Allianz Global Investors

01/2025

Market Snapshot

Equity Snapshot

United States

US equities closed a volatile month moderately higher as investors digested a plethora of executive orders from President Donald Trump, including withdrawing the US from the World Health Organisation (WHO) and Paris Climate Accord, stepping up threats to seize control of both the Panama Canal and Greenland, forcibly evicting illegal immigrants and taking steps to shrink the federal workforce. Late on 31 January, after financial markets had mostly closed, the US administration slapped 25% tariffs on imports from Mexico and Canada, as well as 10% on Chinese imports, with effect from 1 February.

The US economy grew less than expected in the fourth quarter of 2024, with GDP rising 2.3% on an annualised basis, the slowest pace of growth since the start of that year. Consumer spending was the main driver of economic activity, with job growth ending the year on a strong note. Non-farm payrolls increased by 256,000 in December, the biggest monthly rise in nine months. January's flash S&P Global US composite purchasing managers' index slowed, sliding to 52.4 from December's 55.4, marking the weakest expansion in private sector activity in nine months. While manufacturing activity returned to expansion territory for the first time in seven months, activity in the service sector slowed from 56.8 to 52.8.

US inflation accelerated to 2.9% in December, its third consecutive increase, although core inflation decelerated to 3.2%, matching the lows seen in the summer of 2024. At its January meeting, the Federal Reserve (Fed) kept rates on hold at a range of 4.25-4.5% and indicated it had now paused monetary policy easing, attracting the ire of President Trump who has called on central banks to slash global rates. Fed chair Jay Powell said US policymakers "do not need to be in a hurry to adjust our policy stance".

Europe

European equities delivered strong gains over January, with the EuroStoxx 600 Index hitting fresh highs. Shares benefitted from increased interest in the region as attractive relative valuations helped investors overlook lacklustre growth and the threat of higher US tariffs. A rotation away from richly-valued US tech stocks was a further tailwind. At a sector level, financials, communication services and consumer discretionary stocks rallied the most. In contrast to the US, European technology shares also rallied strongly, with semiconductor equipment maker ASML noting that DeepSeek's announcement was good news for chip makers. Meanwhile, the utilities, consumer staples and real estate sectors lagged.

Euro-zone GDP growth was flat over the fourth quarter of 2024 as contractions in Germany and France offset robust growth in Spain: Italian GDP growth was also flat. The flash HCOB euro-zone composite purchasing managers' index (PMI) rose to 50.2 in January, marking the first expansion in the euro-zone's private sector activity since August 2024. Headline euro-zone inflation rose to a five-month high of 2.4% in December, but core inflation held steady at 2.7% for the fourth consecutive month. The European Central Bank cut rates by 25 basis points for the fifth time this cycle and warned that economic risks were "tilted to the downside", due in part to the risks to trade of higher tariffs.

Asia

Asia ex Japan equities was mixed in January with the strength of US dollar and higher bond yields setting a challenging backdrop. The threat of higher US tariffs continued to weigh on sentiment, as did the US Federal Reserve's signal that it had now paused cutting rates. Added to this was Chinese start-up DeepSeek's announcement of a low-cost chatbot that rivalled the significantly more expensive US versions: the news disrupted the entire AI supply chain as analysts rushed to work out winners and losers. China equities began the year on a weaker note due to ongoing concerns about the domestic economy and the likelihood of higher US tariffs. Stocks in Taiwan rose, with index heavyweight TSMC beating fourth-quarter earnings estimates. In South Korea, President Yoon was impeached and arrested after trying to impose martial law at the end of 2024. In addition, India and ASEAN markets declined on balance, although Singapore withstood the sell off, helped by a rally in banking stocks. While Indonesia delivered flat returns, Thailand, Malaysia and the Philippines all fell.

Bond

It was a volatile month for global bonds as stronger than expected US economic data sparked fears of a rate hike rather than a rate cut, causing 10-year US Treasury yields to rise to 4.8% in the first half of January. Nonfarm Payrolls for December came in at 256k against consensus of 165k. Despite this, yields fell in the second half to 4.5% as fears appeared overblown, with YoY inflation data being in line with expectations. The Federal Reserve left interest rates on hold, leading to criticism from Donald Trump who insisted on rate cuts at the World Economic Forum in Davos.

In Europe, as expected, the European Central Bank lowered rates by 25 basis points for the fifth time this cycle to 2.75%. 10-year Bunds closed January slightly higher at close to 2.5%. In Japan, it was the opposite where the Bank of Japan raised rates from 0.25% to "around 0.5%", the highest level in 17 years. This led the 10-year JGB yields to end the month slightly higher by 14 basis points at 1.25%. Meanwhile in China, CGB yields continued to remain low at 1.6% as China's fight against deflation remains, with its inflation rate edging down to 0.1% in December.

Outlook

January 2025 was an eventful month. President Trump's second term started with a deluge of executive orders ranging from declaring immigration a 'national emergency' and challenging the constitutional birthright to US citizenship, to renaming the Gulf of Mexico the Gulf of America and pulling out of the Paris climate agreement just after huge fires swept through Los Angeles. He also threatened to 'take back' the Panama Canal and eyed acquiring Greenland. Whilst The Republican Party is traditionally the party of conservatism, these are not conservative acts. These are the acts of a leader with a revolutionary approach to conventional norms and the status quo. We should expect the next four years to be dramatic, if nothing else.

After the strong relative returns of the US stock market in the second half of last year, January saw more muted gains as Technology was the only sector to retreat. The release of a Chinese AI model called DeepSeek, which was seemingly developed using a fraction of the computing resource and at a fraction of the cost of comparable US-developed AI models, unnerved those who expect unrestricted investments in AI infrastructure to continue. DeepSeek's lower cost come from using optimised training and inference techniques, forced upon the engineers as a result of US actions limiting access of cutting-edge GPUs to Chinese firms.

The rise of DeepSeek is intensifying the debate on AI capital expenditure (capex). On the one hand, for some months there have been concerns voiced by investors that the hundreds of billions spent on AI are yet to be effectively monetised, something which might limit future AI investment. On the other hand, major AI users such as Meta (65bn USD of capex guided for 2025) and Microsoft (80bn USD capex) continue to invest vast amounts in the technology with the AI project Stargate, announced by US president Donald Trump, promised up to 500bn USD capex over four years.

The techniques deployed by DeepSeek appear to represent a step change in the efficiency of model training, which will likely permit a significant reduction in costs. Yet, counterintuitively, this suggests that demand might rise even more. This situation, also known as Jevon's paradox, suggests big changes in the cost of a resource can be outweighed by increases in demand brought about by increased adoption. For instance, England's consumption of coal massively increased after James Watt introduced a new fuel-efficient engine that used much less coal in the late 18th century, as the lower operating cost made the engine viable for more use cases. If AI tools – still in their infancy in terms of development, deployment as well as usage – live up to the hopes of their acolytes, declining costs might lead to an increase in demand that outweighs the productivity gains. This would result in a need for more GPUs, not fewer.

We are in the early stages of AI – a long term transformative trend – and innovation is happening at a rapid pace. Claims of sudden or revolutionary advancements in this nascent field are likely to continue for the foreseeable future – similar to what we have seen over the past 18 months. This ties in with a key part of our investment philosophy: at the early stages of new technology development, it is normal to see standards changing or performance improving persistently – one must thus be very selective about gaining exposure to a new technology during a period when it is more challenging to identify the long-term winners.

The opening weeks of 2025 have hardened our view that navigating an uncertain political and macro environment, as well as investing in transformative technologies, will be best suited to active stock pickers. The ongoing earnings season will help to clarify the current demand picture and provide a useful update from our companies on their 2025 outlook and strategy.

Source: Allianz Global Investors, as at 31 January 2025 unless otherwise stated.

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