MONTHLY UPDATE

Latest views from the investment team

More Ups Than Downs

January was an eventful month for investors, with several key developments shaping market sentiment. A new US President set a record for executive orders on his first day in office, whilst rising inflation created a more challenging environment for central banks. In the technology sector, a Chinese AI newcomer fuelled price volatility and reignited concerns about the sustainability of certain companies' dominance. Nvidia made history by losing $589 billion in market value in a single day, the largest one-day drop ever. Despite pockets of weakness, equities posted gains across regions throughout the month.

Technology stocks experienced heightened volatility in January following advances by Chinese AI newcomer DeepSeek. Its latest machine learning model reportedly delivers performance comparable to US rivals while using significantly fewer chips and less power, reducing development costs. This sparked concerns that AI-related spending could be lower than expected, as businesses shift focus from scale to efficiency. The prospect of slower AI-driven demand weighed on chipmakers and related businesses, leading to sharp one-day declines in stocks such as Nvidia and ASML, where the market had priced in sustained dominance and an ability to capture this exceptionally high AI investment. However, while these developments may raise questions about the long-term positioning of certain firms, they also suggest that AI adoption could become more accessible globally, driving productivity gains. This shift supports the ongoing broadening of market performance. Indeed, US equities saw widespread gains in January, with financials, healthcare, materials, and consumer discretionary stocks all outperforming the technology sector.

Lower costs to achieve AI benefits should be particularly welcome as inflation begins to rise again. Last year, investors and policymakers shifted their focus away from inflation as it fell towards target in the US and UK, bringing much relief. However, since September, the fall in inflation has stalled. Goods price declines have plateaued, exposing slower progress on services inflation, which remains above 4% in both countries, driven by strong wage growth. Inflation expectations have also been rising. A regular US consumer survey, compiled by the University of Michigan, found that five-year inflation expectations have climbed to 3.3% - higher than at any time during the inflation spike in 2022. These higher expectations, which have contributed to the recent outperformance of inflation-linked bonds, may stem from forthcoming policy changes in the US, or in the UK from a weaker pound which increases the price of imports.

Key initiatives from Trump's early days in office include steps to restrict immigration and threats to increase trade tariffs. Policy changes are largely consistent with campaign rhetoric and, therefore, have not upset stocks so far but asset price oscillations suggest some nervousness. Actions being taken to reduce immigration, via border control and deportations, may exacerbate sticky wages if employers find it more challenging to fill vacancies. Also, while details remain undecided yet, tariff threats have indicated figures of up to 25% for Canada and Mexico with China also a target. Such large numbers, if enacted, will push up the cost of imported goods in the US, and prompt other regions to weaken their currencies to keep their products competitively priced for US buyers. This all dampens arguments for the further lowering of US interest rates, generating swings in bond prices over the month, and presents a problem for the US Federal Reserve which is being encouraged to support borrowers by lowering rates by the new President. US Interest rates were held steady in January following 1.0% of rate cuts since September.

Bottom Line

Volatility in asset prices seems likely in 2025 as investors grapple with pockets of high valuations, a slowdown in the pace of interest rate cuts in some regions and the introduction of new government policies. However, fundamentals remain underpinned by global growth, which the IMF forecasts at a healthy 3.3% before inflation, in 2025 and 2026. We, therefore, believe it is advantageous for investors to look through short-term noise in prices and stay invested.

NORTH CAPITAL

Month in Numbers

Change in various markets over the month:

ASSET NAME		CHANGE / VALUE
EQUITIES Local Currency		
United Kingdom	▲	6.13%
Eurozone	▲	7.98%
United States	▲	2.70%
Emerging Markets	▲	1.47%
Japan	▼	-0.81%
BONDS/RATES Absolute change (%)		
Bank of England Base Rate	-	0.00%
		4.75%
Federal Reserve Funds Rate	-	0.00%
		4.50%
UK 10-Year Gilt Yield	▼	-0.03%
		4.54%
US 10-Year Treasury Yield	▼	-0.03%
		4.55%
CURRENCIES		
GBP/USD	▼	-0.96%
		$1.23
GBP/EUR	▼	-1.05%
		€1.20
DXY (USD Index)	▼	-0.11%
		108.37
COMMODITIES		
Gold (USD/ Troy Oz)	▲	7.03%
		$2,809.79
Brent Crude Oil (USD/Barrel)	▲	2.77%
		$76.81
NOTEWORTHY		
Burberry Group	▲	21.63%

February 2025

As of 31 January 2025

Q&A

Why did European Stocks Outperform in January?

European stocks enjoyed strong gains in January following lacklustre performance over previous months. Political uncertainty, including the collapse of governments in France and Germany, and Trump's tariff plans, which could hit Europe's exports hard, led to weak sentiment towards the end of 2024. While the German election in February may warrant some caution, some major parties are calling for tax relief which could pave the way for a much-needed boost. The European Central Bank also demonstrated its determination to offer support by cutting rates again in January. Furthermore, Europe has not been a focus of Trump's tariff plans so far, helping to alleviate some of the fears that had become embedded. Regardless, Europe has been motivated to negotiate more trade deals elsewhere and signed a long-negotiated agreement with the Mercosur bloc of South American countries.

Stocks gained broadly in Europe over the month, but perhaps most notable was a 9% gain in the consumer discretionary sector following weak performance last year. Names such as Cartier owner Richemont, Hermes and Burberry delivered outsized returns. Whilst 2024 earnings reports highlighted poor performance, with much of the blame directed at China where consumer confidence remains weak, encouragingly, the tone has changed. Richemont shares jumped 16% following the release of results, and Burberry rose a similar 15% following their release, as results were boosted by buoyant demand from US shoppers. Upcoming US tax cut policies seem likely to underpin ongoing demand, although investors will remain vigilant on the risks of tariffs and political upset.

Who are DeepSeek?

Chinese startup DeepSeek is the latest major competitor to AI language models like OpenAI's ChatGPT, Google's Gemini, and Microsoft Copilot. Released in January, DeepSeek-V3 quickly overtook ChatGPT as the most downloaded app in the US. Founded in 2023 by a Chinese hedge fund manager, DeepSeek has rapidly emerged as a leading AI player, rivaling OpenAI's most advanced model, GPT-4.

As noted earlier, tech equities reacted poorly, with semiconductor stocks leading declines on the final Monday of the month. Nvidia recorded the largest single-day loss in market value ever, while peers like TSMC, ASML, and Broadcom also saw sharp drops. For context, the key semiconductor benchmark remains up nearly 20% over the past year, with Nvidia up over 120%.

DeepSeek is seen by the market as a threat for two main reasons. First, its rapid rise challenges assumptions about the US's technological edge in AI, particularly amid high US-China tensions. This raises the risk of new US export controls on semiconductors, which could weigh on sales for US firms. Moreover, DeepSeek's success raises concerns about the ability of US tech giants to maintain their dominance in AI in the face of greater competition from abroad. Secondly, the company reportedly reached this level using older-generation Nvidia chips and a relatively low budget of $5.58 million – claims that remain disputed. In an industry expecting to receive hundreds of billions in AI investment from corporates and governments (especially from those in the US) such efficiency raises questions about whether this should shift from sheer scale to optimisation, a negative for the top-line of semiconductor firms reliant on these outlays. These concerns help explain the sector's declines in the final week of January.

Caveats to this negativity exist, and there are clear economic positives to consider. Indeed, even the new President and self-proclaimed China hawk Donald Trump acknowledged the benefits of businesses accessing productivity-enhancing technologies more efficiently and at lower cost. In a market concerned about inflation, this could act as a deflationary force whilst also stimulating economic activity. Trump also framed DeepSeek's rise as a wake-up call for US firms but maintained that they would remain dominant in the years ahead.