efficiency gains suggest between 100% and 300% of global GDP growth over ten years, thanks to Artificial General Intelligence, which goes miles beyond current capabilities. More grounded forecasts include some that project a 7% increase in global GDP over ten years, based on more easily attainable generative intelligence (GenAI) capabilities. Cautious estimates see a 1.1% increase in GDP over ten years, not globally, but just for the leading country in AI research, the US⁹.

The difficulty of estimating AI’s potential impact is best shown by contrasting estimates on computerisation made just ten years ago with today’s data. In 2013, the Oxford University economists Carl B Frey and Michael A Osborne dissected the US economy into 702 different occupations and estimated the probability of computerisation. Aggregating their estimates, they found that 47% of the US labour force were at high risk of being automated “relatively soon, perhaps over the next decade or two”. Especially workers in transport and logistics occupations, but also office and administrative support staff were regarded to be at risk.

²Epoch AI, Data on Notable AI Models, June 2024

³Epoch AI, Can AI Scaling Continue Through 2030?, August 2024

⁴A typical nuclear power plant produces 1 gigawatt of energy. US Department of Energy, Office of Nuclear Energy, How much power does a nuclear reactor produce, 31 March 2021.

⁵Electric Power Research Institute, Powering Intelligence: Analyzing Artificial Intelligence and Data Center Energy Consumption, May 2024)

⁶de Vries, The growing energy footprint of artificial intelligence, 2023

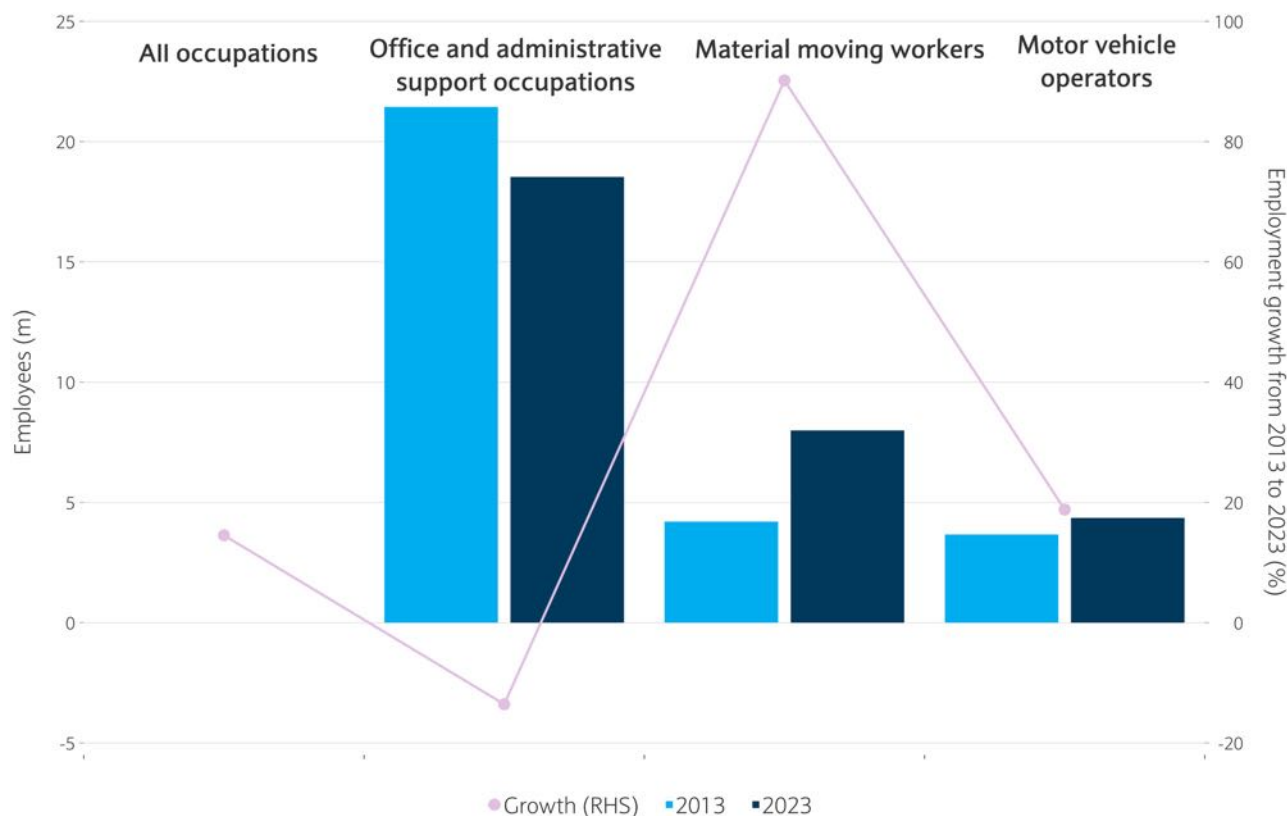
⁷Goldman Sachs, Generational growth: AI, data centers and the coming US power demand surge, April 2024

⁸International Atomic Energy Agency, Nuclear Power Reactors in the World, July 2024

⁹All projections referenced in: Acemoglu, The simple macroeconomics of AI; April 2024

E-COMMERCE BOOSTED TRANSPORTATION AND LOGISTICS OCCUPATIONS

Number of employees in millions and growth rates from 2013 to 2023 for different occupations from US Occupational Employment and Wage Statistics



Sources: Bureau of Labour Statistics, Barclays Private Bank, April 2024

Ten years down the road, it is astonishing to find that the transport and warehousing sector has, among all US sectors, created the largest number of jobs (+44%). Zooming in on occupations, instead of sectors, we find that while office and administrative support occupations have indeed declined, e-commerce has actually boosted job growth in material-moving occupations, while also leading to above-average growth rates in motor vehicle operator occupations. This is a very powerful example of how advances in technology can create new jobs.

CURRENT AI AFFECTS ALL SKILL LEVELS

Whether AI ultimately replaces employees entirely, or uplifts their capabilities, depends on the AI capability and the difficulty of the tasks. Academic research divides the skills used for any job into core skills and the less important 'side skills'. As long as AI is confined to automating side skills, like the drafting of letters for an advocate, it is complementary. Once the technology is powerful enough to automate core skills, it becomes a substitute and, depending on the cost, may replace labour entirely.

Recent research suggests that current AI capabilities already affect the side skills of low- and high-skill workers¹⁰. But the likelihood of a large-scale displacement of labour is still low for lesser-skilled workers, often found in physical jobs, where

side skills are few and secondary. For high-skilled workers, where side skills are relatively more important, the current capabilities of AI are not refined enough. This is likely to limit the productivity gains economies can expect in the near term.

ARE WE IMAGINING THINGS?

AI makes mistakes, just like us. One of the main challenges, which is also holding it back from performing more of the mentioned side skills, is that systems can inadvertently perpetuate biases present in training data. Such embedded biases can systematically, and unfairly, discriminate against certain individuals or groups, potentially favouring others.

Moreover, GenAI introduces new risks, like so-called 'hallucination', where models might confidently produce incorrect but plausible outputs, and these risks may persist despite efforts to improve data quality and transparency.

Therefore, in customer-facing applications, GenAI-supported tools could offer inappropriate advice to non-experts, potentially harming both users and the reputation of the company. For this reason, some sectors may embrace full automation more quickly than others, where data is more sensitive. For example, GenAI use in critical industries such as finance or healthcare requires close human oversight, tailored to the level of risk posed by its application.

¹⁰ Auer et al., The rise of generative AI: modelling exposure, substitution and inequality effects on the US labour market, September 2024

SECTORAL DIFFERENCES IN IMPLEMENTATION

Ensuring robust AI performance has become essential to safeguarding public trust. Robustness in AI spans model accuracy and governance to prevent unethical outcomes – such as bias and exclusion – and address potential privacy shortcomings.

Enterprise-level GenAI systems are being developed to mitigate privacy concerns found in public systems, potentially enhancing data security, such as in finance and healthcare. Enterprise-level applications may reduce certain risks associated with the public ones, though they may not be a cost-effective solution for smaller financial institutions.

Therefore, the issues like transparency, interpretability, data privacy, and potential biases challenge public confidence and the pace of AI adoption, which may vary significantly from one industry to the other.

“There seems limited potential for broad productivity gains... coming from generative AI”

OVERESTIMATE THE SHORT RUN, UNDERESTIMATE THE LONG RUN

In 1933, Keynes described a new disease that he feared would plague economies as a ‘temporary phase of maladjustment’. In the long run – over one hundred years – he claimed the standard of life would be four to eight times that of 1930. Ten years off the full century, we can state that US life expectancy at birth has shot up from 60 years to 79, across genders. Infant mortality dropped from over 100 deaths per 1,000 live births, to below ten. And after adjusting for inflation, per-capita GDP increased 7.5-fold¹¹.

One could argue that anything AI can add from this point onward for the last ten years of Keynes’ projection, is just added bonus. Still, there seems limited potential for broad productivity gains across sectors and jurisdictions coming from generative artificial intelligence for now. As frontier model runs are becoming more resource-intensive to develop, the growth of AI capabilities is very much tied to our ability to generate more energy – something we have been struggling with lately.

In this environment, investing in task-specific AI applications within fields where AI unlocks productivity gains, by automating a large share of an occupation’s tasks, appears more promising to us than banking on ‘breakthrough’ developments from the competing producers of frontier models.

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¹¹ US Social Security Administration, United Nations (2024), US Centers for disease control and prevention (1932, 2024), OECD (2024), Barclays Private Bank, November 2024



Material E, S and G factors in 2025

To protect and grow portfolios in 2025, investors should consider the financially material environmental, social and governance (ESG) factors that are likely to affect their returns. Here, we identify six key ESG factors that investors will want to mind.

Please note: This article is designed to be thought leadership content, to offer big picture views and analysis of interesting issues and trends that matter to our clients and the world in which we live. It is not designed to be taken as expert advice, investment advice or a recommendation, and any reference to specific companies is therefore not an opinion as to their present or future value or broader ESG credentials. Reliance upon any of the information in this article is at the sole discretion of the reader. Some of the views and issues discussed in this article may derive from third-party research or data which is relied upon by Barclays Private Bank and may not have been validated. Such research and data are made available as additional information for the reader where appropriate.

Facing a tentative outlook for the global economy in 2025, investors may want to hold high-quality companies that show their defensive qualities in slowdowns while still having long-term growth potential. When selecting these assets, investors should consider which environmental, social and governance (ESG) factors can affect companies the most in 2025, and therefore their portfolio returns.

The table below of ESG factors, while not exhaustive, highlights common factors that all companies face and that investors can use to inform their investment decisions.

ENVIRONMENT	SOCIAL	GOVERNANCE
Carbon emissions management Climate change vulnerability Energy management Natural resource use Water management Hazardous waste management Recycled material use Nature and biodiversity	Labour management Human capital development Diversity, discrimination, equity Employee safety and working conditions Supply chain conditions Product safety Privacy and data security Community rights and relations Human rights policy	Corporate governance Business ethics Anti-competitive practises Corruptions and instability Anti-bribery and anti-money laundering policy Compensation disclosure Board gender diversity Tax transparency

Investors consider many issues when deciding whether to hold an investment. Importantly, ESG factors are fundamentally about an organisation's internal practices. They provide data about how well a company operates and manages material risks, and its effect on financial performance. It does not include the outcomes of its goods or services on the world. Including ESG factors can enhance existing investment processes by including non-financial information – hopefully to make more informed investment decisions. (For more explanation, see [Why ESG factors matter in investing](#)).

Therefore, through discussion with our investment teams and industry peers, we've identified six key E, S and G factors that are likely to be material for 2025, and what each means for investors.

As a caveat, these factors are neither static nor exhaustive. Rather, we sought to highlight those that possess definitive momentum and those that are underappreciated and are emerging for the year ahead.

MATERIAL "E"NVIRONMENTAL FACTORS

Companies' operations and countries are increasingly hit by the physical impact and the transition efforts around climate change.

To slow, halt, and reverse warmer average global temperatures requires faster global action. In 2025, countries and companies will need to move from their past pledges and plans to taking concrete action.

Reporting and regulation will propel activity around familiar environmental factors, such as carbon emissions. We consider emerging factors, notably in areas of nature and biodiversity and corporate energy usage and sourcing, with their implications for companies in 2025.

NATURE AND BIODIVERSITY FACTORS

How well a company manages and mitigates their ecological impact to ensure sustainable use of natural resources and ecosystem services as well as compliance with environmental standards.

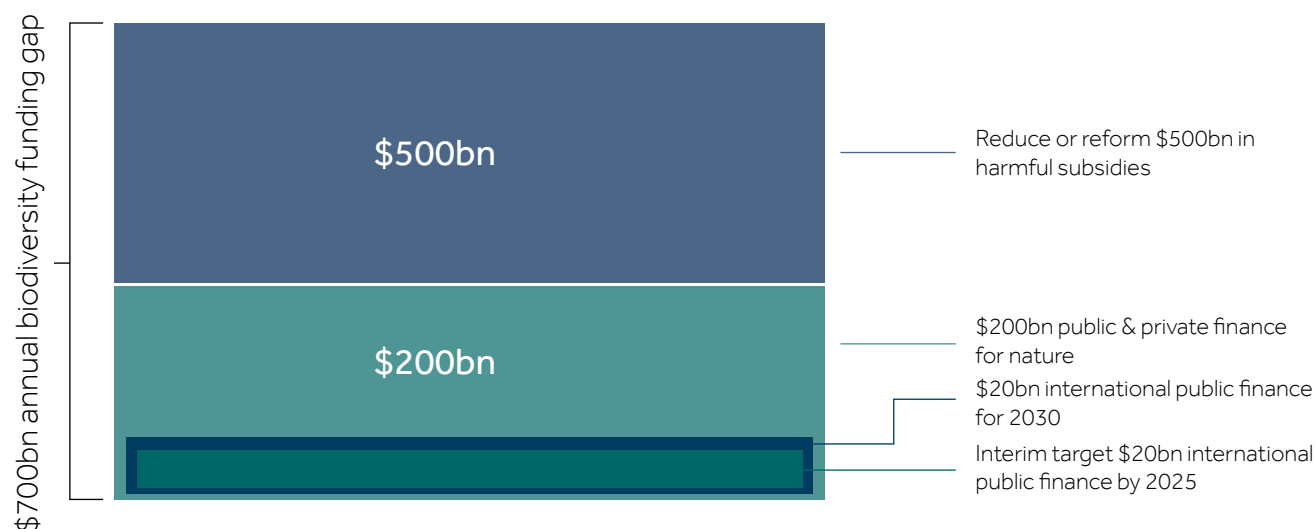
Over half of the world's gross domestic product is dependent on nature and biodiversity¹.

However, companies have not had to account fully for the financial value of these resources. Nor do many investors recognise how much the value of their portfolio relies on nature.

Unfortunately, current levels of global spending (see chart) don't support the preservation, or regeneration, of these natural resources. While roughly \$154 billion is spent each year for positive biodiversity outcomes², an estimated annual funding gap of \$700 billion remains³.

THE BIODIVERSITY FUNDING GAP

Targets for closing an estimated \$700 billion funding gap in biodiversity, involving governments and companies



Source: Biodiversity Finance Trends, Barclays Private Bank, October 2024

¹World Economic Forum, Half of World's GDP Moderately or Highly Dependent on Nature, Says New Report, January 2020

²The Nature Conservancy, A New Deal to Close the Nature Finance Gap, September 2022

³UK Government, 10 Point Plan for financing biodiversity: trends in 2023, December 2023

If these ecosystem services, such as healthy soils, clean water or pollination, and the direct use of resources, such as forests or oceans disappear, companies reliant on them face significant financial risks. This ranges from sectors as agricultural and food & beverage to construction and utilities. (For more on biodiversity and its financial risks, see [Is your portfolio ready for biodiversity loss?](#)).

Generally, a lack of data about companies' reliance on, and impact towards, nature has challenged investors to assess and value the risks. To address this gap, the Taskforce for Nature-related Financial Disclosures (TNFD) published recommendations in 2023 for a standardised framework for firms to assess and disclose their exposure to nature-related financial risks.

The next twelve months will mark the first time that 320 corporates, across 58 sectors, are expected to report data on their 2024 fiscal year⁴.

While reporting is not mandatory, this may change, as it did for similar climate-related financial disclosures in some jurisdictions. Early adopters have faced upfront costs to implement new practises and may disclose previously unknown risks or harms to nature and biodiversity from such behaviours. However, it's more likely these will be leading rather than laggard organisations.

For investors, watching both who discloses (and who doesn't) and incorporates relevant data into their assessment, may provide an information advantage when making selections.

ENERGY USAGE & SUPPLY

A company's energy usage directly corresponds to their emissions footprint and operating costs. Those conscious of their emissions footprint might pursue renewable sources or alternative processes that are less energy intensive.

Companies likely will continue to face high variability of energy input costs as well as uncertainty of supply given geopolitical tensions. As well, those with Net-Zero commitments will start, or continue, to search for alternatives to decrease their carbon emissions from their energy purchase and usage⁵.

At the same time, delivering economic growth in 2025 will require additional energy. Moreover, new technologies, such as artificial intelligence (AI) or blockchain, are spurring greater energy demand. While the net effect is unknown, energy usage is expected to grow rapidly.

Data centres accounted for 1-1.5% of global electricity use in 2022⁶ and, depending on calculations, 0.6%⁷-2.4%⁸ of global greenhouse-gas emissions. Improvements in energy efficiency have helped to limit their energy demand⁹. However, the rapid evolution of AI technologies and wave of investment in data centres in 2024 points to more electricity demand in 2025, which may double between 2024 and 2026¹⁰. (For more about AI's potential impact on the economy, see [Is AI \(b\) reaching its limits?](#)).

While increased demand and risk of energy supply for technology has been newsworthy, all companies require energy for their operations. So, being able to meet their energy demand amid growing uncertainty over satisfying demand with supply and costs, may be a critical factor to separate winners and losers in 2025.

Investors too, can assess the scale and nature of energy demand and how well a company manages this risk. This means considering if a business seeks to directly secure supply or attain self-sufficiency. As well, wondering if those investing in low-carbon energy solutions or energy efficiency upgrades could face short-term costs, but derive long-term operational and cost benefits.

Furthermore, those shifting to renewables should find themselves more shielded from potential volatility in fossil-fuel prices, and with a lower emissions footprint, less exposure to transition risks, such as carbon pricing and policy changes.

MATERIAL "S"OCIAL FACTORS IN 2025

Until the inescapable effects of the pandemic demonstrated their financial materiality, social factors, such as employee safety and working conditions, hadn't generally received the same attention as environmental and governance ones.

While these social issues affecting individuals might be material for companies, for 2025 we wanted to highlight how companies manage their relationships with larger groups and communities, specifically around cybersecurity and community engagement.

CYBERSECURITY

A company must implement the infrastructure to protect the data that they own and produce, regarding customers and stakeholders, to ensure operational continuity and trust.

The estimated \$9 trillion-plus costs of cybercrime would be equivalent to the world's third largest economy (see chart, p30). On the other side of that figure are the individuals, companies and countries that have paid for those illicit gains.

⁴ TNFD, 320 companies and financial institutions to start TNFD nature-related corporate reporting, January 2024

⁵ These indirect greenhouse gas emissions associated with the purchase of electricity, steam, heat, or cooling are known as Scope 2 emissions.

⁶ IEA, Data centres & networks, July 2023

⁷ Ibid

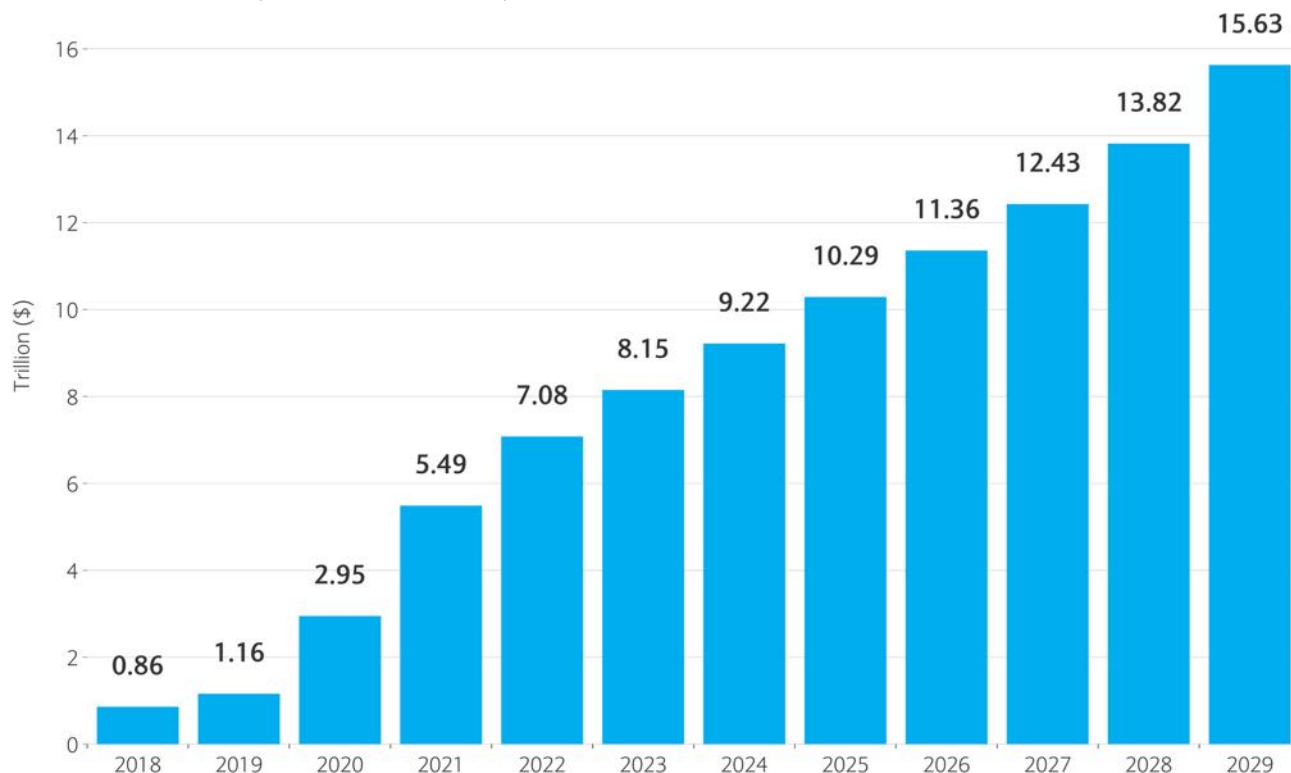
⁸ ClimaTiq, Measuring greenhouse gas emissions in data centres: the environmental impact of cloud computing, April 2022

⁹ IEA, Data centres & networks, July 2023

¹⁰ IEA, Electricity 2024 – Analysis and forecast to 2026, January 2024

MUSHROOMING COST OF CYBERCRIME

The estimated cost of cybercrime internationally since 2018



Sources: Statista, Barclays Private Bank, October 2024

In 2020, 90% of the S&P500's market value was derived from intangible assets, intellectual capital, and goodwill¹¹. Corporate valuations aren't based on factories and machines, instead lines of code, pools of customer and internal data, computational models and algorithms.

Cybersecurity risks threaten these core assets. For example, an outage in 2024 affecting Microsoft devices took 8.5 million of them offline globally; and caused an estimated \$10 billion of economic damage¹². Similarly, the proliferation of smart devices and our increased online presence has offered up our personal data, often concentrated with a few large players in the industry. Cyberattacks, for example at UnitedHealth, which resulted in over 100 million Americans' data being compromised¹³, can create long-term damage to company's viability.

With technology and data essential to running companies from micro- to multi-national size, cybersecurity is an omnipresent risk. Worldwide, in 2023, there were over six billion malware attacks alone¹⁴. Large corporates with mission-critical software or technology, or with extensive, sensitive personal data, face greater reputational, financial, operational and legal risk in the event of an attack, outage or data leak.

Similarly, investors can benefit from assessing the nature of these cybersecurity risks, their financial materiality and how they are managed. Delving into a company's cybersecurity policies and protocols, adherence to industry standards,

employee training, regular assessment of security systems and investment into cybersecurity, can provide comfort for both a firm's stakeholders and investors.

COMMUNITY ENGAGEMENT

The concept of community engagement pertains to the active participation and collaboration within a community, to facilitate dialogue on material topics with the intention to create cohesive and resilient outcomes.

Companies cannot succeed without the acceptance or approval from the communities in which they want to operate. Whether siting new factories, building or replacing infrastructure, or negotiating access rights, engaging communities and addressing stakeholder concerns and expectations, is critical to a company's costs, timeline, or even viability.

Faced with geopolitical tensions, risk management of supply chains and governmental incentives, companies will continue to modify their physical footprint. To near-shore, friend-shore or re-shore, companies need a welcoming berth for facilities and suppliers. To benefit from governmental industrial policies and incentives, such as the US Inflation Reduction Act or Made in China 2025, companies need to open factories. To replace or build new infrastructure, from transport to energy production, firms need space and approval to proceed.

¹¹Ocean Tomo, Intangible Asset Market Value Study, October 2024

¹²Business Insider, Companies ready insurance claims over CrowdStrike outage, July 2024

¹³Bloomberg, UnitedHealth (UNH) Says Ransom Was Paid in Change Cyberattack, April 2024

¹⁴Statista, Number of malware attacks per year 2018, April 2024

As a result, the relative influence of communities will increase in 2025. The relationship can range from synergistic to ruinous, with associated costs or benefits along the spectrum. For example, stakeholder issues over two years, which prevented an oil company's production to come online, caused an estimated \$6.5 billion in value erosion, or a double-digit percentage of its annual operating profits¹⁵. Mining companies also provide historical examples where engagement and community support were material to their success.

Notably, for the energy transition to be successful, more renewables projects need to be built, and at a faster rate. At present, the timeline for offshore wind projects extends to twelve years, onshore wind timelines to ten years, and utility-scale solar facilities to four years. In conjunction with regulatory reforms, firms with better skilled at acquiring local support, and therefore permitting, will be better placed to construct and operate renewables.

Investors can consider a company's need and approach to community engagement. This can be part of a wider assessment of "social license to operate" which is the perception by stakeholders that a business or industry is acting in a way that is legitimate, credible and trustworthy¹⁶. Without effective community engagement a firm's medium- or long-term financial or operating performance, as well as potential for acute short-term financial impacts will affect profitability and viability.

MATERIAL "G"OVERNANCE FACTORS IN 2025

How organisations are managed has been a long-standing, non-financial consideration for investors. Executives and boards are accountable for delivery of results for stakeholders and shareholders.

In 2025, they will have to navigate firms in a world with uncertainty in terms of economic growth and geopolitical tension and increased complexity, with deglobalisation, return of industrial strategy and rise of sustainability regulation. Investors should watch how they manage around two particular challenges - tax and tariffs and sustainability.

TAXES & TARIFFS

Responsibly managing tax and tariffs risks for companies involves transparent reporting in line with operations, demonstrating a commitment to societal obligations.

Next year, increased tariffs could severely disrupt global supply chains and international business operations. As well, tax changes also risk eroding profits as governments seek to recapitalise their balance sheets. Given the increased reference of tariffs on earnings calls, executives already are expressing a clear concern (see chart, p32).

"Over half of the world's gross domestic product is dependent on nature and biodiversity"

As part of a year that saw elections in more than 100 countries in 2024¹⁷, political debate has focused on public finances. The International Monetary Fund estimated that global public debt may exceed \$100 trillion for the first time ever in 2024, reaching 93% of global economic growth¹⁸.

To reduce their budget deficits, governments may use tools to increase revenues, such as increasing corporate tax rates or tightening tax gaps. For example, the French government announced a temporary corporate income tax hike for those with revenue greater than €1 billion, and a tax on share buybacks¹⁹. In the UK, October's budget included rises in capital gains tax, to 18% from 10% at the lower rate, and to 24% from 20% at the higher rate²⁰.

Also, governments may implement new tariffs to boost tax revenue and support domestic businesses, to address escalating geopolitical tensions and campaign promises. The EU decided in October 2024 to implement tariffs of up to 45% on Chinese-imported electric vehicles, both to support domestic European manufacturers and to retaliate against alleged excessive subsidies, which allowed the Chinese electric vehicle manufacturers to undercut European peers on price²¹.

For investors, change in tax legislation or tariffs could have a significant impact on company earnings and shareholder returns. To identify specific industries and companies at risk of tax changes, investors can seek data on a company's effective tax rate, and compare that with relevant statutory tax rates. In addition, businesses with aggressive tax mitigation strategies will likely face the greatest risk and impact.

The threat of tariffs is challenging to screen or quantify. To understand the risk, necessitates detailed assessment of sector and company exposure in relation to relevant industries and national importance. However, based on their frequency of their mentions in briefing calls, executives have become increasingly worried about the potential risks.

¹⁵Davis, R. and Franks, D., Costs of Company-Community Conflict in the Extractive Sector, 2014

¹⁶Boutillier, R. and Thomson, I., Modelling and Measuring the SLO, 2011

¹⁷TIME, Elections Around the World in 2024, December 2023

¹⁸IMF, Global Public Debt Is Probably Worse Than It Looks, October 2024

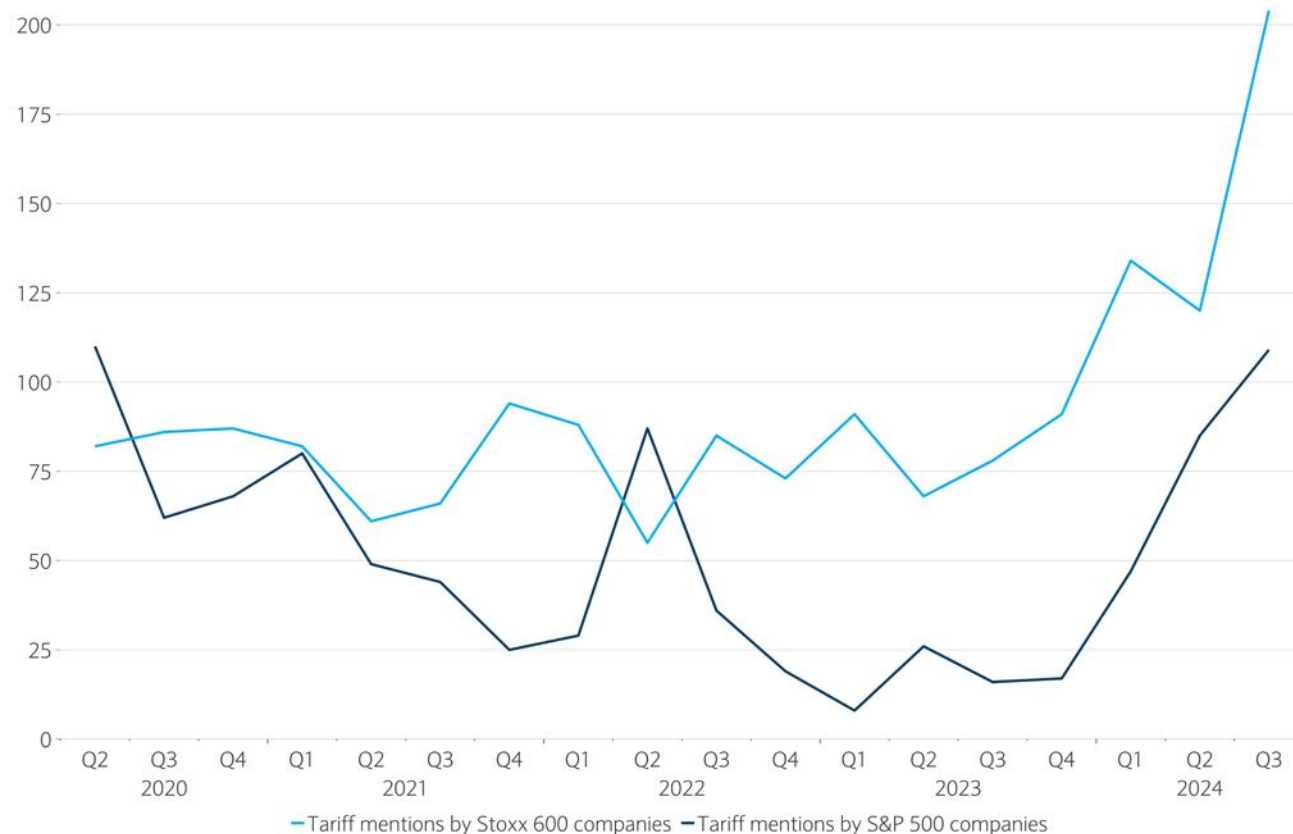
¹⁹CMS law., French Finance Bill For 2025, October 2024

²⁰Barclays Private Bank, UK Budget: Key details, October 2024

²¹Reuters, EU presses ahead with Chinese EV tariffs after divided vote, October 2024

TRADE TARIFFS ON EXECUTIVES LIPS' MORE

The amount of time 'tariffs' are mentioned during company earnings calls, either by members of the S&P 500 or the STOXX 600



Sources – Bloomberg, Barclays Private Bank, October 2024

EXECUTIVE & BOARD COMPETENCY ON SUSTAINABILITY

Evaluates the knowledge, skills and experience of executive leadership and directors on sustainability, and their ability to exercise effective oversight of firm's sustainability practices and regulatory requirements.

Companies face growing pressure from governments and society to operate more sustainably. Without a deep understanding of what this means – its nuances and geographic variations as well as the risks and opportunities it presents – executive leadership and boards will struggle to steer their companies effectively. Boards have the critical role of guiding a company's strategy and managing risks, making their expertise foundational to a company's resilience and growth.

With growth of recognition and expectations around sustainability issues, executive competence in these areas is indispensable. Yet, research from NYU Stern School of Business found that 57% of Fortune 100 boards in 2023 still did not have board members with relevant ESG credentials²².

Similarly, Ceres found that only 31% of 600 large, publicly traded US companies had board oversight of sustainability matters²³. Lacking knowledge in sustainability issues and how to oversee and manage them, means companies may miss opportunities, create potential liabilities or, worse, affect the company's license to operate.

In 2025, these executives face continued increase in sustainability regulations. Often these require greater disclosure and transparency. For example, the EU's Regulation on Deforestation-free products, requires any company importing or exporting cattle, cocoa, coffee, palm oil, soya, wood and rubber from the EU to prove they were not produced in deforested land (see [The growing importance of accountability in the supply chain](#)).

²²NYU Stern School of Business, Boards Better Prepared in 2024 for Tackling Financial Material Sustainability Issues but Major Weaknesses Persist, February 2024

²³Insead Corporate Governance Centre, What's Stopping Boards from Turning Sustainability Aspirations into Action?, April 2023

The first corporate disclosures for the EU's Corporate Sustainability Reporting Directive (CSRD) are due in 2025, on a range of sustainability issues, including greenhouse-gas emissions, water use, waste generation, employee diversity, working conditions and human rights.

Already, executives need to be planning for the now-adopted EU Corporate Sustainability Due Diligence Directive (CSDDD), so that they can report on how their firms are conducting effective human rights and environmental due diligence in their supply chains.

For investors, assessing board and executive expertise on sustainability may provide insight into which firms are likely to fulfil regulatory requirements and stay competitive in a rapidly evolving market. This can come from reviewing executives' and board members' credentials, relevant experience in sustainability, and the firm's governance processes and practices to identify and manage sustainability risks. Through this, investors can gain a clearer picture of how capable leadership is in addressing sustainability risks or to seize new opportunities, which can drive long-term performance.

LOOKING AT ESG IN 2025 AND BEYOND

With sustainability becoming more mainstream, investors are increasingly having to consider ESG factors in how companies operate to make better-informed investment decisions.

This begins by identifying key ESG factors for 2025, like the six highlighted above, and assessing their associated risks and opportunities for holdings.

In what looks like being a low-return era for investors, this integration provides additional tools for investors to select companies and build portfolios with the aim of generating long-term returns for 2025 and beyond.

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Is 2025 the time to decarbonise your portfolio or the planet?

With the impact of climate change increasingly costly to society and financial markets, what can investors do to position their portfolio for 2025 and beyond?

Please note: This article is designed to be thought leadership content, to offer big picture views and analysis of interesting issues and trends that matter to our clients and the world in which we live. It is not designed to be taken as expert advice, investment advice or a recommendation, and any reference to specific companies is therefore not an opinion as to their present or future value or broader ESG credentials. Reliance upon any of the information in this article is at the sole discretion of the reader. Some of the views and issues discussed in this article may derive from third-party research or data which is relied upon by Barclays Private Bank and may not have been validated. Such research and data are made available as additional information for the reader where appropriate.

Climate change is reshaping the world and will be a critical factor that drives the performance of investors' portfolios. By August of 2024, the year was already the hottest on record globally¹, and many impacts of climate change have been earlier or larger than scientists have expected².

The halfway point of the "Decisive Decade" for climate action is 2025³. As the International Energy Agency roadmap to net zero by 2050 indicates (see chart, p34), politicians, businesses and society have to move from pledges to taking action, if global decarbonisation targets are to be met.

As the global community seeks to accelerate the delivery of its transition to a low-carbon world, investors face a fundamental question – should you focus on decarbonising your investment portfolios, or should you invest in ways that help decarbonise the planet?

Both approaches have unique goals, risks, and rewards. This article explains the differences, implications, and considerations to inform your choice and how to begin positioning your portfolio.

DECARBONISING YOUR PORTFOLIO

Decarbonising your investment portfolio involves taking action to reduce your portfolio's exposure to climate risks, and the effects it has on your returns.

The goal is to manage these risks, from the physical impacts of changing climate, whether from the impact of extreme weather or long-term change, as explained in [Making portfolios more weather resistant](#), or to manage risks from the impact of global efforts to reduce emissions, from shifts in policies, technologies and market demand, as pointed out in [Is your portfolio at risk from the low-carbon transition?](#)

Here, the ambition is to have a 'greener portfolio' that's aligned with economic policy and global energy shifts, whether now or in the future, to protect its value by managing potential risks better.

"Transition investing' provides a novel and pragmatic option to invest"

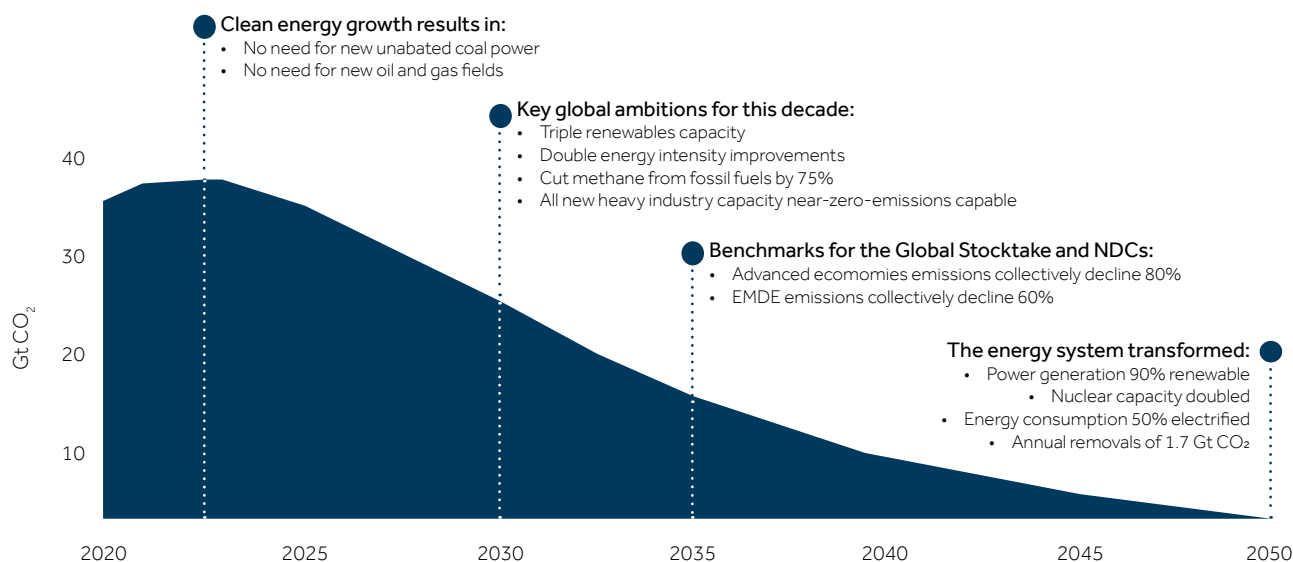
¹Copernicus: Summer 2024 – Hottest on record globally and for Europe, Copernicus Climate Change Service (C3S), 6 September 2024

²The Guardian, Earth's 'vital signs' show humanity's future in balance, say climate experts, 8 Oct 2024

³The Decisive Decade: Organising Climate Action, University of Oxford: Said Business School, June 2021

THE ROADMAP TO NET ZERO REQUIRES ACCELERATING DELIVERY

Key decarbonisation milestones on route to the world being net zero by 2050, as set by the International Energy Agency



Source: International Energy Agency, [Net Zero Roadmap: A Global Pathway to Keep the 1.5 °C Goal in Reach](#), Sep 2024

To decarbonise your investments could involve a simple screening strategy, avoiding or divesting from high-emitting sectors, such as power generation or cement production, and actively overweighting lower-emission ones, perhaps technology or healthcare. Alternatively, if wanting to maintain broad market exposure, you could select 'best-in-class' companies amongst a peer group in a particular industry. And you can draw on the increasing amount of corporate disclosures in the area to support investment decisions as we explained in [Making better use of climate-risk data](#).

Additionally, there is the option to invest in the companies that have a credible, science-based target and transition pathway to meet their net-zero target. Within the widely used Net Zero Investment Framework, and depending on the firm's progress, they would be considered 'achieving net zero', 'aligned to a net zero pathway', or 'aligning to a net zero pathway'⁴.

If investors cut back on exposure to industries such as oil and gas, such portfolios may lag a traditional benchmark's performance in periods when related commodity prices increase. Or potentially, if transition risks arise more slowly or are less than expected. On the other hand, decarbonised portfolios should be able to retain their value with an accelerating transition or if carbon-intensive assets are suddenly, and sharply, repriced, which is generally known as a 'Minsky moment'⁵.

"Politicians, businesses, and society have to move from pledges to taking action, if global decarbonisation targets are to be met"

As a result of this approach, your holdings should be more resilient against climate-related risks, but without directly funding the efforts to decarbonise the planet.

PROTECTING THE PLANET

Decarbonising the planet with your investments means selecting those that actively support reducing total global emissions. The goal is to make returns from investing in companies that provide solutions to deal with climate change or to accelerate action from companies that need to transition.

Your motivation may be to use your investments in a way that should create a greener world, one that can benefit from the transition to a more environmentally-sustainable economy. Or, perhaps the motive is more financial than altruistic, and to recognise a market's growth potential and improve your portfolio's performance by investing in those sectors.

In seeking to invest in this way, you may prioritise companies, or projects, that make a positive environmental impact through their goods or services, such as generating profit from renewable energy, battery or energy storage, and green infrastructure. Also, picking companies that aren't necessarily 'pure-play' green companies, but are providing enabling solutions that help to reduce costs or improve decarbonisation outcomes, such as software businesses or data providers.

Additionally, 'transition investing' provides a novel and pragmatic option to invest to support currently high-emitting and hard-to-abate sectors, to move onto credible transition pathways and accelerate the decarbonisation of their processes, business models, and products. (As explained further in [Capitalising on the low-carbon energy transition](#)).

⁴Institutional Investors Group on Climate Change, Net Zero Investment Framework 2.0, June 2024

⁵Centre for Economic Policy Research, Financial stability at the 'climate Minsky point', June 2022

If portfolios have a larger exposure to companies with climate-change solutions than in a benchmark index, it can add concentration risks. This might cause over- or under-performance, depending on 'sector rotations' and changes in the economic outlook. Additionally, higher interest rates can weigh down decarbonisation-solution businesses, which tend to be newer and more capital-intensive than many other businesses. Furthermore, a portfolio may end up being exposed to more transition risks, if the selected companies or projects do not achieve their decarbonisation targets or plans.

As a result of taking this investment approach, your holdings may support decarbonisation, but can be more susceptible to market sell-offs in the sector or from market perceptions of progress towards net zero, and so impact share prices.

DECIDING FOR YOUR PORTFOLIO

Determining between these approaches comes down to multiple factors, such as your motivations, financial and sustainability goals, and beliefs.

Decarbonising a portfolio could be done to align your holdings with your values, or to seek to safeguard your assets from climate-related risks. Or you may focus on investing for decarbonisation to create positive outcomes, influencing the world that your children and grandchildren will inherit, or to unite your family's generations and create a positive reputation or legacy.

As well, both can be pursued. It's possible to combine elements of both approaches across your portfolio, or apply one approach in a particular asset class, for example in early-stage companies as highlighted in [Four drivers making green ventures attractive](#).

Finally, it's critical to remember that these approaches are only one perspective on which to build your portfolio. This includes fundamental investment principles around asset allocation, diversification, selection of high-quality companies. As well, as ever it's valuable to try to manage the effects of your innate behavioural biases in 2025, as discussed in [Making sense of things](#).

GETTING STARTED

To implement these approaches, you have a variety of possible starting points:

- Review your portfolio to identify holdings that could be exposed to climate risks, or to discover opportunities in environmental sectors that should have long-term growth potential.
- Articulate your motivations and ambitions around climate change, then, to meet those aims, outline what an ideal portfolio would look like. It can be particularly valuable to connect with younger generations for this discussion and help them to understand and prepare them to take on the family portfolio.
- Carve out an allocation and build a set of climate-related investments, by either setting aside a specific amount or portfolio percentage, or by focusing on an asset class. This can be helpful to get started and experiment, while also learning and limiting overcommitment risks.
- Focus on a particular theme or sector of interest, perhaps energy systems or food systems, to search for related opportunities that could span equities, bonds and other types of investments.

You can learn more and gain useful insights into these approaches via sustainable investing specialists, or from peers, who have already adopted these approaches. In all cases, financial advisors can counsel you on the practicalities and consequences of changes to consider any changes holistically.

TAKING THE FIRST STEP

The choice between aiming to decarbonise your portfolio or the planet doesn't have to be an either/or.

Both can offer compelling financial and personal value – whether by aiming to improve returns with a more resilient investment mix, or by supporting the urgent work around limiting and reverse the increasingly costly effects of greenhouse gas emissions.

As always, when investing, actively evaluating and making considered decisions is critical to achieving your aims. Discussing with your family and advisors puts you on a path that's increasingly critical, both for the financial and sustainable future you want. Use 2025 to take the first step.

Author: Damian Payiatakis, London UK, Head of Sustainable & Impact Investing



Making sense of things

It's been another eventful year for investors. As a fresh US administration takes charge, the tech sector powers ahead and rates head down, find out how you can stop your emotions getting in the way of reaching your investment goals.

All data referenced in this article are sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

The year just gone might be summed up in one word: expectations. Markets have been driven by economic expectations, central bank policy, election outcomes and geopolitical developments.

Despite a vast array of events, expected and unexpected, market performance has been strong. Equities have hit all-time highs, fixed income has delivered solid yields.

The coming year will be about delivery. Central banks need to deliver on market expectations, governments on fiscal consolidation and meeting campaign promises, China on unleashing its stimulus and companies on producing the earnings growth needed to support market valuations.

BEWARE OF YOUR BEHAVIOURAL BIASES

Whilst our Outlook 2025 aims to support investors with the right investment strategy and portfolio to navigate this, it is paramount to act on this in the right manner. Having solid behavioural foundations is one way to do so, allowing investors to stick to their investment plans even if the outlook gets murky.

Behavioural biases can significantly influence decision-making, often leading to sub-optimal investment outcomes. Understanding and mitigating these biases is essential for aligning investment strategies with long-term financial goals.

There are three key biases for investors to be aware of when watching the market and making decisions in the year ahead.

“The next twelve months will provide challenges, surprises and opportunities”

KEY BIASES TO BE AWARE OF

1. Confirmation bias

Confirmation bias is the tendency for people to seek out, and pay more attention to, news and stories which confirm their own pre-existing views or beliefs.

Confirmation bias can lead to a range of investment behaviours, such as influencing asset allocation decisions. Investors that have strong views on a likely outcome, which have been strengthened through confirmation bias, may select investments due to that. The result can be a portfolio which is more concentrated, and thus less diverse.

It can also lead to overconfidence – when one's subjective confidence in our own judgments is typically greater than the objective accuracy of those judgments. One such potential result is increased trading activity. Attempting to trade around events or time the market can be costly to investors.

2. Availability heuristic

The availability heuristic is a mental rule of thumb which leads people to assign a greater frequency to events which are more readily available in their minds. This leads to overweighting news, events and data points which can be more easily recalled, which will typically be those that are more dramatic or emotive, such as geopolitical conflict.

This can delay taking action. Investors keeping a close eye on the news, with all the potential for uncertainty and volatility, often tend to hold cash and wait before making investments. For those already holding assets, this heuristic can lead to anxiety which affects composure and satisfaction. For others it can lead to herding behaviour and momentum trades.

3. Familiarity (home) bias

People like the familiar. When it comes to investing, investors might prefer to stick with familiar asset classes, sectors and companies. In addition, they could prefer to hold local equities or bonds, called home bias, rather than investing in a broader, more diverse, portfolio that is more in line with the global market.

Familiarity can provide a feeling of control over outcomes. Investors might attach more risk to investing abroad than is deserved, simply because overseas companies are less understood.

Another reason is our aversion to ambiguity; situations where probabilities are unknown. Past experience can also play a role; investors may think they are better at assessing domestic assets and consequently over-estimate their judgements.

More often than not, this bias can lead to less diversification. For instance, an investor who holds most of their wealth in houses, because they know it and they are 'real', or someone who doesn't invest in emerging markets, because they don't understand it. (In ['Adopting to the yield cycle'](#) we discuss the diversification benefits of emerging market debt in fixed income allocations).

ILLUSTRATING THE BIASES

The trend for investing in anything related to artificial intelligence (AI) was displayed in 2024, and was a key driver of markets. For more on the AI boom and its potential implications, see [Is AI \(b\)reaching its limits?](#)

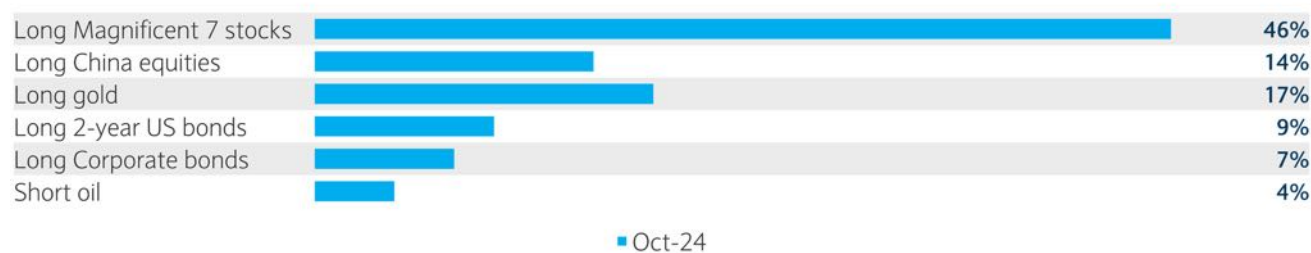
The most crowded trade over recent months was to be long the tech-heavy 'Magnificent 7' stocks (see chart). Questions have been asked about whether investors are being too optimistic about these companies' prospects, as well as concerns over a small group of stocks having such a big effect on market performance. The Magnificent 7 stocks are up approximately 35% in 2024, to 28 October, significantly more than the 23% return seen on the S&P 500, of which they account for approximately 30% of the index's valuation.

Given the importance of these stocks in the performance of the overall market this year, as well as the importance of the thematic story, given the possible wide-reaching impacts of AI, there is understandably a lot of commentary being produced. Reading much of this commentary are investors A and B.

Investor A would describe themselves as an AI evangelist. They firmly believe that AI will change every aspect of how we live and work, and has invested heavily in tech and AI stocks. They spend a lot of time reading about the potential for AI, looking for articles that confirm the importance the Magnificent 7 companies will play, and in turn, become more bullish, and increase their allocations to them.

THE MOST CROWDED INVESTMENT TRADES

Investing in the so-called Magnificent 7 stocks was the most popular trade in October 2024, outgunning trades in bonds, oil and gold and Chinese equities



Sources: Bank of America Global Fund Manager Survey, Barclays Private Bank, October 2024

By contrast, investor B believes AI is just a fad, and that the market is too enthusiastic about its prospects. As such, they have not invested in these seven companies, beyond their market-weighted share in existing diversified holdings. They believe that over-hyped stories about the Magnificent 7 simply confirm that the market is being too optimistic, and could be a bubble which is will soon burst. Indeed, they pay particular attention to stories about the problems facing some of the leading AI companies.

It is easy to imagine how these two investors can draw very different conclusions from the same information. When news is endless, it is also easy to imagine why each investor filters the information and seeks to align it with their pre-existing beliefs. This can exacerbate biases, and influence decision-making.

OVERCOMING YOUR BIASES

Whilst it is difficult, if not impossible, to de-bias yourself when living your life, or investing, there are things which can be done to try and limit their impact. We discuss three key areas:

1. Be careful with the news:

It is important to read a variety of news sources to have exposure to a diversity of views, as a first step to overcoming confirmation bias. It's also important to consume unbiased information, so as to separate the facts from stories and narratives. Reporting designed to stir your emotions can exacerbate your innate biases.

Investors would be wise to keep in mind that news may be less significant to financial markets than is believed. It is also important to bear in mind the distinction between the impact on a market, and that on your portfolio.

2. Delegate to experts:

Delegating to investment experts is one way to get exposure to markets and have your wealth working for you. Having professionals working for you, and navigating the investment landscape on your behalf, can reduce your decision-making needs, and limit the risk of biases with it.

Importantly, experts can help you to understand your own individual goals, time horizons and broader goals. Keeping these important longer-term considerations in mind when making investment decisions, can help to make the best long-term investment calls and to ensure your portfolio holdings, and approach, remains suitable.

3. Portfolio principles:

One of the best ways to reach your goals, irrespective of any behavioural challenges, is to have solid foundations in place, and allow your wealth to work for you across different market conditions.

Constructing a well-diversified portfolio that is designed to perform in various market conditions and investment scenarios is a central tenet of investing. By holding a mix of asset classes, sectors and regions, you can help to smooth out returns over the long term. This, then, also dampens out the effects emotions might have in a less-diversified, and thus more volatile, portfolio could induce.

Following a robust investment process with a long-term focus also allows you to see through any short-term noise in the market. Noise that can derail investors from sticking to their guns. And to do so, safe in the knowledge that your portfolio is built to protect and grow your wealth in the face of the events which can be unsettling.

A 'core-satellite' investing approach could provide the foundations to stay invested through market cycles, whilst providing the headroom for mitigating risks and capitalising on short-term opportunities.

The best investment approach is the one that you, as an investor, can stick with, even in the face of challenges, and thus strategies which provide a degree of comfort such as a phased approach to investing, or putting hedges in place, can also be helpful. The contents of this section is summarised in the following table which can be useful when considering one's reaction to news headlines and stories:

REACTING TO THE NEWS, A FRAMEWORK

IS IT RELEVANT TO YOUR PORTFOLIO?	IS IT KNOWABLE?	WHAT SHOULD I DO?
Yes	Yes	Utilise the information (See part 2, delegate to experts)
Yes	No	Diversification (See part 3, portfolio principles)
No	No	Ignore (See part 1, be careful with the news)

THE CASE FOR INVESTING

For investors who want to take a step closer to reaching their long-term goals, the case for investing in financial markets and benefiting from the potential effects of growth and compounding over that time remains compelling.

Our Outlook 2025 explores the key risks and opportunities that we expect to occur in the year, with ideas on how a portfolio could be positioned to take account of them. As ever, the next twelve months will provide challenges, surprises and opportunities, for those prepared for them and able to act on them without letting their biases get in the way.

History shows us that, through economic downturns, wars and market sell-offs, those who participate sensibly in the markets are usually better placed to have this participation compensated.

Alexander Joshi, London UK, Head of Behavioural Finance



Multi-asset portfolio allocation

Barclays Private Bank discusses asset allocation views for a multi-asset class portfolio. Our views elsewhere in the publication are absolute and in the context of each asset class.

	-		=		+
Cash and short duration bonds					
Fixed income					
Developed market government bonds					
Investment grade bonds					
High yield bonds					
Emerging market bonds					
Equities					
Developed market equities					
Emerging market equities					
Other assets					
Alternative trading strategies					
Commodities					

- denotes a cautious view = denotes a neutral view + denotes a positive view

CASH AND SHORT DURATION BONDS

- Portfolios continue to hold larger allocations to short duration bonds. However, we have started to reduce the allocation, as major central banks start to cut interest rates, prompting bond yields to move lower.

FIXED INCOME

- Value is seen in developed market government bonds, which can also hedge against macroeconomic volatility.
- In credit, the higher-quality segment is preferred, driven by what is considered to be better relative value.
- Exposure is relatively low in high yield, where selection is key, as spreads have room to widen in an adverse scenario.

EQUITIES

- Following a tactical increase to developed market equities in the summer, we see opportunity in maintaining a larger overweight to the asset class. In line with our long-term investment philosophy, portfolios remain geared towards high-quality, cash-generative and conservatively capitalised businesses.

- As a function of bottom-up selection, more opportunities are found in developed market equities, compared to those in emerging markets.

ALTERNATIVE TRADING STRATEGIES (ATS)

- There are a limited number of opportunities in the ATS universe, as the cost/benefit trade-off can be challenging.
- Our focus is on strategies that offer low correlations to equity markets, so providing diversification benefits.

COMMODITIES

- As a risk-mitigating asset, gold remains the only direct commodity exposure held in portfolios.
- Elsewhere, we believe that our risk budget is better spent outside of the asset class.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

2025 key dates

○ Central banks
 ○ Geopolitical events
 ○ International bodies

January	29th Fed meeting	30th ECB meeting	20th US presidential inauguration	20-24th 2024 World Economic Annual Forum	
February	6th ECB meeting	23rd German Federal election			
March	6th ECB meeting	19th Fed meeting	20th BoE meeting		
April	17th ECB meeting	25-27th Spring Meeting of IMF and World Bank			
May	7th Fed meeting	8th BoE meeting			
June	5th ECB meeting	18th Fed meeting	19th BoE meeting		
July	24th ECB meeting	30th Fed meeting			
August	7th BoE meeting	Jackson Hole Symposium			
September	11th ECB meeting	17th Fed meeting	18th BoE meeting	27th Australian parliamentary election	
October	29th Fed meeting	30th ECB meeting	Canadian federal election	17-19th 2024 Annual Meeting of IMF and World Bank	
November	6th BoE meeting	COP30, Brazil			
December	10th Fed meeting	18th BoE meeting	18th ECB meeting		

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