Signia Invest Insights

31 January 2025

Signia Invest
One Connaught Place
London
W2 2ET

Contact Us
info@signiainvest.com
+44 (0) 800 756 1094

Website
www.signiainvest.com

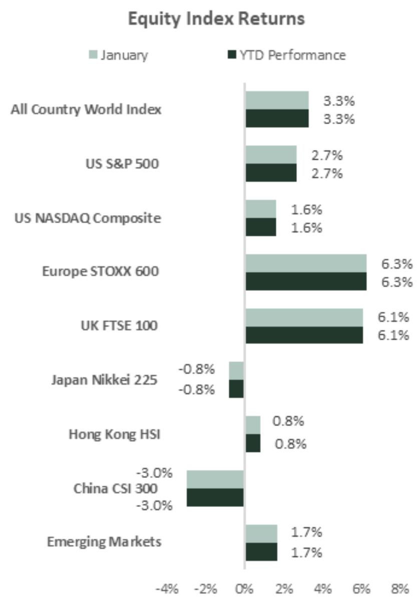
MARKET SUMMARY AND REVIEW

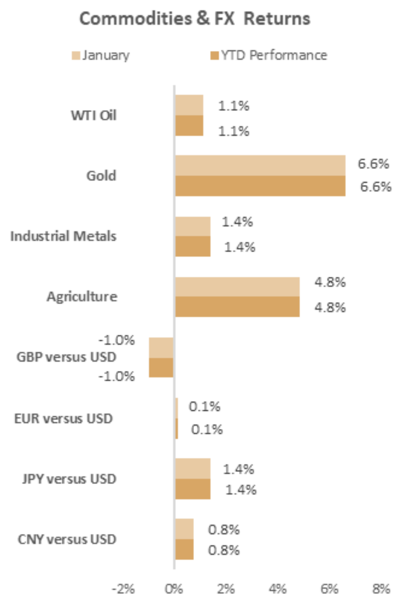
- It's been a wild and relentless start to the year for markets with whiplash being a common injury amongst investors as the three major concerns that dominated minds coming into 2025 all played out in quick succession in January. First, there was a sizeable bond sell-off early in the month sparked by hawkish economic data and higher inflation expectations pushing the US 10-year Treasury yield up to 4.8%, its highest level since October 2023. Second, there was a separate risk-off move because of DeepSeek's new AI model, which led to big questions about the sustainability of US mega-cap tech valuations and the strength of their perceived AI moats, in particular, Nvidia and the Magnificent Seven stocks. And third, trade wars and tariffs were back on the agenda, with markets losing ground at the end of the month as the new Trump administration announced incoming tariffs on Canada, Mexico and China. Despite all of this, the equity bull market managed to shake off these concerns and continue its ascent, with the S&P 500 and STOXX 600 both recording all-time highs .

- World equities rallied strongly to start 2025, rising 3.3% in January, led by European markets with the STOXX 600 and FTSE 100 rising 6.3% and 6.1%, respectively. Asian markets, however, lagged substantially, with the CSI 300 and Nikkei 225 declining -3.0% and -0.8%, respectively. None such dispersion was present in the fixed income markets, where the global bond aggregate rose 0.4% and all major sectors gained, led by EM local sovereign debt rising 1.8% during a risk-on month and weaker US dollar environment. In commodities, gold rallied strongly, rising a very impressive 6.6% during the month on a combination of factors, including rising concerns over escalating US trade wars that could become the dominate theme of uncertainty in markets this year.

- The first few weeks of Donald Trump's second presidential term have been a nonstop flow of news, executive actions, tariff threats, and TikTok resurrections, kicking off what has been a quite remarkable political comeback to the centre of power that has overcome numerous criminal indictments, a conviction, and two assassination attempts. At 78, Trump is the oldest president to be sworn into office, as well as the first Commander-in-Chief to be a convicted felon and the subject of two separate impeachments by the House of Representatives for high crimes and misdemeanours. Nevertheless, and unsurprisingly, he has returned to office more emboldened than ever, and with fewer likely political challenges given full Republican control of both chambers of US government.

MARKET PERFORMANCE AS OF 31 JANUARY 2025





Source: Bloomberg L.P., Arbion Ltd.

DESPERATELY SEEKING ANSWERS

- DeepSeek, the Chinese artificial intelligence company that develops open-source large language models, released its latest R1 model that was reportedly built with just $6 million in raw computing power and dated AI chips, a fraction of the money and resources spent by firms like OpenAI, Meta and Alphabet's Google. Whilst question marks remain over the minimalist cost and resources used to produce the AI mode, what is not questionable is its performance, tied with ChatGPT in a closely watched ranking of AI model capabilities that can perform chain-of-thought reasoning. It's open-source and free for personal use, cheap for businesses, and been a hit with the public too, having topped app stores in the US, UK and Canada. Some in Silicon Valley have called this "AI's Sputnik moment", drawing comparisons to when Russia launched Sputnik in the Space Race, shaking US complacency with respect to its position of dominance. Does this mean that all the billions of dollars poured into chips, talent and energy infrastructure in the US have been for nothing? Perhaps not, but what is clear is that vast sums of investment alone are no longer enough. DeepSeek has shown that the future winners of AI will need both raw computing power and the efficiency innovations that Chinese firms have been forced to develop given US chip curbs.

- This may inject some reality back into the AI market, which at times, has been at risk of believing too much in its own hype and allowing valuations to detach from reality in the near-term. Yet for now, tech earnings have shown strong momentum, and whilst tech earnings growth is set to slow over coming years, it still remains a source of substantial cash flow generation and a dominant driving force for the US equity market. An alternative interpretation of the DeepSeek news could be that this leads to additional determination by the mega cap tech companies to invest more rapidly in the short-term, in order for US firms to demonstrate their renewed leadership in the AI sector. Either way, however this plays out, investors should expect this market theme to continue, but now potentially as a bigger source of market volatility compared to previous years.

TRUMP TRADE WARS 2.0 KICKS OFF WITH A BANG

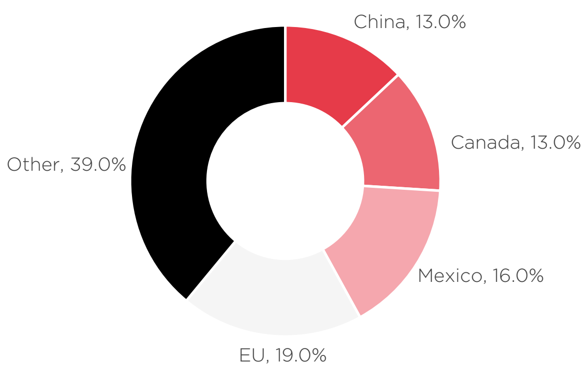
- President Donald Trump signed executive orders imposing 25% additional tariffs on imports from Canada (ex-energy imports at 10%) and Mexico, and a 10% additional tariff on China, citing a national emergency due to the extraordinary threat posed by illegal immigrants and drugs, specifically fentanyl, crossing the US borders. Whilst Canada and Mexico have agreed a temporary reprieve until the beginning of March, China have said they will file legal proceedings against the US at the World Trade Organisation and have announced a list of countermeasures:
    - 15% tariff on US coal and liquefied natural gas imports
    - A 10% tax on crude oil, agricultural machinery, pickup trucks and large-engine cars
    - Announced an anti-monopoly investigation into Google
    - Placed export controls on 25 types of rare metal products to the US
    - Added PVH Corp, the holding company for Calvin Klein and other brands, and US biotechnology company Illumina to its "unreliable entities" list, allowing the Chinese government to impose punitive measures against these companies

- China, Canada and Mexico together make up a significant portion of imported US goods, 42% in 2023 to be precise, or approximately $1.4 trillion. To put this in Trump trade war perspective, in his first presidential term the US targeted around $350 billion of Chinese goods. Global trade has not seen anything like this for decades and at face value takes us back to the protectionist period between the two world wars in terms of scale of tariffs. The average duty rate on US imports in simple terms could move from 2.3% to around 10%, assuming no redirection of trade. The auto sector would be particularly affected, where components can make their way back and forth across US borders as many as eight times during production, heaping duties onto a sprawling industry that relies on materials from all three countries. At the consumer end of the supply chain, the average price of a new car may instantly climb by about $3,000, Wolfe Research analysts have said, further straining affordability with prices already close to all-time highs.

- In terms of reciprocity of response it's clear with such elevated levels of export reliance to the US, that Mexico and Canada do not have the economic capacity to challenge the US as China has done by entering into a costly trade war.

- Given exports to the US for both countries were approximately 80% of total exports in 2023, this would prove a very damaging process to their economies.

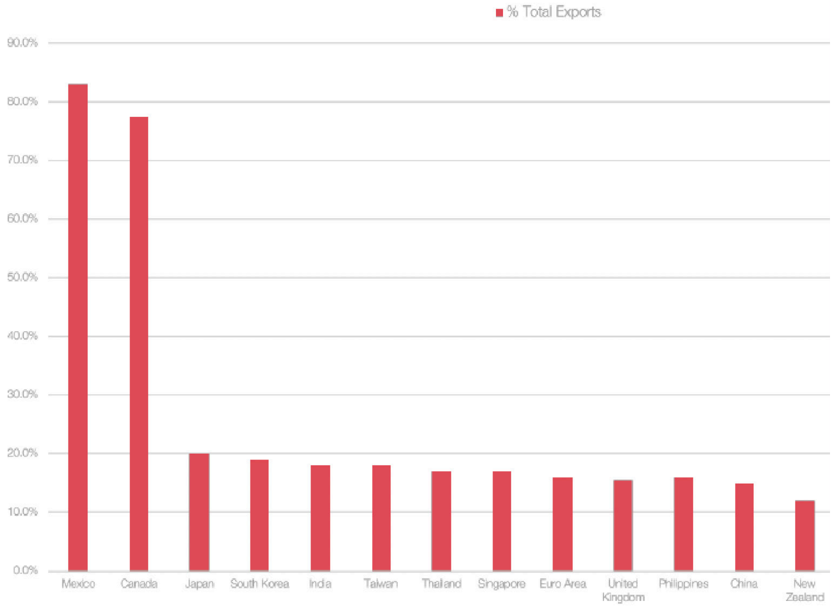
US Imports in 2023 by Source (% of Total)



Source: Arbion Ltd. Bloomberg LP.

- India is on course to be a big winner from the US-led attempt to “de-risk” global trade with China. Its favourable relations with most of the world’s major economies should lead to 6%+ growth in total trade through 2033, to $1.8 trillion annually, aided by incentives for manufacturers, a huge low-cost workforce, and rapidly improving infrastructure. Its annual trade with the US is expected to double to about $116 billion during this timeframe.

Exports to US in 2023



Source: Arbion Ltd. Bloomberg LP.

CORPORATE AMERICA: SOLID BEATS AND CONTINUED RESILIENCE

- US companies are putting up one of their best earnings seasons in three years on the back of continued US exceptionalism and robust economic growth. With most companies having now reported their fourth quarter results, earnings per share are on track to jump 13% year-on-year, compared with an anticipated 7% before the season kicked off, and well above the average 5.5% increase posted since the first quarter of 2022.

- Earnings beats have been broad based across sectors, led by the Financials and Consumer Cyclicals that have beaten by double digit percentages. Materials, Industrials, Cyclicals, Energy and Mega Cap Growth & Tech sectors are also doing well, beating by mid-single digits, whereas Defensive stocks are beating only modestly.

- The S&P 500 earnings momentum is relatively well insulated from the risks of escalating trade wars. Approximately 7% of index revenue is derived from Canada, Mexico and China. Of the roughly $16.5 trillion in sales the S&P 500 does on an annual basis, only about $1.1 trillion is derived from Canada, Mexico and China, with China accounting for the largest share. The industries most exposed to China from a dollar perspective are Autos, Tech Hardware and Semiconductors. For both Canada and Mexico, Consumer Staples distribution and Retail are the most exposed.

SIGNIA INVEST

WORLD ECONOMIC DASHBOARD

	GDP (YoY)	2024 GDP Forecast*	2025 GDP Forecast*	Headline CPI	Core CPI	Unemployment Rate	Central Bank Policy Rate	1Y Yield (Implied Path)
US	2.5	2.8	2.2	2.9	3.2	4.0	4.50	4.24
UK	0.9	0.8	1.2	2.5	3.2	4.4	4.50	4.40
Europe	0.9	0.7	1.0	2.5	2.7	6.3	2.75	2.06
China	5.4	5.0	4.5	0.5	0.6	4.0	2.00	1.27
Japan	0.5	-0.2	1.2	3.4	1.0	2.4	0.50	0.59

*Bloomberg full year economic forecasts

Data as at 10.02.2025. Source: Bloomberg L.P., Arbion Ltd. All figures are percentages.

OTHER NOTABLE ECONOMIC AND MARKET DEVELOPMENTS

- **IMF:** The International Monetary Fund upgraded its global growth forecast for this year to 3.3% from 3.2% in October, spurred by stronger than expected US demand and slowing inflation worldwide that will let central banks continue to cut interest rates, according to the IMF. It kept the estimate for 2026 unchanged, also at 3.3%.

- **US:** In a unanimous decision the Fed held rates steady in the 4.25-4.5% range, pausing their rate cutting cycle which started in September and has seen the policy rate reduced by 100 basis points. There were three key takeaways from Chair Powell's press conference. First, he still sees the policy stance as "meaningfully restrictive," suggesting that the Fed is not done cutting rates this year to get to a neutral equilibrium level. Second, the central bank is no hurry to cut and are hesitant to move until it knows more about what policy changes are coming from the new Trump administration, which makes a rate cut at its next meeting in March unlikely. Third, once that becomes clearer, the bar is not high for further inflation progress to justify another rate cut, however, any sign of upward inflationary pressures building in the meantime will likely keep the Fed on hold for longer.

- **Canada:** Prime Minister Justin Trudeau announced he'd be resigning as Liberal Party leader following significant pressure from other Liberal MPs to resign. Trudeau will stay on as PM until a new leader is picked, and the Canadian parliament will be prorogued until March 24th. With the Liberals currently well behind the opposition Conservatives in the polls, a federal election is due to be held in Canada by October but may come sooner if opposition parties push for a confidence vote once parliament reconvenes.

- **UK:** Core CPI excluding food and energy dropped to 3.2% in December, with elevated services inflation cooling from 5.0% to 4.4%, a welcome development for the Bank of England who have indicated they would like to continue cutting interest rates to support the ailing economy if inflation trends continue to slow. However, we would caution that in the months ahead the UK is braced for higher utility bills, elevated council tax charges, rising food inflation, and increased prices linked to firms passing on higher employment tax charges. Taking all of this into consideration, it is possible that the December inflation data could be as good as it gets for the Bank, at least for the time being.

- **China:** China must implement extraordinary countercyclical policies while deepening economic reform to achieve 5% GDP growth in 2025, according to a report by the Institute of Chinese Path To Modernisation at Nankai University. Countercyclical measures should focus on boosting consumer spending and improving investment efficiency, which require greater fiscal expenditure.

- **Japan:** The Bank of Japan raised its policy rate by 25 basis points to 0.5%, the first since July when their unexpected hike seemed to kick start a huge but brief global summer sell-off. This follows core inflation (excluding fresh food) coming in at 3%, also in line with expectations but the first time since August 2023 that this measure has hit 3%. The BoJ have upgraded their inflation forecasts with the hike which was a somewhat hawkish development. Although the BoJ currently worries about how it raised rates prematurely in 2000 and 2006, only for the country to return to a deflationary state, we think the underpinning dynamics are now very different in the economy. Rather, with core inflation above 3%, there may be more scrutiny devoted to whether the BoJ is instead falling behind the curve when normalising policy only at a very gradual pace.

- **Middle East:** Israel and Hamas agreed on a multi-phased ceasefire after 15 months of war, with Hamas releasing 33 hostages and Israel releasing 1,000+ Palestinian prisoners and withdrawing from populated areas in Gaza.

SUMMARY AND PARTING THOUGHTS

- Just days after the White House announced the Stargate initiative, which included a $500 billion investment into AI development and potentially US leadership in the space, DeepSeek showed up and completely changed the narrative. In a way this development has highlighted both the key weakness and the strength of the US equity bull market, with the S&P 500 falling sharply in the immediate aftermath of the DeepSeek announcement, especially Nvidia, but the equity index managed to bounce back relatively quickly. Plenty of question marks remain, but none bigger than this: Will the hundreds of billions of dollars in AI spending yield a return for these US hyperscaler companies and will it boost broader economic productivity for the US and ultimately the world? It is far too early to discount the effectiveness or potential of this AI development, but what is quite clear is that it would be wise to curb one's AI enthusiasm until we know more about where this new market narrative is heading.

- The strong momentum in the US economy has, in part, been driven by rising stock prices, but importantly also by high home prices, vast amounts of corporate capex and government defence spending, and continued fiscal spending from Biden administration fiscal programs, namely the CHIPS Act, the Inflation Reduction Act, and the Infrastructure Act. Combined with low jobless claims and higher animal spirits since the election, the bottom line is that the US economy is entering 2025 in very healthy shape. It is a big if, but if the inflation genie remains in its bottle this year and the Fed can continue to cut rates, then this goldilocks environment should be well received by the bull market. However, with tentative signs to the contrary coming from rising commodity prices, elevated shelter and services inflation, and growing inflationary threats from trade war risk, maintaining a diversified portfolio across global equity markets and other asset classes in fixed income, commodities, and alternatives, continues to make most sense to us at this juncture.

ROBERT LEE

HEAD OF MODEL PORTFOLIO SERVICES; HEAD OF RATES

Robert has been managing the wealth of private clients since 2006 as a portfolio manager and fixed income specialist. He is jointly responsible for the multi-asset investment team, global fixed income strategies, Arbion's MPS business, and is portfolio manager for the Arbion Sovereign Opportunities strategy.

Previously, he worked for Lehman Brothers on the European Capital Markets team, and then Coutts & Co where he was a member of the fixed income and foreign exchange selection committees, responsible for managing the advisory and discretionary portfolios for private clients and institutions.
Robert is a Chartered Financial Analyst and a member of the Chartered Institute for Securities & Investment.

CONTACT US
Signia Invest

One Connaught Place,
London, W2 2ET

www.signiainvest.com
info@signiainvest.com