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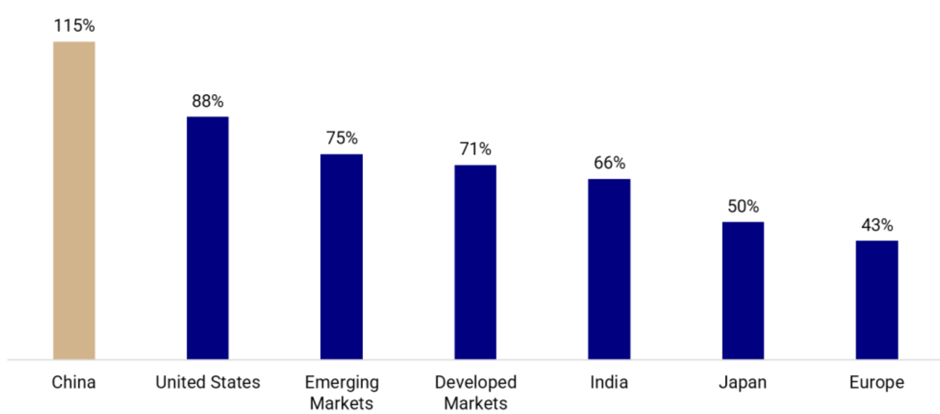
Breakout Capital Quarterly Q4 2024

Outlook

In 2024, a historically busy year for elections worldwide, politics took center stage—and held it. Now, many analysts have built their projections for 2025 around Trump and how his policy and personnel choices will shape global economic and market trends.

We believe, on the contrary, that no single factor (or personality) is a solid foundation for forecasting. Case in point: the start of Trump's first term. Analysts expected disruption in the US and in Trump's favorite tariff target, China. Yet 2017 turned out to be one of the least volatile for US stocks ever. China ended up as the world's best performing major market over the course of Trump's first term (Chart 1). In 2025 we expect forces larger than Trump to shape market trends, including the five below.

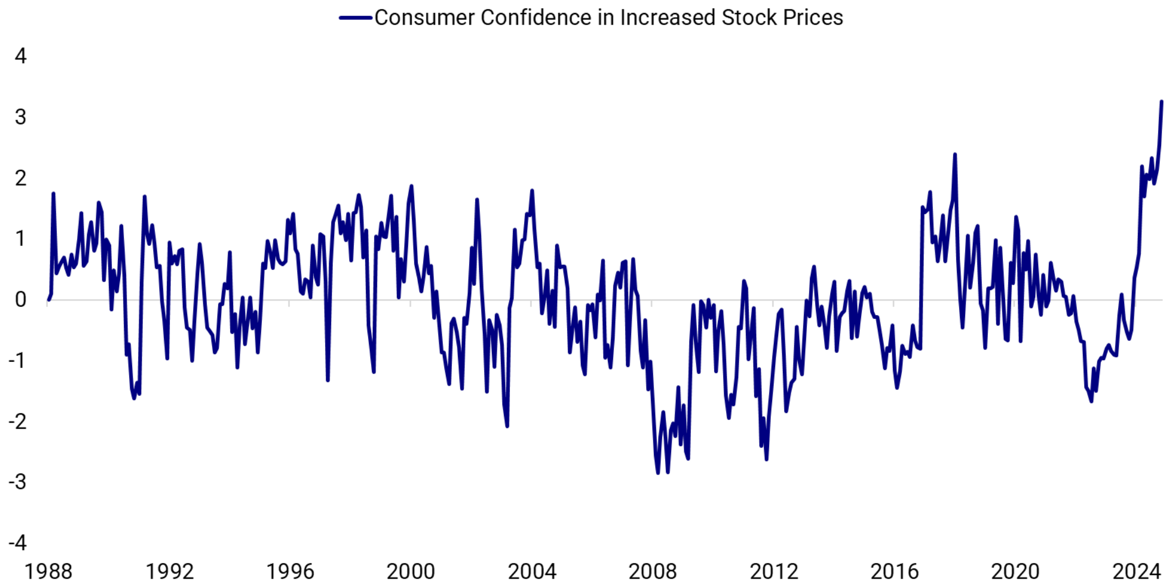
Chart 1: Performance of Major Stock Markets During Trump's First Presidential Term



Source: Bloomberg, Breakout Capital Calculations

- **Contrarians Return:** Rarely do global market and economic trends survive more than one decade. The list of top 10 global companies, for example, has always changed dramatically from one decade to the next. Only now, the normal process of competitive churn has stalled. Halfway through the 2020s, the top 10 list is still dominated by the same firms—mainly US Big Tech—that dominated the 2010s. Most analysts have found reasons to believe none of this will change. And Americans have never been more confident that US stocks will rise from here. (Chart 2). We expect a major shift, starting with a turn away from the US and its top tech companies.

Chart 2: Consumer Confidence in Increased Stock Prices

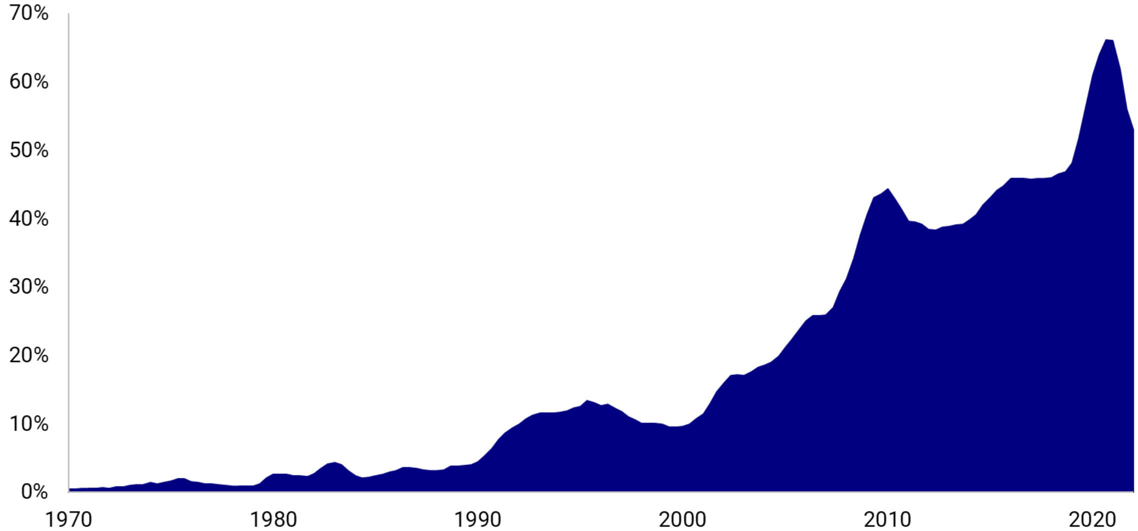


Source: The Conference Board, Breakout Capital Calculations; Expressed in z-score terms. As of December 31, 2024.

- **US Exceptionalism Fades:** The buzz about "American Exceptionalism" is built on faith that the US economy will continue growing faster than its peers, by a wide margin. This faith overlooks a fatal flaw, which is that US growth is increasingly dependent on state support. The pandemic is over, but stimulus still courses through the system. The US deficit is now running at 6 percent of GDP, far higher than the unemployment rate, and that gap is now five times higher than ever before in a post-World War II recovery. Today 20 percent of new US jobs are created by government, up from 1 percent in the 2010s. Public transfers including Social Security account for more than a quarter of residents' income in more than 50 per cent of US counties — up from just 10 per cent in 2000. (Chart 3 on next page)

  Either the fiscal stimulus wears off, or bond markets begin punishing the US for profligacy. Coupled with a slowing pace of monetary stimulus, these forces are – we expect—likely to slow the US economic growth from near 3 toward its long term potential rate of 2 percent, if not lower.

Chart 3: Share of US Counties that Depend on Public Transfers for More than a Quarter of their Income



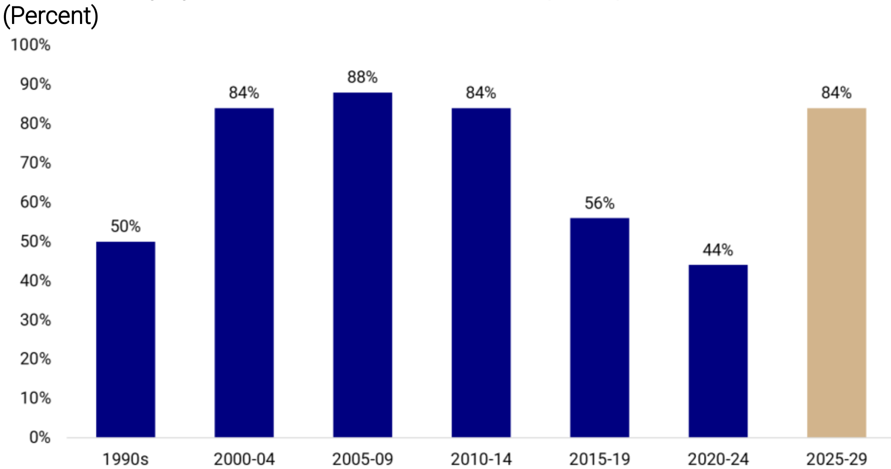
Source: EIG

- **Rotation to the Next Stars:** As the US begins to look less exceptional, we believe investors will start looking at countries—including emerging markets--which have been off investor radar, despite strengthening fundamentals.

  Normally emerging economies grow faster than developed ones. That gap narrowed in the last decade, but is widening again now. The share of emerging economies in which per capita GDP is expected to grow faster than in the US is set to rise from 48% over the past five years to more than 80% in the next five (Chart 4). This would match the peaks hit in the 2000s, the last boom period for emerging markets.

  Emerging market resilience is also visible in sovereign credit ratings. Prudent government spending has caught the notice of ratings agencies, and upgrades outnumber downgrades by 2.5 to 1, the widest margin in at least a decade.

Chart 4: Emerging Economies: Share with Real GDP per Capita Growth Faster than the US (Percent)



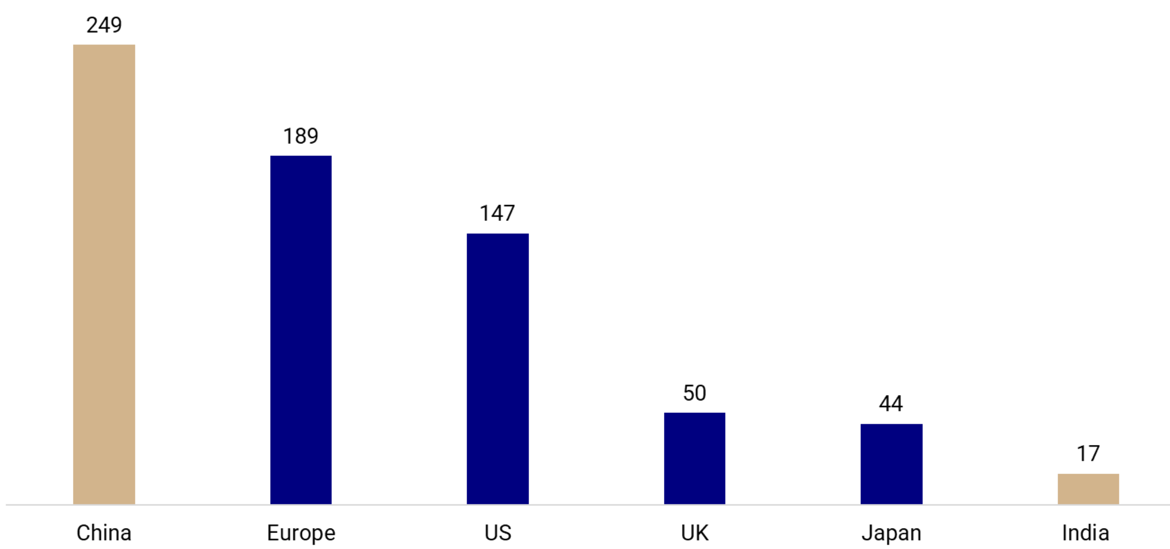
Source: IMF, Haver, Breakout Capital Calculations, 2025-29 numbers are based on IMF estimates

- **Investable China:** China's deflationary slowdown is scaring off foreign investors, many of whom now dismiss the world's second-largest stock market as "uninvestable."

  In our view, any consensus this universal opens up contrarian opportunities. Somewhere in this desert we believe there will be solid gems. Screening for large, profitable firms—with a market cap over $1 billion and free cash flow yield above 10%--we find nearly 250 such stocks in China, or roughly 100 more than in the US, and 60 more than in Europe (Chart 5). One of them is China's leading electric car maker, BYD, which is growing sales volume faster than Tesla with similar profitability, but trades at a valuation 80% below Tesla's.

  We believe investors may come to see the profitable corners of the China market as investable again in the coming year.

Chart 5. Number of Non-Financial Firms with Market Cap >$1bn and Free Cash Flow Yield > 10%



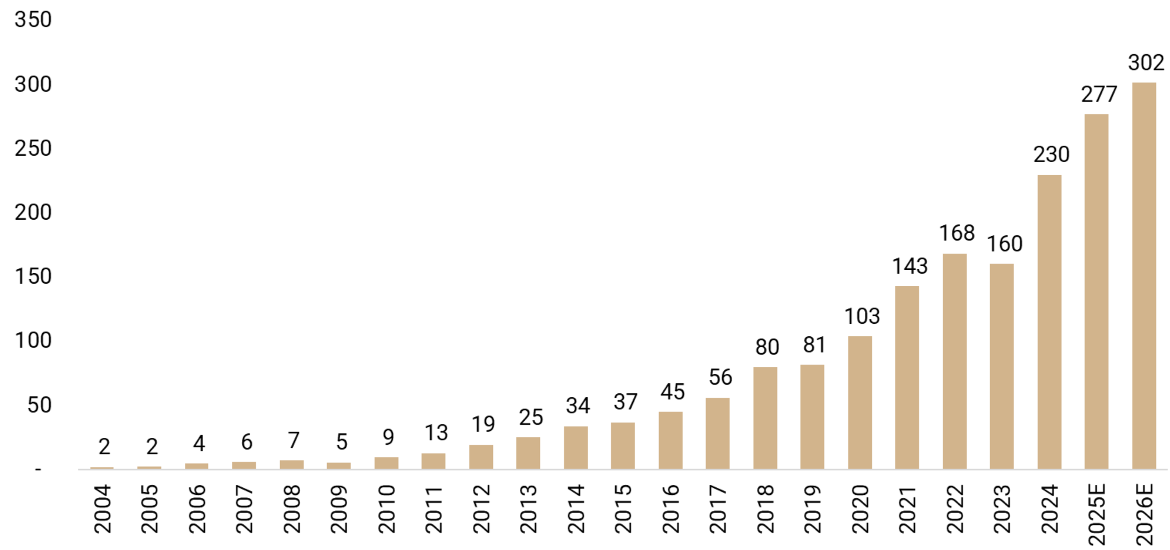
Source: Bloomberg, Breakout Capital Calculations

- **AI Undercuts Big Tech:** US tech has dominated global markets over the past 15 years, driven by superior earnings and free cash flow, which justify—in the consensus view--premium valuations. However, this lead is dwindling. Desperate to dominate the future of Artificial Intelligence, the big 6 US tech firms* are on track to spend close to $280 billion this year on CapEx, up from $80 billion five years ago (Chart 6). This spending race is cutting into earning and free cash flow growth, which recently turned negative for the big 6.

  Meanwhile, surveys show that just about 5 percent of workers use AI daily, and less than 10 percent of US companies have incorporated AI into their operations. That's not to say AI will not prove its practicality, just that it's far from clear how it will be used or which firms will make money on it. Much like the dotcom era, a shakeout or reordering seems likely before winners emerge.

  ** These include Apple, Amazon, Facebook, Google, Tesla and Microsoft*

Chart 6: Capital Expenditure of Big Tech Firms (US Dollar in billions)



Source: Bloomberg, Breakout Capital Calculations. 2025 and 2026 estimates are based on Bloomberg Consensus data.
Note: The big tech firms include Apple, Amazon, Facebook, Google, Tesla and Microsoft

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