

# Equity Newsletter

1st Quarter 2025

**We are striving to stay balanced as we hold a moderately positive view of the equity market.**

After the strong equity market rally of 2024, there is still much to like about the prospects for the U.S. market, which was bolstered in part by excitement towards Artificial Intelligence (“AI”) technology.

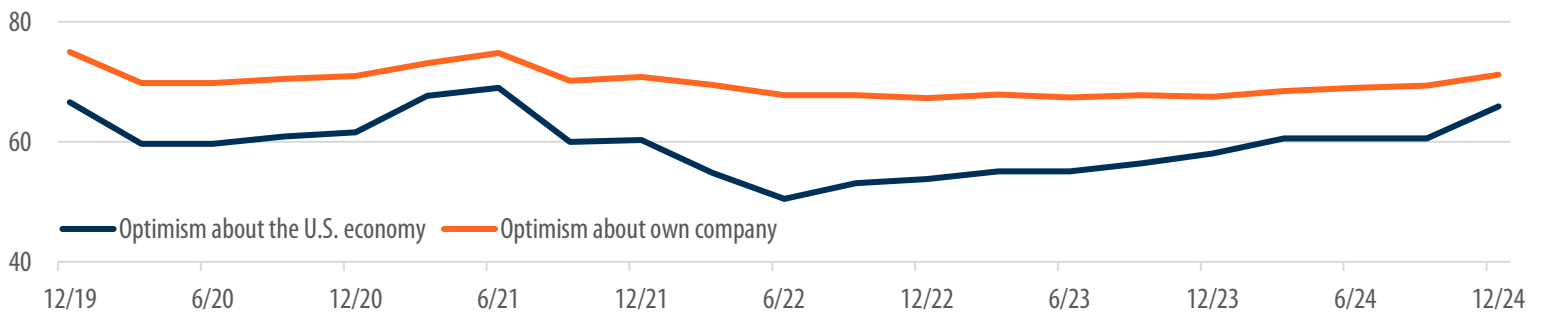
According to Gartner, data center spending is expected to surge from 329 billion USD in 2024 to 530 billion USD in 2027, a 61% increase. Additionally, Gartner forecasts 29% growth in spending on servers in 2025, driven by continued and increasing investment in accelerated servers supporting AI workloads. North America is expected to enjoy the strongest growth worldwide in server spend globally in 2025.

Post-election, general business optimism improved markedly as well. The Duke University CFO survey indicated that CFO optimism about the U.S. economy rose from 61 in the September survey to 66 in the December survey, which is the highest reading in over three years (Chart 1). Further, CFO’s most pressing concern shifted from monetary policy in the third quarter of 2024 to finding qualified workers in the fourth quarter of 2024.

While business optimism overall has been steadily improving, economic policy uncertainty is notably increasing for both trade and healthcare (Charts 2&3). Other risks we are monitoring include potential weakness in lower end consumers who are still feeling the effects of inflation, and any early signs of softening in the labor market.

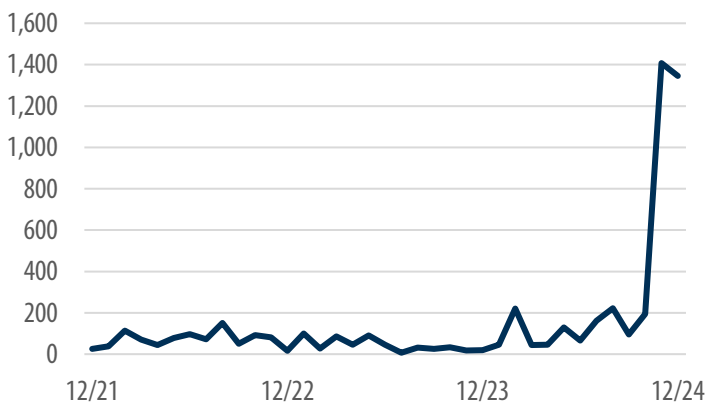
Turning to valuation, in our view, while the outlook for earnings growth remains positive, further multiple expansion from here may be challenging, and we also expect a broadening out of the market after the narrow equity market leadership of 2024.

**Chart 1: The CFO Survey: Optimism Indexes**



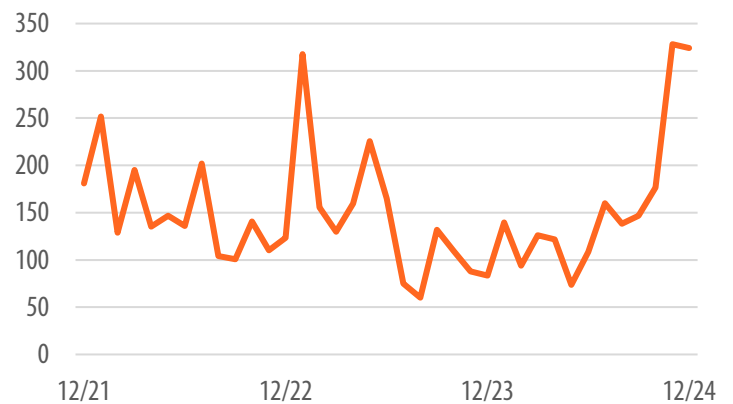
Source: Duke University, FRB Richmond and FRB Atlanta, THE CFO Survey. Data from 12/1/19 to 12/1/24.

**Chart 2: Trade Policy Uncertainty**



Source: Bloomberg, US Categorical Economic Policy Uncertainty - Trade Index. Data from 12/31/2021 to 12/31/2024.

**Chart 3: Healthcare Policy Uncertainty**



Source: Bloomberg, US Categorical Economic Policy Uncertainty - Healthcare Index. Data from 12/31/2021 to 12/31/2024.

**Past performance is no guarantee of future results.**



# Sector Views

## Communication Services

- We expect digital advertising spending to remain strong.
- Internet and streaming firms are investing in Artificial Intelligence (AI) to increase monetization and improve efficiency.
- Growing risk of increasing regulation and anti-trust scrutiny for mega-cap internet.
- Streaming media is increasing mix of ad supported revenue to improve profitability.

## Consumer Discretionary

- Low unemployment and strong wages are positives for consumption, but declining job openings and a falling quit rate are early indications that the demand for workers may be slowing.
- Cumulative impact of inflation in recent years remains painful for consumers, especially on the lower end of income distribution. High income consumers benefiting from strong wealth effect.
- Increasing e-commerce penetration, automation of warehouses are secular positives to profitability.
- Valuation not particularly attractive, in our view.

## Consumer Staples

- Defensive sector, but offers what we see as relatively meager growth.
- Consumer staples retailers and grocers have less pricing power amidst slowing inflation.

## Energy

- We are relatively neutral towards energy given upside and downside risks to oil prices, but note that energy sector equities provide strong free cash flow generation.
- The U.S. has recently imposed new sanctions on Russian crude oil, while the Trump administration may increase enforcement of sanctions against Iranian oil supply.
- OPEC oil production cuts have been extended to the end of 2025, but curtailments are expected to taper over the course of the year, gradually easing supply.
- U.S. economic growth remains robust and should continue to generate solid demand for energy.
- Risk to global oil demand from any tariff escalation, or continued weakness in international economic growth.
- Geopolitical tail risks to oil supply exist due to tensions in Middle East between Israel and Iran, although any resolution to Ukraine and Russia conflict would ease oil supplies.

## Financials

- Trump administration may adopt a more industry friendly regulatory stance towards banking, including less scrutiny of mergers, and the possible easing or delay in further tightening of capital requirements.
- Investment banking revenue and trading expected to strengthen amid increased capital markets activity.
- Loan growth is expected to improve overall in 2025, as increased corporate confidence may drive a recovery in commercial lending, while consumer credit card utilization is expected to remain robust. Commercial real estate lending is a notable area of weakness.
- Net interest margin (NIM) may improve in upcoming quarters as the cost of bank deposits gradually eases, and the yield curve potentially steepens.
- Credit quality is slowly deteriorating but remains reasonable. That said, any significant rise in unemployment would increase delinquencies.
- Valuation levels remain attractive, in our view.

## Healthcare

- Provides opportunity to invest in growth that is less correlated to the business cycle, that said, post the election, policy uncertainty has significantly increased in the sector.
- Focus within the pharma industry is on key drugs such GLP-1s for obesity, and the need for innovation to re-accelerate growth.

## Healthcare (continued)

- Healthcare providers and services industry benefiting from still strong utilization and growth in elective procedures and office visits. Additionally, moderating costs from contract healthcare workers are a tailwind to profit margins. The expiration of ACA enhanced subsidies at the end of 2025 is a medium-term risk to the industry.
- Biotechnology stands to benefit from secular innovation, and potentially increasing merger activity as cash rich Big Pharma is motivated to replenish their pipelines, additionally, funding environment for smaller biotechnology firms may ease over time.
- Life science tools industry may benefit from progress made towards normalization of excess inventories, but biopharma and hospitals remain focused on maintaining spending discipline.
- Valuation is attractive in the sector, in our opinion.

## Industrials

- Demand for capex is a secular driver that may benefit sector, as firms are motivated to reshore supply chains and increase productivity in tight labor market.
- Increasing infrastructure requirements to support data centers another key secular driver for some industrial firms.
- ISM Manufacturing PMI index continues to indicate cyclical weakness in industrial activity.
- Weak international macroeconomic growth may impact industrial exports.
- Defense industry names may benefit from increasing geopolitical risk.
- We believe valuation in sector is reasonable.

## Information Technology

- Key innovations such as AI and process automation offer substantial secular growth opportunities.
- We expect IT corporate spending to accelerate, barring a recession, with some recovery in end markets outside of AI, such as traditional enterprise servers.
- Prefer quality within the sector, particularly firms with strong corporate balance sheets and reasonable valuation.
- We see innovation benefiting cloud software firms, with the implementation of AI features improving value-added to clients.
- Key semi end markets such as AI, high bandwidth memory, and vehicle electrification benefit from secular tailwinds. Valuation is a risk for some well-known semis benefiting from investor enthusiasm towards AI, although earnings have been robust.
- Due to geopolitical tensions with China, we believe increased export restrictions are a risk to the industry.

## Materials

- On a cyclical basis, international economic weakness, especially weak Chinese construction, is a risk to basic materials demand.
- We believe incremental demand from clean energy grid infrastructure and electric vehicle transition is a secular positive for some metals, such as copper.
- Materials sector stands to benefit over time from policies and investment designed to reshore supply chains amid geopolitical tensions.

## Utilities

- Defensive, dividend paying nature is more attractive in times of macroeconomic uncertainty.
- Utilities are sensitive to interest rate movements, a potential positive if rates have peaked.
- Data center power consumption is a source of secular growth in electricity demand.

## Real Estate Investment Trusts (REITs)

- Higher yielding sector and has been sensitive to interest rate movements, stands to benefit if rates continue to decline.
- Data center REITs may provide strong secular opportunity, but any IT spending slowdown would impact the industry.

## DEVELOPED MARKETS

### Europe

- Inexpensive valuation in comparison to U.S. stocks, but no clear near-term catalyst.
- Economic growth remains sluggish, but positive. Uneven industrial activity and soft exports are key areas of weakness, while consumer is benefiting from decelerating inflation.
- European Central Bank is expected to continue to ease policy amid moderate inflation, as the central bank turns its focus to stimulating growth.
- Any re-acceleration of growth in China potentially stimulates demand for Europe's exports, but we remain cautious towards Chinese growth.
- European sentiment stands to benefit from any de-escalation of the Ukraine/Russia conflict.
- Geopolitical risk from increased influence of populism on national politics within Eurozone, and tariff uncertainty.

### United Kingdom

- Manufacturing PMI surveys point to softening of industrial activity.
- The Bank of England expected to gradually ease interest rate policy.
- Rising UK bond yields in recent months has potential to increase the risk of further cuts to fiscal spending growth in 2025.
- Inexpensive valuation in comparison to U.S. stocks.

### Japan

- Growth outlook is positive as robust wage growth is improving domestic demand prospects, driving inflation and corporate pricing power.
- Rising wages and core inflation has led the Bank of Japan to embark on a monetary tightening cycle, potentially lifting the Yen.
- Japanese Prime Minister Ishiba may be more hawkish on fiscal policy, creating some uncertainty, while Trump administration creates tariff uncertainty.
- Japan benefits from "friend-shoring" and increased secular demand for advanced technology exports such as automation equipment.
- Structurally low return on equity, although some corporate governance reforms have been implemented by the Tokyo Stock Exchange.
- Challenging demographics limit long-run potential economic growth.

### Australia

- Commodity exporter which stands to benefit from higher commodity prices.
- Exports of raw materials to China key driver of economic growth.

### Canada

- U.S. is key trading partner, benefits from strong U.S. growth, but tariff rhetoric creates uncertainty.
- Energy and metals exporter which stands to benefit from higher oil prices and commodity inflation and would suffer from a U.S. recession or a decline in oil prices.

## EMERGING MARKETS

### Emerging Asia

- Chinese policymakers have recently announced more forceful monetary stimulus measures, and signaled that fiscal policy stimulus may be increased, as well. That said, Chinese economic growth remains underwhelming, in our view, as the beleaguered Chinese property market continues to weigh on fixed asset investment.
- Rising geopolitical tensions between U.S. and China present risk to supply chains for key technologies and materials, and complicate U.S. firms' decision to invest in China. Chinese exports may benefit in short run from a desire to front load ahead of tariffs, which may increase under Trump.
- India is experiencing robust economic growth, driven by strong consumption trends and infrastructure investment; valuation remains a risk.

### Latin America

- Mexican economy stands to benefit from exports to U.S. but would be negatively impacted by any eventual U.S. recession. Over time, supply chain diversification away from China may be a structural tailwind to exports.
- Populist election results impact sentiment towards the region, as fiscal discipline may be called into question. Mexico is recent example.
- Brazil and Latin America overall are sensitive to demand for commodity exports, and commodity price inflation.
- Federal Reserve policy easing affords Latin American central banks more monetary policy flexibility.

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