Allianz Global Investors

02/2025

Market Snapshot

Equity Snapshot

United States

US equities retreated over February, underperforming most other developed markets, as sentiment was knocked by rising inflation expectations and signs of slowing momentum in the US economy. President Trump remained unpredictable, continuing to announce deliberately disruptive policies. Additionally, President Trump stepped up the trade war, slapping an additional 10% tax on Chinese exports and announcing that the 25% tariffs on exports from Mexico and Canada, which had been postponed by a month, will now start on 4 March. Growth shares lagged value stocks over the month, with small-cap stocks, which are more exposed to domestic growth, especially weak. The retreat meant that US stocks have now lost most of their gains so far in 2025.

US economic momentum appeared to be slowing given aggressive cuts to government spending, federal job cuts and higher import tariffs. Retail sales slumped 0.9% in January, the largest monthly fall in two years, while the Conference Board's Consumer Confidence Index sank to a nearly four-year low of 98.3 in February compared with 105.3 in January. February's flash S&P Global US composite purchasing managers' index dropped sharply, slowing to a near stagnation level of 50.4, with services activity contracting for the first time in more than two years.

US headline inflation edged up to 3.0% in January while core inflation accelerated to 3.3%. Inflation expectations have jumped since President Trump took office, with one-year expectations surging to 4.3% in February, according to the University of Michigan, while five-year forecasts have risen to 3.5%, the highest level since 1995. Minutes from January's rate-setting meeting revealed policymakers wanted to see further progress on reducing inflation before making any further rate cuts, with US Federal Reserve Chair Jay Powell saying he was in "no hurry" to cut rates.

Europe

European equities rallied over February, as President Trump's push for peace in Ukraine raised hopes that the three-year war would soon end, although markets closed the month on a weaker note after he hinted that he may introduce 25% tariffs on European exports to the US. Defence stocks, in particular, benefitted from signs that European governments will be forced to increase military spending sharply. At a sector level, financials, communication services and consumer staples rallied the most, while information technology was the only sector to close the month with notable losses.

The flash HCOB euro-zone composite purchasing managers' index (PMI) held steady at 50.2 in February. Services activity slowed to a three-month low of 50.7, while manufacturing activity picked up to 47.3, the weakest contraction since May 2024. Headline euro-zone inflation rose to a six-month high of 2.5% in January, but core inflation held steady at 2.7% for the fifth consecutive month. The European Central Bank continued to signal that further rate cuts were likely.

Asia

February was another mixed month for Asia ex Japan equities, with markets closing the month modestly higher after US President Donald Trump stepped up rhetoric on a global trade war. China was by far the strongest market in the region. In part, the advance was driven by hopes that US tariffs may prove to be milder than expected, although the gains were tempered by President Trump's month-end announcement of an additional 10% US tax on Chinese exports. Technology companies also contributed to the rally as investor interest rose following DeepSeek's recent AI success. Elsewhere, South Korean equities ended slightly higher, while Taiwanese stocks sold off. ASEAN markets moved lower overall. During the month, the Bank of Thailand unexpectedly reduced rates by 25 bps to 2.0%, taking borrowing costs to their lowest level since July 2023. Officials said the move was in response to a weaker growth outlook and increased risks posed by global trade uncertainty. Indian equities also lost ground, declining sharply to mark their worst consecutive monthly rout in nearly three decades. Given rising trade uncertainty and with inflation falling to a five-month low of 4.31% in January, the Reserve Bank of India cut interest rates by 25 basis points (bps) to 6.25%, its first reduction since May 2020.

Bond

Global bond prices moved higher in February, with investors fleeing to safe haven assets on the back of President Trump's tariffs, coupled with softer than expected economic data. 10-year US Treasury yields fell by 33 bps to 4.21%. President Trump imposed tariffs of 25% on all aluminium and steel imports with no exceptions given, scheduled to take effect from March 12. In addition, tariffs on China's imports were raised to 20% from the initial 10%, with the increase taking effect on March 4. Trading partners Mexico and Canada were not spared as well, with tariffs at rates of 25% coming into effect also on March 4. The president also announced plans to impose further tariffs of 25% on imports from the European Union, as well as all automotive, semiconductors, and pharmaceutical imports at rates of 25%. On the data front, consumer sentiment slumped to a 15-month low amid tariff and inflation worries. The Michigan Consumer Sentiment index dropped 6.4 points to 64.7, the largest monthly decline since May and falling short of the 67.8 forecast. Initial jobless claims also came in higher than expected at 242k versus expectations of 221k. Meanwhile, inflation data for January came in as expected, with core PCE index increasing 2.6% year-on-year.

In Europe, a shift in US policy towards the Russia-Ukraine war has been a major concern for European officials. The EU seeks to bolster its defence spending, with Germany's new chancellor-designate Friedrich Merz saying his priority was to strengthen Europe to achieve independence from the US. Investors remained calm, where the 10-year Bund yields closed February slightly lower at 2.4%. In Japan, 10-year JGB yields continued to rise by 13 basis points to 1.4% on optimism towards future rate hikes by the Bank of Japan. Meanwhile in China, CGB yields rebounded sharply by 15 basis points to 1.8% on the back of tighter liquidity and stronger demand for RMB-denominated risk assets. The stronger demand resulted from increased optimism in Chinese assets, where President Xi chaired a symposium with various business leaders including Alibaba co-founder Jack Ma, aimed at boosting private sector investments.

Outlook

While a "soft landing" for the US economy remains the most probable scenario, recent economic data suggest that strong growth and persistent inflationary pressures could challenge expectations for a smooth transition. Additionally, uncertainty surrounding President Trump's economic and geopolitical policies is adding complexity to both the economic outlook and the trajectory of Federal Reserve monetary policy normalisation.

At the same time, US equity valuations remain comfortably above their longer-term averages despite the recent relative weakness. Earnings growth expectations for the technology sector appear especially optimistic and this disconnect between valuations and broader economic risks could contribute to increased market volatility. In this environment, risk-aware investors may seek diversification in more attractively valued markets.

There are already signs of increased capital flows into European equities since January, where select companies with global business models remain resilient despite weaker regional macroeconomic conditions. Furthermore, potential US diplomatic efforts, particularly regarding Russia-Ukraine negotiations, could improve investor sentiment, supporting a more stable business climate and stimulating capital expenditures.

Despite ongoing political and economic uncertainties, corporate earnings remain robust for now, historically supportive of equity markets and our portfolios. We were pleased with our companies' Q4 and H2 results overall, although in the recent rotation, Value oriented areas of the market such as banks, weapons and consumer staples are currently shining even brighter. Much like heat came out of the US market recently, this may not be enduring.

Within our portfolios, we invest predominantly in market leading, often global businesses. Our companies offer pricing power, critical products and services, and are heavily integrated into production processes and IT infrastructure, offering resilience in a trade war scenario. In Europe, we have plenty of construction exposure which could benefit from a potential rebuild of Ukraine, not to mention the general recovery of semiconductors anticipated later this year and medtech which can benefit both our European and Global portfolios. While there are considerable political uncertainties, corporate earnings should remain robust for now, and healthy corporate earnings are usually favourable for our fundamentally focused strategies.

Source: Allianz Global Investors, as of 28 February 2025 unless otherwise stated.

Issuer:
Hong Kong – Allianz Global Investors Asia Pacific Ltd.