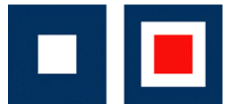

PAPAMARKOU WELLNER PERKIN

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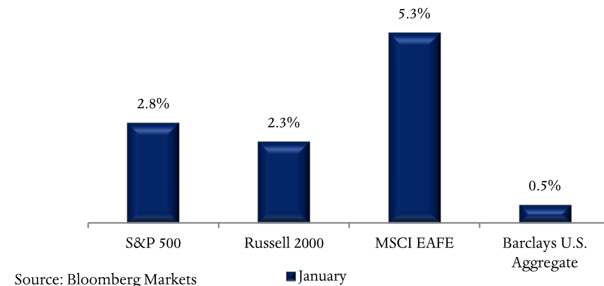
Markets

Global financial markets started the year off strongly. The return of President Trump to the White House, along with his 'America First' policy agenda, proved supportive for US equities, but the emergence of Chinese artificial intelligence company DeepSeek sparked scrutiny into technology companies' business models, profitability outlook and capex plans. Overall, the S&P 500 index rose +2.8% during the month, achieving a record high. Market breadth was also positive, leading the equal-weighted version of the index to outperform by over 70bps. Small-caps in the Russell 2000 improved by +2.2% in January, only partially recovering some of their -8.0% loss from December. Overseas equities were the best performers in January, a departure from the status quo of the past two years. The MSCI EAFE index rallied +5.3%, led by European bourses, which advanced +7.1% on average. Asian markets were standout underperformers due to trade uncertainties and worries over technological disruption. This was most evident in the Shanghai composite's decline of -4.3%.

President Trump's proposed policy mix of tax cuts, immigration curbs and tariffs have fueled expectations for higher US inflation. Nevertheless, government bond yields and credit spreads contacted slightly on the promise of lower inflation. This led the Bloomberg US Aggregate Bond Index higher by +0.5% for the month.

Commodities were among the top performers in January, rising +4.0%. Metals rose on China's restrictions of exports of five minerals used in defense, clean energy and other industries, in retaliation to Trump tariffs. In energy markets, WTI crude oil rose +1.1% ($72.53/bbl) driven by winter weather, US sanctions on Russia and possible 10% tariffs on Canadian crude. Gold (+7.1%) and Bitcoin (+9.3%) achieved record highs reaching $2,801/oz, and $102,412/$, respectively.



Source: Bloomberg Markets

Geopolitics

January ushered in the new US Republican administration. In the few short weeks since his inauguration, President Trump sprung into action, issuing numerous executive orders. Tariffs appear to be his preferred method for gaining leverage, against allies and foes alike, on various issues including the flow of migrants and narcotics across borders, as well as correcting trade imbalances. Across-the-board tariffs of 25% were mandated on imports from Mexico and Canada (with a lower 10% rate on energy), which were subsequently postponed; China tariffs were set at 10%. President Trump also ordered the US withdrawal from the Paris Climate Agreement and reversed several policies supporting green industries and renewable energy projects, while increasing support for the fossil fuel industry. In the technology arena, Trump unveiled the "Stargate" project, a $500 billion investment plan to build AI infrastructure in the US, seen as a strong endorsement of AI development amid competition from China. In addition, he unleashed the Department of Government Efficiency's tech-enabled team to map out the processes of various agencies and track their money flows. Concurrently, some agency spending is being cut or eliminated. Overall, the swiftness and purpose has put Trump's political opponents on the defensive, unsure how to respond given that 70% of Americans approve of his execution of campaign promises.

Overseas, Trump has shown an unexpected toughness toward Russia, seeing Putin as the one who stands in the way of a ceasefire in Ukraine. He also announced the ill-received desire to rebuild Gaza after all Palestinian residents had been evacuated. As for China, it remains to be seen how the Trump administration will choose to address the country's carefully calibrated response to US tariffs. Trump seemingly wishes to establish a good working relationship with Xi Jinping, irrespective of the geostrategic elements of the US-China relationship, indicating that an economic settlement is possible. With regard to Iran, President Trump stated that it cannot be allowed to develop or acquire nuclear weapons, suggesting a diplomatic route, including a "verified nuclear peace agreement" and lifting of economic sanctions if an accord is reached.

US

Tariff threats, financial market volatility, and rapid-fire executive orders led Americans across the political spectrum to feel less optimistic about the economy than they did before President Trump took office. As per the University of Michigan's recent survey, consumer sentiment tumbled 5%, to its lowest reading since last July. A significant driver was the expectation for inflation in the year ahead, which has jumped sequentially from 3.3% to 4.3%. The Fed's preferred gauge of inflation, the PCE, sped-up in December, rising 2.8% over the past year. On the employment front, January's job growth of 143,000 slowed more than expected following robust gains in the prior two months. Wages were higher by 4.1% over the trailing year, while the unemployment rate ticked down to 4.0%, the lowest since last May.

Given the resurgence of inflation and employment, the Federal Reserve stood firm on interest rates in January, ending a three-month 100 bps rate-cutting streak. Fed Chair Powell indicated that the central bank is in no hurry to make changes, with financial futures markets calling for no rate reductions until at least June.

January 2025 Economic Statistics

	Jan-25	Dec-23	Dec-22
Federal Funds Target Rate	*4.25 - 4.50%*	*5.25 - 5.50%*	*4.25 - 4.50%*
Consumer Confidence Index	*104.1*	*110.7*	*108.3*
Manufacturing PMI Index	*50.9%*	*47.4%*	*48.4%*
Unemployment Rate	*4.0%*	*3.7%*	*3.5%*
JPY/USD	*155.18*	*141.06*	*131.11*
USD/EUR	*1.0362*	*1.1036*	*1.0702*
Gold/oz.	*$2,801.00*	*$2,062.59*	*$1,824.40*
Oil (WTI)/bbl	*$72.53*	*$71.65*	*$80.26*

Sources: see disclosure *

Europe

Eurostat data indicated that regional economies stagnated in Q4, leading to estimated GDP growth of 0.7% for the full-year 2024. The European Central Bank cut interest rates, as expected, by a further quarter of a percentage point, with President Christine Lagarde warning that economic risks are tilted to the downside given rising trade frictions and weak consumer confidence, hinting at an additional rate cut in March. However, the purchasing managers' index saw business activity in the eurozone return to growth, with January's composite PMI of 50.2%, rising above the expansionary level. Meanwhile, Eurozone inflation ticked up slightly in January to 2.5%, rising from 1.7% in September, driven by energy price increases, while core inflation was sequentially steady at 2.7%.

Asia

China met its 2024 GDP growth target of 5% thanks to an annualized 5.4% pickup in Q4, aided by fiscal and monetary stimulus from Beijing. The country's manufacturing PMI registered 50.1% in December, slightly below the prior month's reading, but non-manufacturing PMI was notably higher. The underlying data showed consumption recovering slightly, with industrial output from new economic sectors as well as export data showing robust growth. Investor attention will now to turn to the National People's Congress meeting on March 5, expecting further measures to boost growth and public confidence, including innovative ways to revive the stagnant real estate sector and

labor market. Investors will also be watchful of relations with the US, especially where tariffs are involved. The Trump administration's approach has been more tactful than expected, and China's response measured, giving hope that matters won't spiral downward.

The Bank of Japan hiked interest rates by 25 bps to 0.5%, matching expectations, without leading to a repeat of the global financial market convulsions of last August. The central bank also released a report forecasting inflation metrics remaining above 2% for the foreseeable future. Japan's core CPI accelerated to 3% year-over-year in December, the highest since August 2023. On the political front, Japanese Prime Minister Shigeru Ishiba's first in-person meeting with President Trump ended without friction. As a result, Japan, which has been the largest single-country investor in the US over the past five years, will begin importing an increased amount of LNG and explore investment in Alaskan oil and gas.

Outlook

While the incoming Trump administration's actions have dominated headlines thus far in 2024, the announcement of 25% tariffs on imports from Mexico and Canada (which were subsequently postponed) and 10% against China have created the most angst among corporations and investors. Looking ahead, President Trump warned of additional tariffs on chips, steel, aluminum and copper and mentioned he has not yet settled on a universal tariff rate. The potential for related inflation and lower growth could induce additional volatility in both the fixed income and equity markets. Investors will also be assessing the likelihood and extent of tariff-associated retaliatory measures.

The AI narrative faced a setback arising from the surprise introduction of China's relatively low-tech, open-source, DeepSeek AI model. This revelation triggered concerns surrounding potential disruption of America's leadership in the segment, along with scrutiny of US technology spending and related returns on invested capital. The idea that robust AI applications could be implemented at a small fraction of the established costs, without use of the latest semiconductor technology, cast doubts on existing business models and the width of their competitive moats.

The Department of Government Efficiency is off to a torrid start, using data to quantify processes in order to optimize America's bureaucratic entities. From a fiscal perspective, this is sorely needed given the Congressional Budget Office's forecasts of 5.7% of GDP average fiscal deficits for 2026-2035 (excluding potential extensions of the 2017 Tax Cut and Jobs Act). Yet more austerity will be required, given that the vast majority of spending is non-discretionary. A failure to curtail current deficits and rising federal debt may lead investors to demand higher risk premiums on US Treasuries. As such, we remain cautious of the value of investing in longer-dated government bonds, especially given the low returns over inflation.

Nearly half of S&P 500 index constituents have reported Q4 earnings thus far, with average results coming in well above consensus. The Financials and Communications sectors have provided the most upside surprises, while Industrials have somewhat disappointed. Overall, the expected earnings growth rate for the fourth quarter has increased to 13.2% (on sales growth of 4.5%) which would be the highest year-over-year growth rate since Q4'21, marking the sixth consecutive quarter of increased profits for the index. For the full-year 2025, we expect a further 15% advance in index earnings. This level of growth bodes well for equities, even though we expect higher volatility and the potential for multiple compression.

Given our lukewarm outlook for fixed income, we continue to favor select hedge funds and non-market correlated investments which can serve as alternative volatility dampeners and sources of alpha. In addition, our research indicates that precious metal miner investments, which have trailed the appreciation of gold and silver bullion, offer attractive potential with reduced correlation to equities. For capital appreciation oriented investors, select software equities, with an activist element, have further room for appreciation. We have also identified innovative private equity funds with expertise in the cybersecurity, education and healthcare industries.

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*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.