YAD CAPITAL AG
INVESTMENT ADVISORY

YAD HOUSE VIEW

February 2025

Welcome

Dear Reader,

Welcome to the February 2025 edition of the YAD House View.

As we continue navigating an ever-evolving economic and investment landscape, this issue offers our latest insights on market dynamics, monetary policy shifts, and strategic portfolio adjustments. With data dependency shaping the Federal Reserve's actions and geopolitical shifts impacting global markets, understanding the interplay of these factors has never been more critical.

Join us as we delve into these developments, highlighting how they influence our approach to asset allocation and risk management, all while staying true to our commitment to delivering informed and forward-looking perspectives.

Your faithfully,

Dan Stemmer
Partner

Ygal Abergel
Managing Partner

Damjan Csiba, CFA
Portfolio Manager

What changed in our active allocations?

Equity - Geography

We adjusted our geographical equity allocation, reducing our UK exposure from Overweight to Underweight and increasing our US position from Underweight to Overweight in the Growth portfolio.

Equity - Sector

We reduced our exposure to Financials from Overweight to Underweight after strong outperformance in recent months. Additionally, we moved Underweight in the energy sector, as we expect oil production in the US and OPEC to grow while demand remains relatively flat. Conversely, we increased our allocation to IT and Communications, given the significant demand for AI and strong technological development. However, we remain slightly underweight compared to the MSCI World Index benchmark in these two sectors.

Fixed Income

Growth Portfolio: Average yield to maturity (YTM) of 5.46% with a modified duration of 8.46.

Yield Portfolio: Average YTM of 5.49% with a modified duration of 6.62.

Return Portfolio: Average YTM of 5.04% with a modified duration of 6.73.

Market expectations for higher inflation and interest rates under the Trump administration have driven a sharp rise in yields. We maintain a well-diversified, relatively long-duration fixed income portfolio spanning short-, mid-, and long-term bonds. In our view, the labor market is softening, and the Fed's 2% inflation target is likely to be met or nearly achieved by 2025, potentially leading to more rate cuts than currently anticipated. While tariffs may have short-term inflationary effects, their broader impact is disinflationary due to the drag on GDP growth. Furthermore, the new administration's proposed fiscal policies—focused on reducing government spending and deficits—are also disinflationary. If this holds true, it will create a favorable environment for long-duration bonds, reduce term premia, and mitigate the risk of a credit rating downgrade. Our fixed income holdings are primarily composed of investment-grade bonds from developed markets, with limited exposure to emerging markets. Based on Fitch methodology, the average credit rating is A+ for the Return and Growth portfolios and A for the Yield portfolio.

Alternatives

We did not change our alternatives allocation.

Our current active allocations

Asset Class	Overweight	Underweight
Equity - Geography	India, Israel, France, Switzerland and US in Growth portfolio	Australia, Japan, UK and US in Yield portfolio
Equity - Sector	Industrials, Utilities, Consumer Staples and Discretionary	Financials, Energy, IT and Communications

Index Returns

YTD 2025

Equity	YTD Performance
Euro STOXX 50	8.76%
Tel Aviv 125	6.35%
Nasdaq 100	3.06%
S&P 500	3.14%
SPI - 214 Swiss stocks	8.31%

Fixed Income	YTD Performance
Global Crp High Yield	1.49%
US Treasury 7-10Y	1.55%
Emerging Market ($)	1.58%
$ Investment Grade	1.62%
€ Investment Grade	0.66%

Alternatives	YTD Performance
Global Hedge Fund Index	0.94%
Gold	8.99%
Crude Oil	0.51%
Bitcoin	5.58%
Global Real Estate	2.71%

Currencies	YTD Performance
USD/ILS	-2.40%
USD/CHF	-0.26%
USD/JPY	-2.93%
GBP/USD	-0.73%
EUR/USD	0.10%

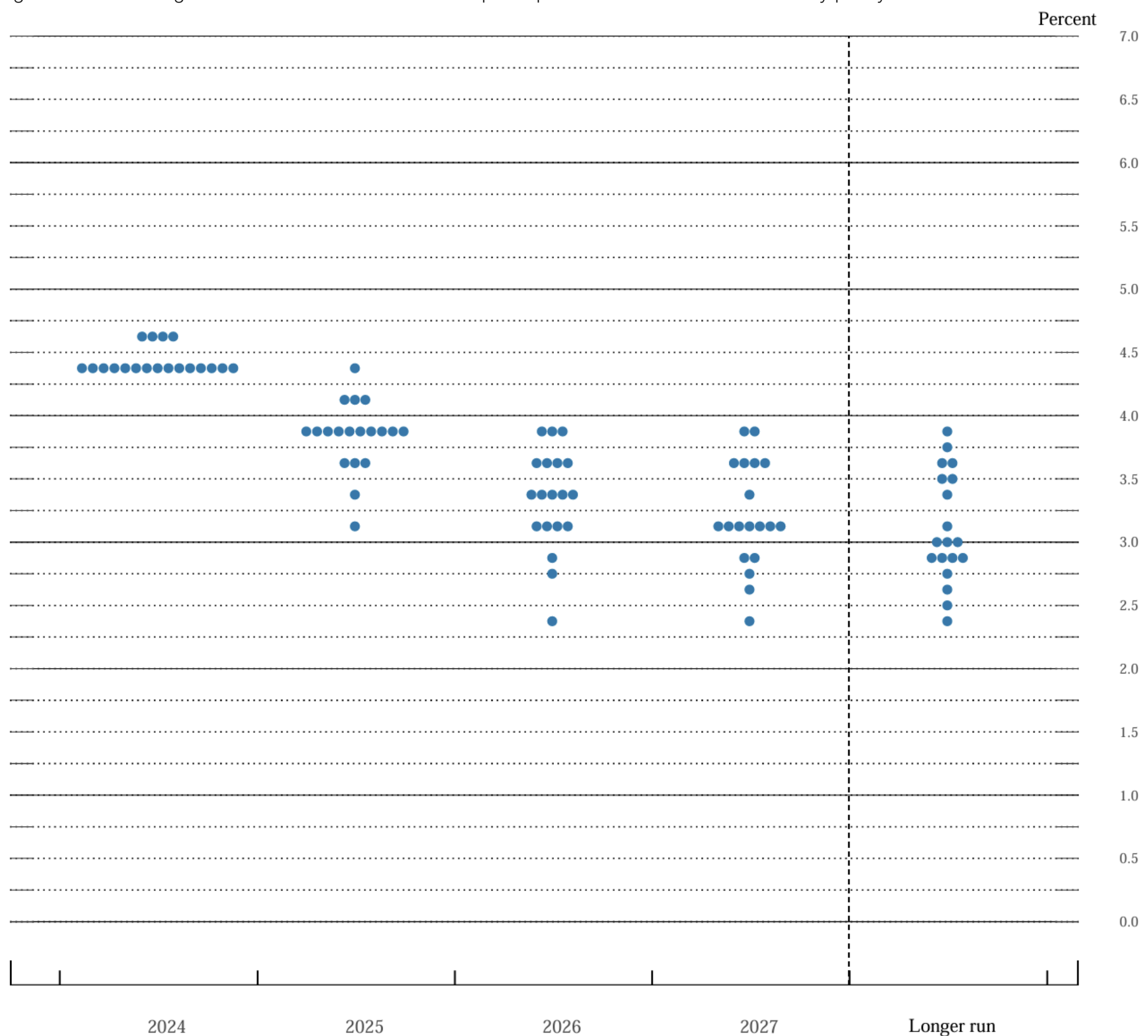
As of Thursday, 06 February 2025, 11:29am CET

More Cuts Ahead Than Markets Expect?

The Fed’s Stance On Rate Cuts For 2025

In December, most Federal Reserve members projected two rate cuts for 2025, and the market aligned with this outlook. However, these expectations are highly contingent on two key factors: inflation and employment data. The Fed has demonstrated a preference for relying on backward-looking data rather than forecasts, emphasizing their data-dependent approach. As a result, these projections could shift quickly if weaker employment data or lower-than-expected inflation figures emerge.

Figure 1: FOMC target level for the federal funds rate participants’ assessments of monetary policy:



Source: FED, https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20241218.pdf

Market Mispricing Versus Economic Reality

The Federal Reserve made significant missteps during the COVID crisis by relying on speculation and forecasts, labeling inflation as "temporary" for far too long. This eroded its credibility, and it is now understandably working to rebuild trust by adopting a more cautious and conservative approach. However, the downside of this approach is that disregarding forward-looking indicators could lead to unnecessarily higher unemployment, increased credit defaults, and slower economic growth.

Compounding the issue, fiscal policy has long worked at odds with monetary policy, making the process of disinflation exceedingly costly for the U.S. economy. Recently, Treasury Secretary Scott Bessent and Department of Government Efficiency (DOGE) leader Elon Musk have suggested that the U.S. will finally address its unsustainable overspending by reducing the budget by $2 trillion. This move could help restore U.S. debt as "risk-free" and lower the currently elevated long-term Treasury premiums. Budget consolidation is strongly disinflationary and could pave the way to very low interest rates, supporting economic growth and reducing the government’s interest expense burden.

Table 1: Expected monetary policy decisions based on labour market and inflation conditions

Labor market condition	Inflation above target	Inflation on target	Inflation below target
Tight labor market	Hike ↑	Hold →	→ Hold or Cut ↓
Moderate labor market	→ Hold or Hike ↑	→ Hold or Cut ↓	Cut ↓
Loose labor market	→ Hold or Cut ↓	Cut ↓	Deep Cuts ↓↓

The table above outlines our expectations for the Federal Reserve's potential policy decisions in response to inflation and labor market trends. Given the Fed's strong reliance on data and Chair Powell's communication that further labor market weakening is not necessary to achieve the 2% inflation target, we anticipate rapid rate cuts if the labor market softens further, as evidenced by the initial 50 basis point cut. Even if inflation remains above 2%, a weakened labor market could prompt additional cuts.

Inflation data was elevated during the first four months of 2024. However, once these monthly data are excluded from the year-over-year calculations, inflation is likely to moderate and be near to 2%. Moreover, oil prices have fallen significantly due to expectations of increased supply from the U.S. and OPEC, flat demand, and reduced geopolitical risk premiums. The latter stems from improved prospects for peace in Ukraine and the Middle East this year.

High interest rates are gradually but steadily impacting the economy, which is expected to slow GDP growth. Additionally, tariffs on China are negatively affecting economic growth in the U.S., China, and globally, while the EU economy continues to struggle with slow growth.

Closing Thoughts

In this issue, we explored how inflation, labor market conditions, and fiscal policy are shaping the Federal Reserve's rate decisions, alongside the broader implications for global growth.

While uncertainties persist, our commitment to a diversified and forward-thinking investment strategy remains unwavering. As always, we encourage you to reach out with questions or for further discussions about how these market shifts might impact your investment goals. At YAD, we continue to prioritize resilience, adaptability, and long-term value creation in all our strategies.

Good Investing.

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