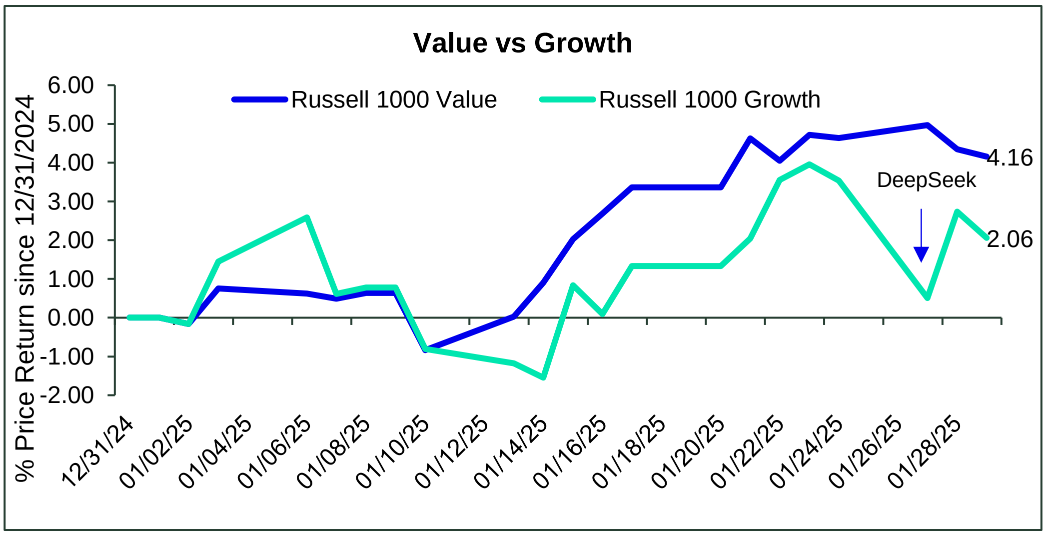
January 30, 2025
Commentary

Weekly Market Update

Insight of the Week

DeepSeek's Shifting Dynamics

The past week has seen a turbulent market, driven mainly by AI uncertainties out of China. The threat comes from a company named DeepSeek who is enhancing AI capabilities, reducing barriers to entry, and making cutting edge technology more affordable, efficient, and accessible to a larger audience. On Monday, the market reacted harshly on semiconductor giant NVDA, an AI darling, which was down 17% on the basis that DeepSeek's efficiency means less demand for advanced chips. However, what's interesting is that much of the rest of the US market didn't have a negative reaction. As the technology evolves and becomes cheaper to implement, it becomes in-reach to more companies.



Source: Russell, FactSet. Cumulative price return from 12/31/2024 through 01/29/2025.

In some ways, this represents our overall view of US equities this coming year. Similar to how this technology is rounding out across more companies and industries, we see a rounding out of earnings to the broader market, making it less reliant on the heavy hitting Mag 7 alone. The chart above shows the YTD performance of the Russell 1000 Growth vs Value, and although only a one month lookback, both still show positive returns while the more cyclically exposed Value style has outperformed. Notably, notice how the Value index didn't have the same negative reaction to the DeepSeek news. For a deeper look at our AI views given recent developments, please look at our latest piece from our Chief Strategist Jenn Bender here.

Source: FactSet. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Equities

Update on China's Equity Market

The Chinese economy met their official growth target with GDP expanding by 5% over 2024, bolstered by strong exports and fiscal stimulus. However, domestic demand remains an issue with consumer confidence at all-time lows and disappointing consumer spending amid a deflationary environment.

Though the economy has struggled with organic domestic growth, the equity market in China performed well last year putting up a positive return (MSCI China +19%) for the first time since 2020. Financials, IT, and Communication Services were the best performing sectors. The majority of this run up in performance came upon news of stimulus measures announced by the government to reduce reserve requirements of banks, lower interest rates, and increase government spend. It remains to be seen if the stimulus measures will be long lasting enough to combat the structural problems ongoing in China.

Looking ahead, China faces the risk of increased tariffs from President Trump. Observing flows, institutional investors let up on China positions prior to President Trump's inauguration. However, as the administration's approach became less prescriptive, institutions put a pause to selling and are now in a wait and see mode. As exports have supported gross domestic product while domestic demand falters, tariffs could drastically impact the GDP outlook.

Of course a bright spot out of China relates to the latest headlines from DeepSeek. Though a privately held company, the news of DeepSeek's efficient AI model provides hope for companies outside of the U.S. (to the dismay of US policymakers), especially when considering the open source platform. There will be challenges as the latest talks within the Trump administration include tighter curbs on Nvidia chip sales.

Though China performed well over the past year, our outlook on the region is bearish into 2025. However, we have identified a China "comeback" as a potential grey swan in 2025, a less likely but possible outcome.

Source: State Street Global Advisors, FactSet, MSCI. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Fixed Income

Bank of Japan Rate Hike

The BOJ raised rates to 0.5% this month, with sufficient political backing and finally a clear communication channel established with the PM's office following the October election. Another factor driving BOJ's "slight hawkish hike" is core CPI has been trending above 2% for the past 3 years, and core CPI forecasts are revised higher to above 2% through FY26 in the latest report.

Our expectation is for another hike in late 2025, most likely in September, post the July upper house election, unless excessive JPY weakness occurs.

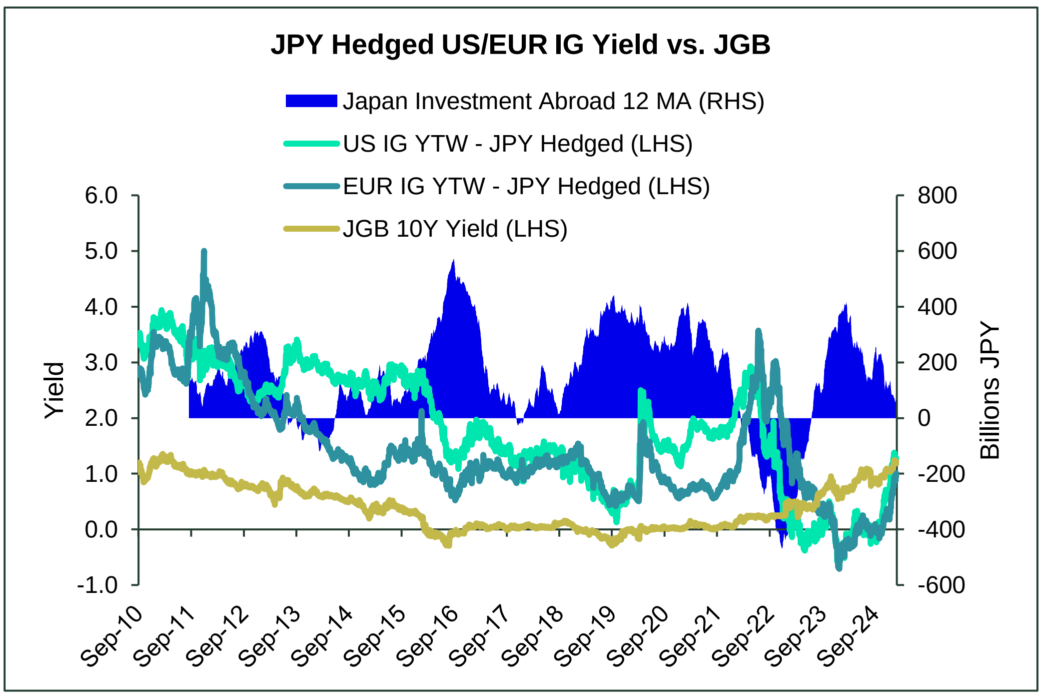
In terms of implications to Global Fixed Income and currency:

Rates (JGB): We retain our favorable outlook for developed market sovereign bonds in 2025. The JGB curve should stay steep in the near term as investors shun duration. We anticipate the JGB curve to potentially flatten in 2H25 with more room for 5 year yields to rise than the longer end of the curve. Additionally, the long-end also acts as a hedge under any flight-to-quality event, driving US Treasury yields lower.

Currency (JPY): The yen is likely to stay within the 150~160 range versus the USD in the near term as higher inflation and a potential tariff war benefit the USD. Having said that, we are favorable for the Yen in cross-yen pairs (CHFJPY, EURJPY, GBPJPY) as diminished peer carry would reignite JPY status as a safe haven, trailing only the USD and gold.

Flows: A gradual BOJ hiking cycle accompanied by mild Fed cutting this year translates into lower USDJPY hedging costs, per a narrower US-Japan base rate differential. Japanese investors should restart foreign bond purchases gradually alongside lower hedging cost, with hedged US credit (in JPY) now yielding at par with 10year JGB, and has the potential to out-yield JGB into 2026. This would represent a tailwind for the US bond market especially within the higher quality credit cohorts.

[Figure 1] Hedged US IG in JPY now on par with JGB10yr yield



**Japan securities investments abroad (medium & long term bonds), 12-month rolling average Source: MOF, Bloomberg. Data as of 1/22/2025.*

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*Pensions & Investments Research Center, as of 12/31/23.
†This figure is presented as of December 31, 2024 and includes ETF AUM of $1,577.74 billion USD of which approximately $82.19 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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