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Investment Management

Window on the World

FEBRUARY 2025

Early signs of broadening out

	Total Returns (%)			
	1 Month	3 Months	12 Months	YTD
UK Equities	6.2	7.6	17.9	6.2
US Equities	2.8	6.2	26.3	2.8
European Equities	8.2	9.9	17.5	8.2
Japanese Equities	0.1	3.6	11.8	0.1
Emerging Market Equities	1.8	-1.9	15.3	1.8
UK Gilts	0.8	0.0	-0.9	0.8
UK Corporate Bonds	1.1	2.3	4.4	1.1
UK High Yield Bolds	1.2	2.4	10.2	1.2
US Corporate Bonds	0.6	0.0	3.1	0.6
US High Yield Bonds	1.4	2.1	9.7	1.4

Source: Bloomberg, VIM. Total return, as of the end of January 2025

The year has got off to a good start, with equity markets in positive territory at the end of January. In a departure from the previous two years, it was not led by US technology stocks.

Perhaps surprisingly, it was European equities that led the way, supported by tentative signs of stabilisation in European economic data and optimism around the global economy as we move into 2025. January was the month that Donald Trump was inaugurated, and, having sign-posted many of his “day one” intentions, the US dollar had already strengthened, which helped galvanise UK international earners, with UK equities benefiting as a result, returning over 6% in the month.

US technology stocks took the back seat this month, in more ways than one, as the new Chinese Artificial Intelligence (AI) engine, DeepSeek, hit the world, an event few investors seemed to have been anticipating. This caused notable volatility in the current poster child for AI (Nvidia – more below). Meanwhile, other areas of the US market performed better, with the equal-weighted US equity indices outperforming market capitalisation-based indices and value strategies outperforming growth strategies – the broadening out seems to have begun! US economic data continued to exhibit ongoing resilience, albeit investors are now focused on the policy changes that President Trump will implement following his return to the White House.

Emerging market equities had a good month, with the exception of Indian equities, where weak corporate earnings and economic activity led to the market losing ground, although it remains at a premium to its regional peers. Japanese equities seem to tread their own path, and in January, lagged other developed markets – the Bank of Japan has been, and is expected to continue to raise interest rates driving an upward move in the yen, putting pressure on its export-heavy equity market.

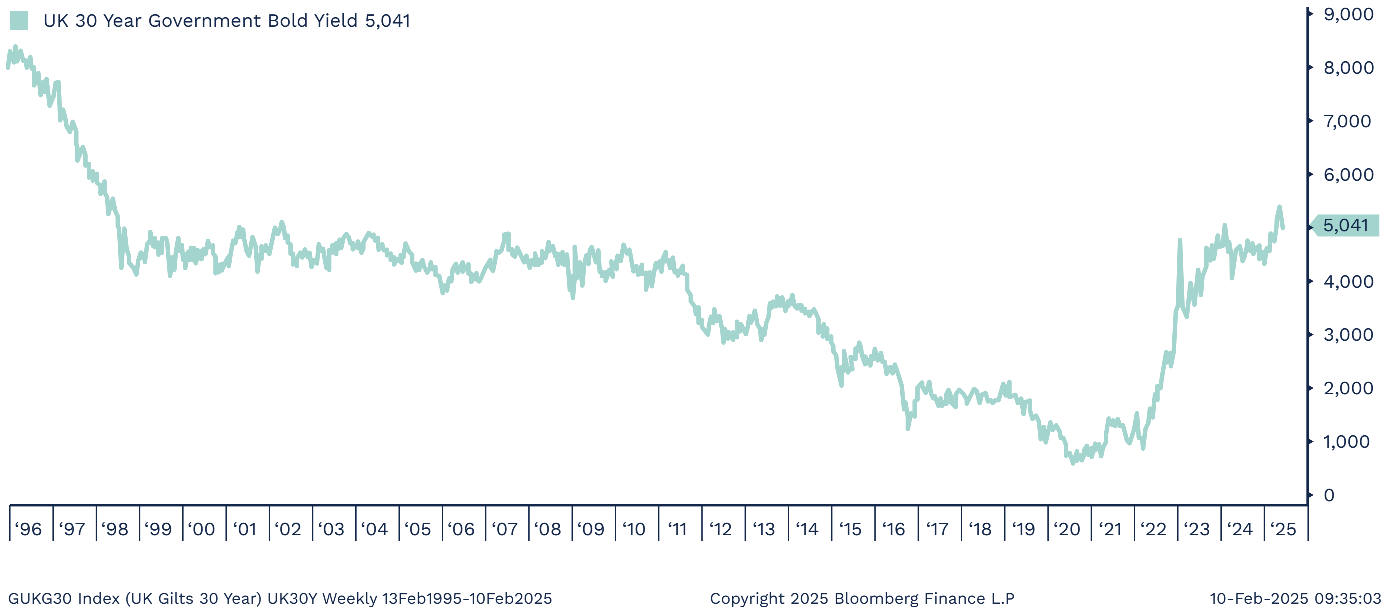
Gilts wobble

The normally quiet UK gilt market hit the headlines in early January, with yields on certain maturity government bonds reaching 30-year highs.

This coincided with some weakness in the pound and came amid concerns that any wriggle room the chancellor had within her fiscal rules had been evaporated by higher borrowing costs, a consequence of the move up in bond yields. This briefly led some commentators to see parallels with the gilt sell-off in 2022. However, there was little similarity between the two episodes – with no technical selling which caused the dislocation in prices observed during Liz Truss's short-lived premiership, and the fact that UK government bond yields were simply moving in line with US Treasuries as the markets priced in the prospect of stickier inflation and rates being higher for longer.

Subsequently, the move up in yields unwound following softer inflation numbers, allowing gilts to recover. The valuations offered in the UK gilt market remain attractive, and we retain exposure to our fixed-income and multi-asset portfolios.

\ THE YIELD ON THE 30-YEAR GOVERNMENT BOND BRIEFLY REACHED LEVELS LAST SEEN IN 1998



Source: Bloomberg, VIM. Total return, as of the end of January 2025

Outside of government bonds, where you expect to find higher yields, the spreads (difference between government and credit yields) in both the investment-grade and the high-yield space remained tight amid optimism for the outlook for the global economy, allowing them both to deliver positive returns during January. Here, we continue to favour shorter-dated credit and high yield, where attractive yields to maturity can be found.

The new AI player in town

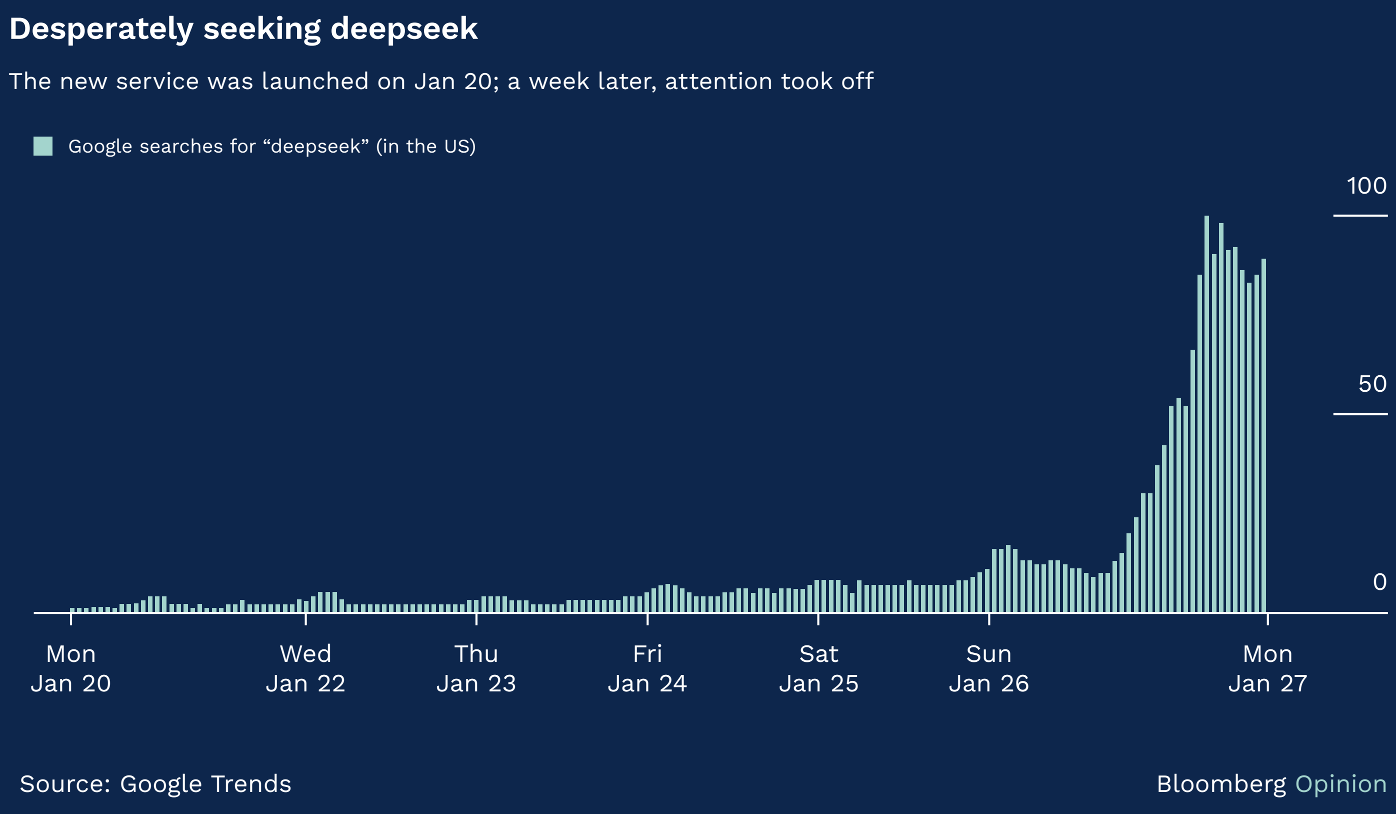
As we mentioned at the beginning of this edition, shockwaves rippled through the technology space in late January as DeepSeek – a Chinese AI start-up – unveiled two open-source large language models that can perform at levels comparable to models from Google, OpenAI and Meta, at a substantially lower cost.

Nvidia, the poster child for AI capital expenditure, subsequently lost nearly $600 billion of market value in one day following the news, the biggest one-day write down in market capitalisation in US history. The ability of DeepSeek to deliver similar performance to leaders in the field, but at a fraction of the cost and processing power, has raised questions about the sustainability of the high levels of capital expenditure being put into AI technology, and the future dominance of US technology companies.

There is a concept called "Jevons paradox", which states that as technological advancements reduce the cost of producing a resource, overall demand increases, causing total resource consumption to rise. In effect, the cheaper and more ubiquitous a technology is, consumption will increase; in this case, Deepseek will enable AI adoption to grow further. So, it seems likely that DeepSeek's arrival will help to drive the faster realisation of AI's transformational power and anticipated improvements in productivity. In the short term, this is unlikely to derail or significantly reduce the amount of capital expenditure focused on AI infrastructure, which allowed technology stocks to recover some lost ground in the days that followed.

Indeed, in January, Meta announced capital expenditure plans totalling $60 to 65 billion in 2025 (50% higher than 2024), and the US administration announced the Stargate project, which plans to invest $500 billion in AI infrastructure over the next four years. That said, earnings expectations and valuations are elevated in this part of the technology sector, and so we continue to underweight the exposure within our portfolios and remain positioned for a broadening out of investment returns.

\ INTEREST IN DEEPSEEK EXPLODED A WEEK AFTER ITS LAUNCH



Source: Bloomberg, VIM

Trump tariffs 2.0

Donald Trump has hit the ground running following his inauguration, wasting little time in starting to implement his policies on trade.

The situation is quite fluid, and so far, the headline announcements of 25% tariffs on Canada and Mexico – two of the US's largest trading partners – have been deferred by a month after commitments from both to slow the flow of fentanyl across their borders into the US, along with better policing of borders to prevent illegal immigration. He has also implemented a 10% tariff on Chinese imports, which has come into force, and has threatened Europe with tariffs in due course... We wait on this one!

None of the announcements are surprising as they were flagged well in advance, nor was the decision to defer the tariffs on Canada and Mexico, with the size and scale of the tariffs likely designed to provoke some concessions. As such, the full extent of tariffs and their impact on economies and inflation remains to be seen, no doubt there will be further wranglings before it settles down and we can get a better understanding of the impact on corporate fundamentals. There is also the issue of whether other countries retaliate, and the risk that it all escalates into a global trade war. For now, what is clear is the underlying resilience of the US economy, and signs of a pickup in momentum in China which provides a constructive macro-economic backdrop for investors, and as such we continue to have a positive outlook for equity markets, and particularly favour the UK and emerging market equities, where valuations are attractive.

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