CIO Daily Outlook

3 February 2025

It was a tumultuous week that started on the back foot with the DeepSeek technology rout followed by an earnings-driven recovery, and ended with some profit-taking on President Trump's announcement that tariffs would be coming. Both the Fed meeting and the PCE inflation release turned out to be non-events, while macro reports overall confirmed American exceptionalism against a goldilocks backdrop. Stocks closed in negative territory in the US (-1%), though not in other developed countries (+0.8%), nor in the Emerging markets (+0.3%). Technology led losses (-4.6%), as investors took shelter in telecommunication services (+2.7%), and consumer staples (+1.9%). Treasuries gained (+0.5%) in a flight to quality, and the US dollar rebounded (+0.9%) as tariffs were announced. Cyclical commodities weakened, while gold climbed (+1%).

On Monday the IT sector was thrown in total disarray by DeepSeek, a Chinese AI chatbot competitive with ChatGPT, yet built on a small fraction of the budget, and available open source at 3% of the cost. The main chip-related stocks ended sharply lower, led down by Nvidia (-17%). Also, companies known to provide energy for AI data centres tumbled, including uranium stocks. Will DeepSeek upend the IT golden days in the United States? It is not all doom and gloom, as increasing competition in the sector will drive more, rather than less technology investment as no side will want to be left with the shorter end of the stick. The dark lining is that the so-called US hyperscalers will have to accept the commoditisation of AI services and be forced to give up the building of a moat around proprietary models based on huge investments. End-users will be the primary beneficiaries of AI democratisation. An even darker lining for the Washington administration is that China is proving to be a formidable competitor, despite the enforcement of multiple trade restrictions.

Investors cheered megacap earnings and the Magnificent Seven emerged largely ok from the DeepSeek tsunami. Apple, IBM, and Meta Platforms were earnings winners, while Microsoft was amongst the losers. Tesla (-0.5%) showed weak results but rebounded on Musk's announcement of robotaxis to be launched in June. Microsoft (-6.5%) disappointed by guiding lower on current-quarter revenue, while the Azure cloud infrastructure business slightly missed. Meta (+6.5%) beat both on earnings and revenue, though revenue guidance was weak. IBM (+13.8%) beat expectations, signaled a strong 2025 citing AI growth, and broke out higher.

The Federal Reserve meeting confirmed a wait-and-see stance. Policy was unchanged, Powell said that the Fed is in no rush to cut rates, and that a "serial reading" of lower inflation rates is required for further easing. The current stance is deemed to be meaningfully, though not highly restrictive. In summary, the Fed is on hold, and possibly for longer than initially planned given Washington's political uncertainty. At the opposite end of the spectrum the ECB cut the benchmark rate by 25bps to 2.75%, pointing to further accommodation in the direction of the neutral rate, that the majority of the council sees sitting at 2%. Risks to growth are deemed to be to the downside.

The US economy confirmed its strength against the presence of moderate inflationary pressures. The rise in the Dallas and the Richmond Fed manufacturing indices was a positive read-across for the soon-to-be-released ISM manufacturing, whose improvements would support the trade in cyclical stocks. Q4 GDP, though below estimates, printed 2.3% QoQ, that was solidly above trend, with internal demand rising to 3.1%, and consumer spending showing the biggest acceleration since 2023.

PCE inflation was in line with estimates across the board, while a four-month-low in the consumer confidence reading pointed to household's concerns about a slower labor market. Overall, still a sort of Goldilocks scenario. China business surveys were disappointing, with investors now mainly focused on the impact of tariffs and the possible announcement of new stimulus measures in early May at the National Party's Congress.

Markets this morning:

It is now trade war 2.0. President Donald Trump announced new tariffs and signed them on Saturday against Canada and Mexico, slapped with a 25% rate, as well as China that is now faced with 10% on top of the existing measures. US index futures tumbled in the early morning session, falling as much as 2.1%, while Nasdaq contracts were down 3%, alongside Euro Stoxx 50 futures. The MSCI Asia Pacific fell 2.4%, the Hang Seng slid as much as 0.9%, while mainland China bourses were closed for Lunar New Year holidays. The Canadian PM Trudeau unveiled counter-tariffs, the Mexican leader pledged retaliatory levies, and China "corresponding countermeasures". Yields on 2-year US treasuries rose on the prospect of a more cautious Fed, the dollar surged, while the Canadian dollar sank, and the euro declined. Trump said tariffs on EU goods would "definitely happen", and that his measures are not a negotiating tactic. According to Bloomberg estimates, all of the new levies and retaliatory measures at the same level would shave 1.2% off US GDP and add around 0.7% to core PCE.

Upcoming Key events/data:

The main highlights will be the US payrolls report (Fri), the UK (Thu) and India (Fri) rate decisions, and results from Amazon and Alphabet, amongst others. The release of business surveys across the major developed countries and in India will also be closely watched.