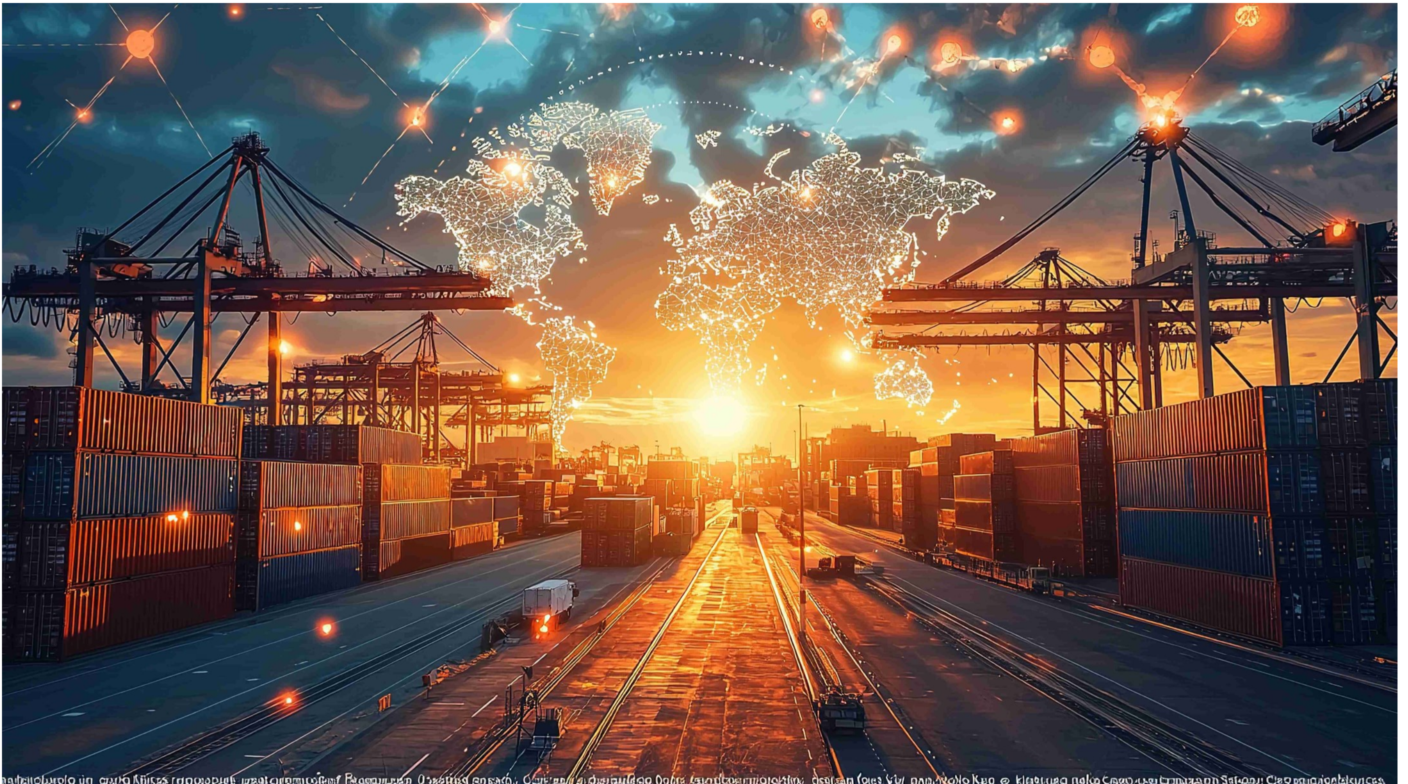
CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

INVESTMENT COMMENTARY

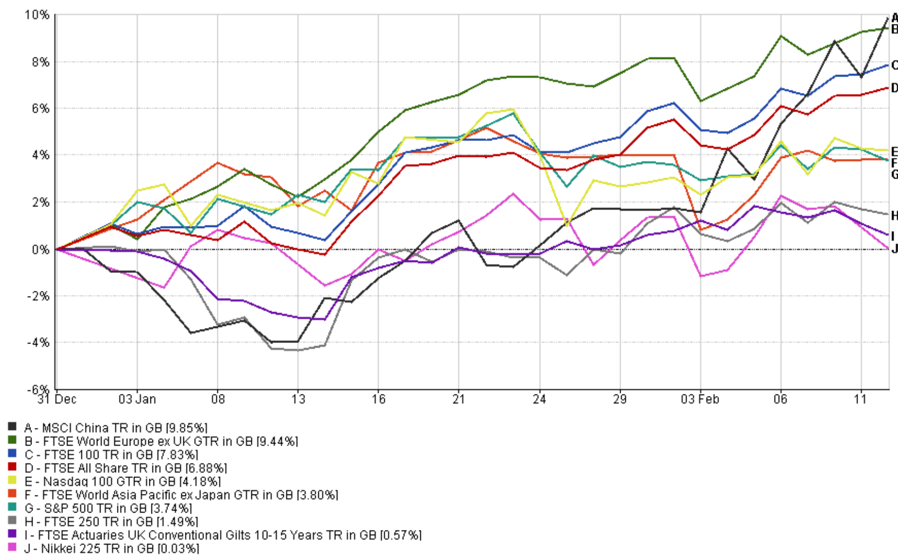


13 FEBRUARY 2025

OVERVIEW

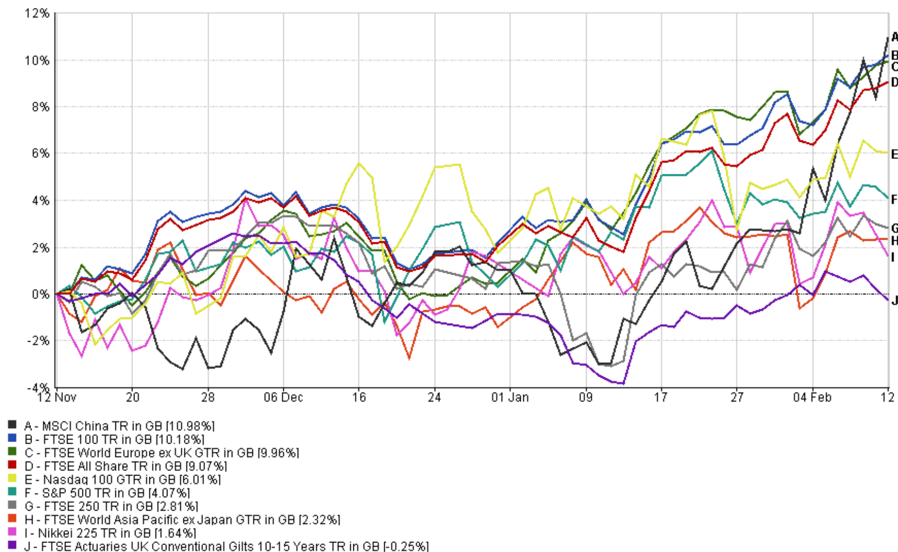
Since our last investment commentary of 19 December 2024, multiple events have influenced investment markets. President Trump was inaugurated on 20 January 2025, which was followed by swift action in imposing tariffs on imports from Canada and Mexico - then suspending them. A 10% increase in tariffs on Chinese goods imports, then an announcement of tariffs on all imports of steel and aluminium to the US followed. The unexpected announcement by ‘DeepSeek’, a small Chinese technology company, claiming that its newly developed AI model used fewer, less expensive and less powerful chips sent the valuations of chip manufacturers sharply lower, most notably Nvidia wiping billions of dollars from the company’s vast valuation in a single day. On the macro-economic side, the Bank of England (BoE) and European Central Bank (ECB) reduced interest rates, the Bank of Japan (BoJ) increased its interest rates and the US Federal Reserve (Fed) kept its rates on hold. There is still uncertainty over the direction of inflation in many larger economies, stoked by the possible introduction of US trade tariffs. Whilst volatility increased as a result of these geopolitical and economic developments, equity markets had a positive start to the year with investor focus now turning to other regions and to sectors other than technology.

YEAR TO DATE INVESTMENT MARKETS STERLING RETURNS



31/12/2024 - 12/02/2025 Data from FE fundinfo2025

THREE MONTHS INVESTMENT MARKETS STERLING RETURNS



12/11/2024 - 12/02/2025 Data from FE fundinfo2025

The US economy looks to be in good shape although recent figures indicate the jobs market may be softening with fewer jobs added in January 2025 than expected and new unemployment claims rising. The services sector remains strong whilst statistics point to a recovery and improving business confidence in the manufacturing sector. US inflation still remains above the Fed's target of 2.0% reaching 3.0% in January 2025. As largely expected, the Fed held its interest policy rates steady at a range of 4.25%-4.50% at its latest monetary policy meeting in January. Jay Powell, the Chair of the Fed, commented that the Fed does "not need to be in a hurry to adjust" its policy and would only really need to do so once inflation starts to fall towards target (2.0% pa) or the jobs markets becomes a lot weaker. If widespread tariffs are introduced by President Trump, inflation may well increase as a result - especially if other countries retaliate, so making interest rate cuts less likely, for all market expectations remain otherwise.

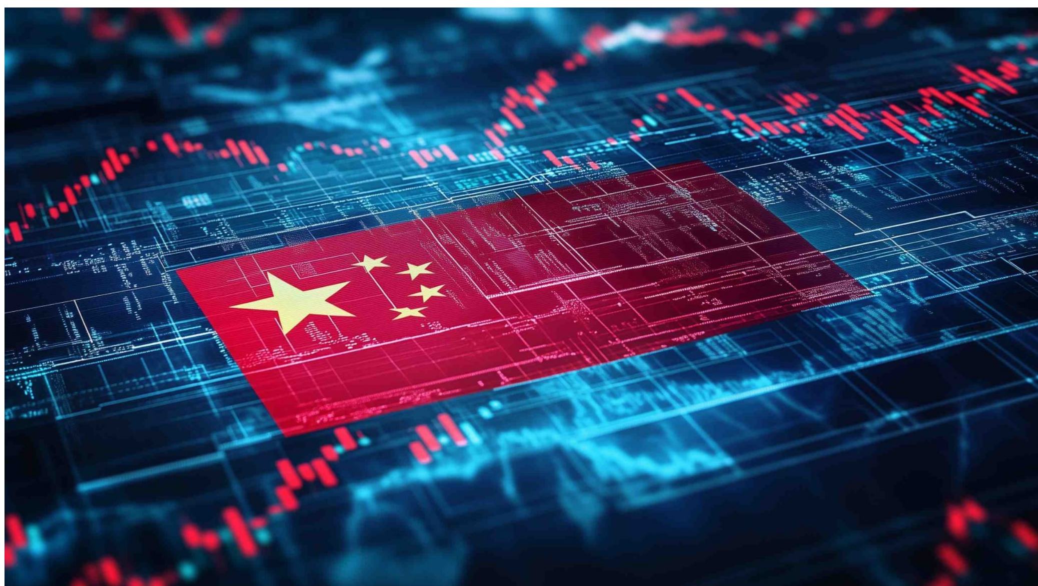
Nvidia saw its share price decline steeply on 28 January 2025 following the announcement by DeepSeek, a small Chinese AI company, that it has developed an AI model that can perform like ChatGPT at a cost of $5.6m compared with hundreds of millions of dollars spent training AI. DeepSeek has developed its AI using fewer and less expensive Nvidia chips. Since then, Nvidia's share price has recovered although still lower than at the start of the year. Big spending commitments of around $325bn from Amazon, Alphabet, Microsoft and Meta Platforms – mainly directed at AI infrastructure – have helped the Nvidia share price rebound. Essentially, investors will increasingly need to see that the massive amount of expenditure on AI development is sufficiently beneficial to prospective revenue and earnings growth to justify elevated valuations. If DeepSeek's approach can reduce costs of AI then this should be positive for the speed of adoption of AI by companies across all sectors.

The Monetary Policy Committee (MPC) of the Bank of England voted by 7-2 to cut Bank Rate by 0.25% to 4.50% at its latest meeting. Significantly, the two MPC members voting against this cut actually wanted to reduce interest rates by 0.50%. Therefore, it would appear more cuts are highly likely in the coming months. The consumer price index (CPI) rose 2.5% pa in December 2024. Worryingly, the BOE slashed its economic growth forecast for this year, next year and the year after. For 2025, the prediction is now 0.75%, down from 1.50%. Whilst the BoE expects the October Budget public spending programme to boost the economy by 0.75%, the rise in employers' National Insurance Contributions is likely to depress growth and increase unemployment. Employment figures are already showing signs of weakness as payroll numbers and job openings have fallen. The BoE also flagged the possibility of US tariffs weighing on growth but had not factored in their impact on the economy. With economic growth stalling and government borrowing costs rising, the Chancellor may now have to tighten government spending or raise taxes again to meet her own rule that current spending (excluding investment) has to be funded by tax receipts.

The UK equity market has performed well in the shorter term supported by the prospect of lower interest rates. With Sterling weakening, the overseas earnings of mainly larger UK companies become more valuable in Sterling terms, supporting share prices. The return of the FTSE 100 index compared to that of the FTSE 250 index illustrates this point. Medium sized and smaller companies are more affected by developments in the domestic economy – currently negatively impacted by the prospect of higher National Insurance Contributions and low growth. Nevertheless, reducing interest rates should be beneficial for both companies and consumers as loan costs decrease. The UK equity market has modest exposure to the technology sector, thus avoiding the sector volatility experienced in January. UK companies remain inexpensive in comparison to their US counterparts so are attractive takeover targets for overseas companies – especially those in the mid-cap area of the market. There has also been a high level of share buybacks further reflecting value in the UK equity market - announcements from BP and Barclays being most recent examples.

Sentiment towards European equity markets had been mixed as political uncertainty in Germany and France, coupled with lacklustre economic growth, weighed on confidence. Against the backdrop of a weak economy and the disinflation process being “well on track” according to Christine Lagarde (ECB President), the series of five interest rates cuts by the ECB has helped equity markets - with improving returns over the last few months. The weak euro has also been beneficial for companies with significant overseas earnings. Despite a struggling domestic economy, some global-facing German companies performed strongly over 2024, including SAP, pushing the German stock market to new highs. The volatility in US technology stocks in January saw investors turn to Europe for alternative opportunities which supported the market in the shorter term. As with the UK equity market, the European equity market has less exposure to the technology sector. However, the prospect of the imposition of trade tariffs by the US continues to create market uncertainty.

The Bank of Japan is following a different monetary policy trajectory to that of the central banks of other major developed economies. At its last meeting in January, it raised its short-term interest rate to a 17 year high of 0.50%. After decades of deflation, Japanese core inflation reached 3.00% in December 2024. This level of inflation is domestically driven, with wage growth at its highest level in around 30 years. The BoJ is expected to continue to normalise its monetary policy as these real wage rises should lead to durable price rises and (the BoJ hopes) to increased consumer spending. It is likely interest rates will be increased further this year, but the BoJ officials have said that the pace of hikes will be gradual. The yen has strengthened as interest rates have increased. Large exporting companies have seen their share prices impacted as their overseas earnings become less valuable as the yen is stronger. The Japanese equity market has made a positive return in the short term, although the volatility in the technology sector as a result of the ‘DeepSeek’ developments weighed on returns.



The Chinese equity market has performed well since the start of the year. Its technology sector has soared as investments in Chinese internet companies have increased significantly in the aftermath of DeepSeek's announcement of its AI breakthrough. Chinese technology companies have outperformed the US Magnificent Seven over the past month. This positive sentiment has outweighed the concerns surrounding the increase in US trade tariffs, the ongoing problems in the Chinese property market and deflationary pressures in the Chinese economy. The lack of consumer demand in China has weighed on sentiment over the past few years. The recent New Year holiday has seen some improvement in domestic demand. Spending on domestic travel and entertainment has increased over the holiday period. Other economic indicators still show some weakness in the wider economy with the services and manufacturing sectors expanding at a slower pace.

Fixed interest assets continue to offer attractive yields. In the US, the impact of possible trade tariffs and tax cuts could lead to the level of inflation remaining above target and therefore interest rates remaining higher for longer. Consequently, yields have remained elevated although the bond market has been placated to some extent by some softening in the jobs market. In the UK, gilt yields have also remained relatively high as worries persist about slower economic growth and the public finances, although slightly better inflation figures have been supportive. Corporate bond yields remain reasonable but spreads between corporate bonds and gilts have decreased as risks have reduced, as companies have paid down debt in previous years.

OUR VIEW

Compiled by Angela Cooper, MD - Investment Services.

Angela runs Cartlidge Morland's Investment Management team, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

The market returns over the last few months have shown the need for diversification in portfolios by asset class, region and sector. The falls in the share prices of some of the US mega tech companies have been negated to some extent by holdings in tech-lite equity markets such as the UK and Europe. The unexpected developments in the AI market have also been beneficial for Asia Pacific and emerging markets funds, as sentiment towards Chinese technology companies turned more positive. The broadening out of returns from the US equity market is welcome and our portfolios contain US equity funds which are less exposed to the technology sector for balance within this area of portfolios. It goes to show that if enthusiasm for US equities decreases marginally, investors look elsewhere in global markets for opportunities.

We cannot afford to ignore the likely 'Trump effect' on the US economy which the President aims to ignite with fresh impetus. Only the Fed stands in his way, with the prospect of stubbornly higher interest rates (to curb inflation) spoiling the party. As the US economy continues to enjoy momentum – President Trump's Federal spending seems likely to increase it – corporations operating in a broad range of sectors, including financials, should perform well. There are risks in the tech sector owing to current valuation/investment levels but if AI investment pays off there will be further gains. Whether all the 'Magnificent Seven' can emerge winners in the AI shoot-out remains to be seen. 'Uncle Sam' appears likely to continue delivering for investors presently.

EU economies may suffer shock from US tariffs, especially Germany. This would affect others as Germany is a massive importer from other EU states, for all it runs a huge trade surplus with them. The latter is a cause for concern but arguably more than priced in. It may be that generally improving economic conditions in China will result in increased consumer spending and European exports. Chinese appetite for domestically produced vehicles will continue to damage mid/lower range EU exporters. The EU is home to some truly global companies amongst the dominant players in high value sectors. They remain capable of delivering earnings growth for their shareholders and increased share prices too.

The UK Government will need to handle trade relations with the US adroitly. The US is the UK's largest single export market – and perhaps mercifully - the value of exports of steel, marmalade, whisky, pharma and luxury vehicles is modest when set beside that of financial services, which seem unlikely to be hit by President Trump's tariffs. Overall trade is not too far from balance either – making the UK a 'better' trading partner in the President's eyes than the wily Europeans, Mexicans, Chinese and Canadians seeking only to exploit a far too docile US.

UK companies are generally in good shape and some of them will benefit handsomely from the Government's spending/investment plans. The latter presently seem likely to be the only major source of economic growth/employment, as the public sector burgeons at the expense of the private – competing hard for capital and labour. The silver lining is that the FTSE 100 companies earn 70% of their profits overseas and seem likely to benefit from a faster growing global economy. The Chancellor has stated that the public sector must become more efficient, instead of dragging national productivity down. Only time will tell, but her Budget undermined business confidence in the Chancellor considerably. There is value in the UK market and reasonable rates of earnings growth are anticipated – comparable with European ones, but not as strong as US expectations.

Fixed interest in US/UK continues to deliver strong yields but in real terms these will lessen if inflation rises. If interest rates are reduced further (widely expected for the UK) then bond prices are likely to rise. US Treasuries are vulnerable to higher inflation and potentially to interest rates rising, although not in the shorter term. The yield remains strong for what many view as the world's safest asset class.

If you have any queries please do not hesitate to contact your Cartlidge Morland consultant.

80 Coleman Street London EC2R 5BJ **t:** +44 (0)20 7709 5560 **e:** enquiries@cartlidgemorland.com **www.cartlidgemorland.com**

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