Allspring

A Matter of Perspective

ALLSPRING'S ALLVIEW: 2025 OUTLOOK

FOR PROFESSIONAL/QUALIFIED INVESTOR USE ONLY WHEN USED OUTSIDE OF THE U.S.

What's Ahead for Growth, Inflation, and Rates?

MATTHIAS SCHEIBER, PH.D., CFA
Head of Multi-Asset Solutions

GROWTH STABILIZING, MORE QUICKLY IN THE U.S.

U.S. growth will likely stabilize in 2025 as the effects of lower interest rates make their way through the economy. Lower mortgage rates and robust real earnings should underpin a U.S. growth rate of 2–3%. Additional fiscal stimulus from a Republican sweep will likely boost economic growth further. We expect the labor market will remain strong enough to support private consumption. Economic weakness internationally probably won't meaningfully affect the U.S. growth rate.

We anticipate international growth will trend lower until mid-2025 as a number of countries, especially in Europe, continue struggling due to tighter fiscal policy and not-loose-enough monetary policy. Potential Trump administration–induced tariffs could hit growth in China and Europe overproportionately. This situation will be partly offset by strong stimulus from Chinese authorities that benefits not only Chinese consumers but also economies with strong trade links to China.

INFLATION NORMALIZING, MORE SLOWLY IN THE U.S.

U.S. inflation will likely progress very slowly toward the Federal Reserve's (Fed's) 2% target rate as the U.S. economy stabilizes, but it's unlikely to be a straight line to the target. Further cooling in the labor market should support lower inflation readings in 2025. However, additional rate cuts, more fiscal spending under the incoming Trump administration, and potentially higher geopolitical risks could affect inflation expectations. Overall, the Fed's focus must remain on bringing core inflation closer to 2%, and "data dependency" will remain the key phrase used.

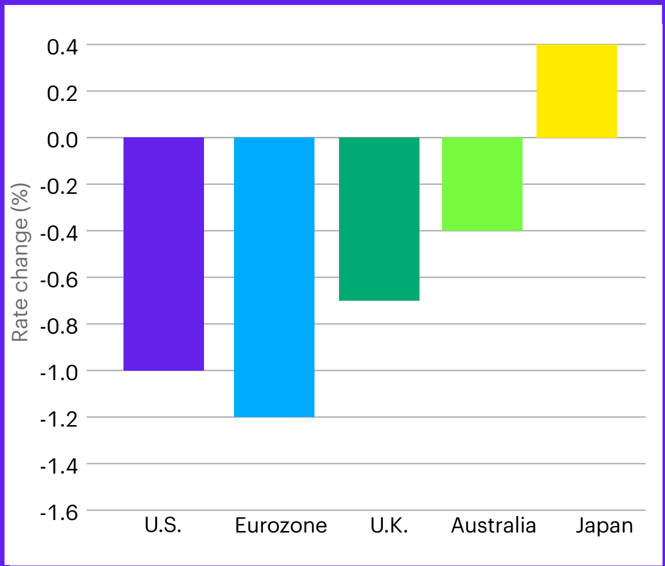
Outside the U.S., most countries' inflation targets have already been reached. Consequently, central banks can afford to be more stimulative—a favorable situation as consumer demand and sentiment remain weak in the eurozone and China. Japan remains the outlier: The Bank of Japan aims to drive inflation expectations lower while avoiding a repeat of the market volatility Japan experienced in 2024.

FED CUTS MOTIVATING OTHER CENTRAL BANKS

As the Fed continues lowering nominal rates in line with falling inflation, other central banks will be incentivized to follow swiftly to avoid too much strengthening in their currencies. We believe that the U.S. economy can avoid a 2025 recession and that gradual rate normalization makes sense. Should these hold true, we expect short-term U.S. rates will decline to 4.0% by summer 2025.

Internationally, the European Central Bank will likely stabilize Europe's short-term rates at 2%. However, we wouldn't rule out a more aggressive approach, as the eurozone might have entered a low-growth, low-inflation environment. This would mean sales of government bonds—quantitative tightening—would end in 2025. China and Japan will likely remain the outliers: Japan will aim to normalize monetary policy further while China is expected to deliver more fiscal and monetary stimuli to boost consumer demand.

INTEREST RATE CHANGES WE EXPECT BY AUTUMN 2025



Sources: Allspring and Bloomberg Finance L.P. Data as of 07-Nov-24.

Our Outlook:
Bond-like returns in 2025

GEORGE BORY, CFA
Chief Investment Strategist, Fixed Income

Globally, front-end rates are likely to come down in 2025. The pace of their decline, however, is highly uncertain. Inflation is trending lower, but with a new administration in Washington touting tariffs, tax cuts, and increased spending, it's unclear if it truly has been tamed. Only time will tell.

If the Fed's 2% inflation target is achieved, then the federal funds rate will likely be 3.0–3.5% by the end of 2025. The U.S. Treasury yield curve will likely normalize and steepen as a result, but longer-maturity bonds are vulnerable to higher yields if inflation remains elevated and/or fiscal impulses strengthen. **Interest rate volatility is high**, and it may move higher due to inflation uncertainty and technical pressure in the government bond market.

Tight credit spread risk premiums are underpinned by **robust credit fundamentals across the large-cap investment-grade and high yield bond universe** of companies in the U.S. and around the world. However, creditworthiness continues to erode among lower-rated and smaller credits.

Structured cash flows provide well-defined income streams in a highly uncertain economic environment. Some taxes are likely to rise as the costs of COVID bailout programs come due, which would increase the value of tax-exempt income. **Emerging market country-level credit fundamentals look favorable** compared with developed markets, and furthermore, relative value is more diverse and more attractive. In short, we believe bonds should deliver "bond-like" returns in 2025.

JANET RILLING, CFA
Senior Portfolio Manager,
Head of Plus Fixed Income

Q: What do you view as top opportunities in 2025 for global fixed income?

Invest mindfully in fixed income: The available yield being produced by global public fixed income markets is at a cyclical high. However, the proportion of yield from credit spread compensation is lower than it has been for most of the past 15 years. This presents attractive opportunities to earn generous income, but it also presents risks to those who invest indiscriminately.

Don't take anything for granted: Yields on the front end of the curve are particularly attractive today, but they are likely to move lower through 2025. Cash investors should consider extending duration to increase the income their portfolios produce while benefiting from duration as yields decline over time. Similarly, credit spreads may stay tight given the supportive fundamental and technical backdrop. Waiting for a better entry point may cause investors to miss out on attractive carry.

Prioritize flexibility: A high level of flexibility and broad diversification afford investors the opportunity to find and exploit mispricings across the global fixed income markets.

Q: How are you positioning to take advantage of those opportunities?

We are positioning multi-sector "plus" portfolios with a high degree of diversification and flexibility. This includes **exposures beyond the U.S. and tilting allocations toward sectors where spread compensation is closer to long-term averages.** We currently favor securitized sectors, including agency mortgage-backed securities (MBS), and a variety of asset-backed securities subsector exposures. Value exists in the higher-rated portion of high yield to drive income in portfolios. The opportunity to exploit substantial yield breakevens while earning attractive real income offers resiliency to a diversified fixed income portfolio.

SCOTT SMITH, CFA
Senior Portfolio Manager,
Head of Investment Grade Income

Q: What do you view as top opportunities in 2025 for investment-grade credit?

A diversified portfolio of U.S.-dollar-denominated investment-grade (IG) fixed income bonds with intermediate (5- to 10-year) maturities has the potential to generate 6.00–7.50% total return over the next 12 months if interest rates fall approximately 50 basis points (bps; 100 bps = 1.00%). Much of the capital appreciation would likely come from the **"normalization" of the yield curve**, as front-end yields are expected to decline while longer-dated yields stagnate and generate mostly income. A **higher-quality bias** is appropriate as the business/credit cycle advances and credit risk premiums remain compressed.

Q: How are you positioning to take advantage of those opportunities?

We are overweight intermediate key rate duration buckets with a bias to be neutral/slightly overweight overall duration. While credit spreads are tight, we remain overweight to credit but with a higher-quality bias. Credit fundamentals should prove resilient with the Fed at the start of its rate-cutting cycle. **Demand for IG bonds remains robust** due to strong positive real yields and large cash balances earmarked for investment. Government agency MBS provide high-quality exposure and income for IG multi-sector portfolios.

NICHOLOS VENDITTI, CFA
Senior Portfolio Manager,
Head of Municipal Fixed Income

Q: What do you view as top opportunities in 2025 for municipal bonds?

Income: We are bullish on municipal bonds for the income. Investors who buy munis today and reinvest that income over time may be poised for outsized returns even without the yield curve moving lower. If it does move lower, investors could see equity-like returns for muni-like risk.

Tax exemption: Some investors are exploring strategies to minimize taxes. Munis are the original "tax-exempt" asset class. When taxes go up, the tax exemption that munis provide gets even more valuable.

Low correlations: Financial asset price correlation converged in 2022. Correlations should trend lower because the income stream is back in fixed income. Munis also have lower correlation from a credit perspective. For example, a school district in central Kansas isn't likely to be affected by wars in the Middle East or Eastern Europe.

Q: How are you positioning to take advantage of those opportunities?

Right bond, right price, right time: We believe munis offer attractive yield, but not every issue is attractive. Therefore, **we focus heavily on security selection**. Duration has gotten cheaper, but prudence dictates duration diversification. Modest duration extension is warranted. Muni credit spreads have gotten quite narrow, but that doesn't mean we avoid credit. We're highly selective, knowing that, over time, there will be winners and there will be losers.

ALEX TEMPLE
Senior Portfolio Manager,
Head of Credit, Global Fixed Income

Q: What do you view as top opportunities in 2025 for global fixed income?

Focus on quality: Reach-for-yield strategies compressed valuations across global credit markets in 2024. In 2025, we see **better value in defensive subsectors**, including utilities, telecommunications, and health care. Lower cash yields only reinforce the trend and push investors further into high-quality segments of the credit market.

Harbor in short maturities: As developed market government bond curves steepen, we expect to see short- and intermediate-duration bonds outperform. Spread levels at the shorter end are also trading cheap relative to longer-dated counterparts.

European outperformance: Diverging economic data out of Europe and the U.S. have added to rate path disparity. We expect the European Central Bank to run a more accommodative policy than the Fed, contributing to the **attractiveness of euro corporate debt** and facilitating further spread compression.

A megatrend for years to come: Climate change is a megatrend that countries and companies worldwide have increasingly recognized they must tackle now and continue to address for the foreseeable future. Funding the transition to a net-zero economy is a broad-reaching investment theme that should continue creating opportunities for credit investors to benefit financially while also supporting the transition. Allspring's approach to climate transition investing seeks to optimize financial returns via security selection by investing in companies we believe are transition leaders and beneficiaries while maintaining the desired risk profile.

Q: How are you positioning to take advantage of those opportunities?

We have moved up in quality in favor of more defensive subsectors. This is expressed through overweights in health care and communications and an underweight in cyclicals. We are also overweight short/intermediate-dated maturities and underweight duration in the longer-dated part of the yield curve.

AJAY MIRZA, CFA
Senior Managing Principal,
Head of Investments,
Galliard Capital Management

Q: What do you view as top opportunities in your asset class?

We are focused on **higher-quality, shorter-duration bonds** and emphasize lower-risk sectors, diversification, and liquidity within portfolios as "cheap insurance."
Here's why:

+ Although policy easing has started, we believe an extended period of restrictive monetary policy means liquidity will continue to be a concern and volatility in risk assets could return.
+ While a recession doesn't appear to be on the short-term horizon, our base case is that the Fed will need to walk a fine line to orchestrate a soft landing.
+ The U.S. economy's ultimate trajectory is still unknown, and a harder-than-expected landing is certainly not out of the question. In our view, caution is still warranted.

Q: How are you positioning to take advantage of those opportunities?

+ Barring a material change in valuations, we look to **position more cautiously in credit** and manage the overall allocation relative to other market opportunities.
+ Given shifting monetary policy and economic uncertainty, we believe there's **better value in more defensive spread sectors**, such as agency MBS/multifamily and securitized assets.

Our Outlook:
Equities gain momentum in 2025

ANN MILETTI
Head of Equity, Chief Diversity Officer

In Allspring's Midyear Outlook, I noted that the back half of 2024 "looks ripe for potential volatility"—and equity markets did experience their fair share of it, especially in the U.S. with August's short-term correction, uncertainty around November's election, and concern over whether a "soft landing" would be possible as the Fed cuts rates.

Now, with the election's market impact fading, we're fully focused on 2025: what our data and experience tell us likely lies ahead for different sections of the equity market and the positioning decisions our equity teams have been making as they look forward.

In 2025, we expect to see these four themes gain momentum:

+ The **breadth of the U.S. equity market should continue to widen** beyond the handful of mega-cap growth stocks that have pushed index concentrations to unprecedented levels.
+ It's also likely that we'll see many of the **value-focused sectors continue to outperform.**
+ Investments in small- and mid-cap U.S. equities will likely increase. Given their attractive valuations relative to large caps, **investors are being compensated to move down in market cap.**
+ The relative payoff has been growing for **emerging market investing,** and we expect this trend to continue.

As we work to capitalize on these trends, we strongly believe that **quality will be our key to identifying small-, mid-, and large-cap companies capable of success.** We've found that careful security selection within each market-cap universe—not macro timing—ultimately drives an equity portfolio's performance.

In our efforts to identify quality companies of any size, these are the characteristics we look for in each potential candidate:

+ **Fluid cash flow:** Sustainable cash generation through all parts of the economic cycle
+ **Well-structured balance sheet:** Modest financial leverage, elongated maturity profile, and margin of safety versus debt covenants
+ **Competitive advantage:** A differentiated product or service with strong customer demand
+ **Proven management team:** Skilled capital allocators who have experience navigating through an economic cycle

We believe companies that exhibit these four characteristics are well positioned to differentiate themselves and deliver competitive results over time.

BRYANT VANCRONKHITE, CFA, CPA
Senior Portfolio Manager,
Co-Head of Special Global Equity

Q: What do you view as top opportunities in 2025 for value investing?

Emotions create mispricing, which creates opportunity.

In July 2024, we reported our research indicating that investors historically have coalesced around investment themes based on their feelings at the time about the market's direction—and that their most extreme sentiments, at opposite ends of the spectrum, are *fear* and *exuberance*. This was evident in 2023 and 2024, as we saw investors chase a small group of stocks due to *both* exuberance and fear—both extremes simultaneously. The artificial intelligence (AI) theme sparked exuberance about a tech revolution driving growth and efficiencies, but there were just a few early AI winners. Meanwhile, fear over whether the Fed could deftly direct a soft landing caused concern of possible economic contraction. Investors who were fearful due to the lack of broad growth aptly allocated to the biggest and "best" companies in the world.

This emotionally driven divide created imbalances that show up as uniquely narrow equity markets. Growth style dominated value style for a while. Relative valuations of small-/mid-cap stocks compared with large-cap stocks have become historically—and attractively—wide.

In our July report, we suggested a value-led rotation and a move down in market capitalization should be the next intermediate-term phase of the U.S. equity market—and we've been proven accurate so far. Although we don't believe investors should assume this phase to be linear, we do believe it's in motion.

We think that moving into 2025, the emotions of 2024 should fade and investors could take advantage by moving down in market cap and positioning for a value-led rotation.

Q: How are you positioning to take advantage of those opportunities?

In terms of our team's positioning, under the covers of this market **we see a multispeed economy creating divergences between the haves and have-nots** in consumer budgets and corporate boardrooms. We believe **these divergences should drive lower correlations of returns among stocks, creating opportunities for discerning stock pickers,** like us, as we pursue attractive stock selection alpha with the market's shift to value leadership.

> "Emotions create mispricing, which creates opportunity.

MICHAEL SMITH, CFA
Senior Portfolio Manager,
Head of Growth Equity

Q: What do you view as top opportunities in 2025 for growth investing?

The Growth team's top opportunity for 2025 is "**the Great Rebalancing**."

We base our outlook on three main expectations:

01 **The end of extreme narrowness:** The extraordinary concentration in mega-cap stocks—like a pendulum stretched to its limit—must eventually swing back. **Current benchmark concentration levels are unprecedented,** driven by pandemic dynamics and macro uncertainties. As these forces normalize, we expect broader distribution of market leadership.

02 **The small-/mid-cap renaissance:** Small- and mid-cap stocks have lagged, creating compelling opportunities. As inflation moderates and monetary policy shifts, **we believe these stocks are poised to outperform,** supported by attractive relative valuations, an improving earnings-growth trajectory, and historically favorable performance during Fed easing cycles.

03 **The importance of stock picking:** Market breadth will expand beyond the handful of dominant stocks, creating greater dispersion. Superior profitability and fundamental strength should drive returns, particularly in an environment of modest economic growth.

Q: How are you positioning to take advantage of those opportunities?

Staying disciplined: We maintain our focus on businesses with sustainable earnings growth and strong competitive positions in our efforts to keep our portfolios on the right side of change. We believe **selection—not macro timing**—will drive performance.

Investing, not trading: While policy shifts may trigger short-term rotations, structural growth scarcity should continue to command premium valuations. We avoid chasing cyclical rallies under the banner of "new regimes."

AI 2.0—from infrastructure to implementation: The next phase of AI will likely shift from building capacity to practical applications. For example, rather than focusing on chip manufacturers, we see opportunities in software and services companies using AI to reduce costs and improve quality and efficiency for their end clients.

Following the fundamentals, not the crowd: While capital has crowded into mega caps and private markets, we see **compelling opportunities in small- and mid-cap stocks.** We believe these companies offer more attractive valuations than large caps and better liquidity/healthier balance sheets than private alternatives. We're positioning for where we think returns will be, not where capital has been.

ALISON SHIMADA
Senior Portfolio Manager,
Head of Total Emerging Markets Equity

Q: What do you view as top opportunities in 2025 for emerging markets?

We believe AI will likely affect every sector worldwide. **Emerging markets (EMs), in particular, are AI enablers** as they dominate the supply chain for AI development. For example, semiconductor foundry companies in Taiwan manufacture the chips used in AI, while materials companies in Latin America produce the copper used in data centers and electric grids. From a demographic perspective, many EM countries have large and relatively young populations that can provide substantial labor capacity to facilitate various types of production related to AI.

Looking for opportunities at the country level, we believe **China is well positioned for a recovery.** While uncertainty may persist in the near term due to erratic macroeconomic data and U.S.-China tensions exacerbated by the impending Donald Trump presidency, our optimism is based on consistent fiscal and monetary support and attractive valuations. In addition to the stimulus passed in September, we anticipate China will continue to implement targeted measures to support its property sector and the broader economy. Additionally, dividends, buybacks, and government support should potentially provide downside protection, while the easing of regulatory restrictions and anti-corruption campaigns will likely lead to further re-ratings of state-owned and private enterprises. We also remain optimistic about the investment opportunities in technology innovation, green development, and industrial upgrades, as well as the overall consumer recovery in China.

Q: How are you positioning to take advantage of those opportunities?

+ **Artificial intelligence:** We are positioned to take advantage of opportunities in both AI enablers (semiconductor foundries, utilities, mining, etc.) and AI adopters (including health care, finance, and internet firms that stand to benefit from AI efficiencies).
+ **China:** We currently hold an overweight to China. Following the recent market surge over an unusually short time frame, we expect a pullback and further market consolidation. In addition, recognizing that President Trump is likely to make louder noises regarding U.S.-China relations, we are marginally trimming our China exposure in the near term, but we plan to maintain a slight overweight due to attractive valuations and cyclical improvement.

> "We believe AI will likely affect every sector worldwide. Emerging markets, in particular, are AI enablers as they dominate the supply chain for AI development.

JOHN CAMPBELL, CFA
Senior Portfolio Manager,
Head of Systematic Core Equity

Q: What do you view as top opportunities in 2025 for systematic core equity?

+ Dividend stocks historically have performed well through Fed rate-cut cycles. We believe this trend will hold true in the current cycle. One potential headwind (should it occur) that could dampen performance is reignition of inflation. However, we do not currently see this on the horizon.
+ Like my colleagues, we believe **small- and mid-cap stocks are positioned to capitalize** in a lower-rate environment and as market breadth returns given that:
    - Lower interest rates are likely to financially benefit smaller-cap companies more than large caps because small caps tend to carry higher debt levels and rely more on external financing—including interest-rate-sensitive floating-rate debt.
    - Valuations of small caps and mid caps, at very near their 20-year average, are currently quite attractively priced relative to large caps, which are more than 50% higher than their 20-year average.
    - Concentration risk in large-cap indexes currently is extremely high. Investors holding primarily large caps can lower that risk by diversifying some assets into small caps and mid caps, where concentrations remain near normal levels.

Q: How are you positioning to take advantage of those opportunities?

+ We're positioned to pursue alpha primarily from companies outside the mega-cap growth category.
+ From a fundamental perspective, our strategies generally are tilted toward smaller caps and overweight to mid-cap stocks. In terms of macro risk exposure, they are positively exposed to smaller-cap stocks.
+ Our positioning is tightly controlled but exhibits a small bias toward rising long-term rates. This is partly because the last leg of inflation remains somewhat sticky and also because there's some uncertainty over the potential for more deficit spending postelection, which could increase the supply of Treasuries. Most of our strategies are **positioned for credit spreads to widen** from their current levels, which remain near historical lows.
+ With valuations stretched, our process is designed to systematically **identify and overweight undervalued, high-quality companies** that have positive earnings momentum and market support.

For further information

We're committed to thoughtful investing, purposeful planning, and the desire to deliver outcomes that expand above and beyond financial gains. Visit our website at **www.allspringglobal.com.**

Contact details

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All investing involves risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful. Investments fluctuate with changes in market and economic conditions and in different environments due to numerous factors, some of which may be unpredictable. Each asset class has its own risk and return characteristics. High yield securities and junk bonds have a greater risk of default and tend to be more volatile than higher-rated securities with similar maturities. Mortgage- and asset-backed securities may decline in value and become less liquid when defaults on the underlying mortgages or asset occur and may become volatile in periods of rising interest rates.

Diversification does not ensure or guarantee better performance and cannot eliminate the risk of investment losses.

Duration is a measurement of the sensitivity of a bond's price to changes in Treasury yields. A fund's duration is the weighted average of duration of the bonds in the portfolio. Duration should be interpreted as the approximate change in a bond's (or fund's) price for a 100-basis-point change in Treasury yields. Duration is based on historical performance and does not represent future results.

Alpha measures the excess return of an investment vehicle, such as a mutual fund, relative to the return of its benchmark, given its level of risk.

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