

Expert investor series

Navigating 2025: Market outlook and implications for defined benefit pension schemes

The global economic outlook for 2025 looks promising but also presents challenges.

Inflation is expected to moderate amidst steady U.S. growth, resiliency amongst some emerging markets, and shifting geopolitical and trade dynamics. According to the IMF, global GDP growth is expected to align with its long-term average, marginally above 3%. However, risks from elevated valuations, geopolitical tensions, and trade disruptions call for a measured approach by investors.

Our central case is moderately positive for defined benefit (DB) pension schemes, but with a high level of uncertainty. Forward planning, liquidity and collateral management, and having dry powder to make the most of opportunities will be more important than ever.

The outlook in the US, Europe and beyond

We expect the US economy to grow at a steady pace underpinned by domestic demand and productivity gains. Inflation is likely to moderate further, driven by easing energy prices and stable wage growth, but remain above central banks' targets. Fiscal policies, including infrastructure investments and technological spending continue to support U.S. performance, making it a standout amongst developed markets.

In Europe, we believe structural weaknesses, including industrial stagnation and constrained fiscal flexibility, will weigh on growth. The UK is projected to grow slightly faster than the Euro area despite facing challenges from elevated inflation and subdued economic momentum. Japan, while grappling with demographic and consumption challenges, is expected to see modest improvements under revised monetary policies. In contrast, we anticipate select emerging markets to outperform, supported by robust domestic demand and global trade shifts as supply chains diversify away from China.



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Monetary policy

Monetary policies across major economies will play a pivotal role in shaping the economic environment of 2025.

According to data from Bloomberg, the U.S. Federal Reserve is expected to reduce interest rates by 0.50% to a range of 3.75% - 4.0% in response to declining inflation. This marks a revision from the September 2024 projection of a full percentage-point rate cut, as the Fed seeks to avoid reigniting inflationary pressures, especially considering the anticipated expansionary policies of the new administration.

We expect the European Central Bank (ECB) to maintain an accommodative stance, further easing policies to combat weak growth across the Eurozone. The Bank of Japan (BoJ) may take a divergent approach, tightening its policies moderately as wage-driven inflation takes hold.

In the UK, we hold the view that the Bank of England (BoE) will navigate a delicate balancing act, managing elevated core inflation and slowing economic momentum. Gradual rate cuts are expected but will likely remain cautious to ensure the stability of the Sterling and support for the broader economy.

Geopolitical risks

Geopolitical tensions will be a defining feature of 2025, with U.S. / China trade conflicts and heightened tensions in the Middle East dominating the agenda.

New tariffs and trade realignments could disrupt global supply chains and amplify inflationary pressures, particularly in trade-sensitive sectors like technology and manufacturing. Meanwhile, concerns around Taiwan and ongoing conflict in Ukraine introduce further uncertainties for global markets.

Asset class returns

In our opinion, risk assets will deliver modest gains in 2025. We believe valuations remain elevated, and future returns will likely depend on earnings growth rather than multiple expansions.

Fixed income is expected to draw strong inflows at attractive levels. High-grade corporate bonds remain well supported by declining inflation and strong corporate balance sheets. Meanwhile, within commodities, Brent crude is forecast to remain stable, barring major geopolitical shocks.

Gold continues to be an attractive hedge, benefiting from its safe-haven appeal amid persistent geopolitical uncertainties.

Among major currencies, the US dollar stands out, supported by growth and rate differentials. The yen could strengthen on a tightening bias, while the euro and sterling face headwinds from structural challenges and weak economic momentum.

For investors, the path forward requires agility and strategic foresight. In our view, diversification across asset classes, regions, and sectors will be crucial to mitigate risks and unlock opportunities.



Implications for DB Pension schemes: funding, risk, and strategy

Modest gains in risk assets can still positively impact schemes with exposure to these investments by helping to reduce deficits or improve surpluses. In addition, a continued rise in yields would improve funding levels for under-hedged schemes but could test collateral adequacy for those employing liability-driven investment (LDI) strategies with derivatives.

Recently UK yields have exceeded levels seen during the 2022 gilt crisis, but the measured pace of the rise in yields and generally strong collateral buffers have so far meant minimal disruption to investment strategies. Still, intelligent collateral management, that ensures maximum collateral efficiency, is likely to prove a key determinant to success. As part of this, at Brightwell, we run ongoing scenario analysis to stress test client portfolios and understand both the shorter-term impacts on collateral and liquidity, as well as the longer-term implications on clients' journey plan outcomes. This allows us to develop "playbooks" and assess different actions to help optimally manage client funding outcomes.

Tight credit spreads, however, leave little buffer if borrowing costs rise or default rates increase, potentially impacting schemes' funding levels.

As a result, it is important for pension schemes to work closely with top-tier credit managers to safeguard capital, navigate spread widening, and mitigate the risk of defaults and downgrades. Our scenario analysis helps us think through these risks to ensure we have the ability to take advantage of wider spreads and accelerate the build of long-term cash-flow aware portfolios. We believe it's important to maintain dry powder to capitalize on market dislocations, enabling our clients to more efficiently and cost-effectively build their low-risk, low-dependency portfolios.

Finally, geopolitical risks and inflationary pressures could create volatility in asset values, underscoring the importance of an integrated approach to investment strategy, funding and risk management.

So, DB schemes may need to reassess their strategies to ensure they remain resilient amid these economic and market dynamics. For over a decade, we have employed overlay strategies and hedges that provide downside protection for client portfolios. These strategies create greater stability in funding outcomes during various market events while also generating dry powder, through the monetisation of hedges, to capitalise on opportunities aligned with clients' long-term goals.

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