Does February start with a **trade war**?

- **Last week was volatile yet positive for most asset classes except for US stocks facing an AI challenge**
- **February starts with the shock of US tariffs being set on Mexico, Canada and China**
- **Markets' instant reaction will be sharply negative, time will tell whether it's justified**

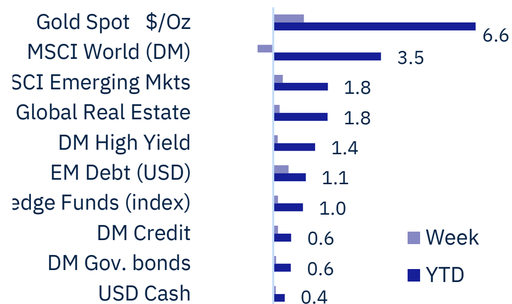
Last week was volatile on global markets, with the global tech ecosystem being challenged by China's DeepSeek R1 artificial intelligence model, which comes full open source, and claims to have been developed at a fraction of the cost of US peers. This is the single factor explaining an underperformance of US stocks, driven by tech and energy last week. All other asset classes did fine, as macro data continued to send overall positive messages, and as both the Fed and the ECB didn't surprise markets at their respective policy meetings.

The focus has obviously shifted over the weekend on the risk of a global trade war, ignited by President Trump's decision to impose tariffs on Canada (25% except 10% on energy), Mexico (25%) and China (10%). As we write today, market reaction is extremely negative on stock markets, from Asia to Western futures. The dollar and crude oil are rising for the same reason.

There is usually no winner in a trade war, and the worst-case scenario could be a nightmare for markets, with a spiral of retaliation pressuring growth and supporting inflation. Tariffs may also have a limited effectiveness in a multipolar world. Many market participants, including ourselves, were hoping for a level of moderation from the new US administration. At this stage, we would definitely not change our view. Tariffs on US neighbours appear to be linked to policy issues about border and national security, which means that they may be reversible. Tariffs on China should not come as a surprise and a 10% rate looks quite reasonable. China's trade surplus has printed records despite tariffs from the US for years.

We remain fully invested at this stage and are prepared for a tough week, after a positive January. The week ahead will provide more corporate earnings, policy meetings from the central banks of India and the UK, and the always important US monthly job report on Friday. Our global investment outlook will be released imminently. Have a great week.

ASSET CLASSES USD % TOT.RETURN, LAST WEEK AND YTD 2025



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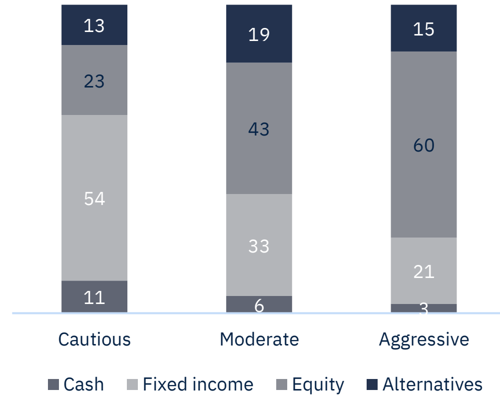
Cross-asset Update

Gold is the best asset class so far for the year returning 6.6%. It is reflective of rising policy uncertainty with political turmoil ushered in by the new Trump's presidency aimed at leaving a deep mark at all levels. The breaking with past norms, a more assertive stance internationally, the return of tariffs and the unknown that comes alongside these changes requires a higher risk premium across asset classes, and thrusts gold in the foreground. Trade frictions bring to mind inflationary pressures first and foremost, and commodities have had a good start to the year, outperforming equities, though by a small margin. We would not be able to appreciate tariff effects before year-end, so inflationary pressures are more likely to be in investor's minds than to represent a real issue here and now. Still, trade frictions will at some point impact business globally, Powell will not be able to be as accommodative as in the past, and ensuing uncertainty is enough to warrant protective gold purchases. Central bank buying in the meantime has continued, and future dollar strength is far from guaranteed given how expensive the reserve currency is against major peers and considering that Washington rather needs a weaker currency for US growth. We see gold as a valuable hedge for the decade, as one of the few asset classes offering protection against currency debasement.

Technology against expectations is trailing other sectors in 2025. On Monday IT equities were 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, and 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.

Despite heightened volatility our models suggest markets should be in a corrective phase before resuming their uptrend. Our cross-asset indicator is holding firmly in positive territory, and market breadth has not deteriorated substantially. The first quarter of year 1 in the presidential cycle, the current year, has historically shown poor returns, and in this respect Donald Trump has had an exceptional timing in the announcement of new tariffs.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

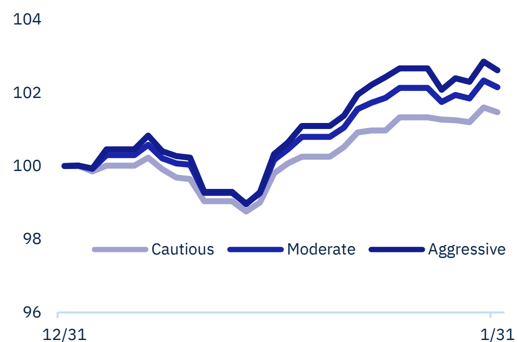


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW: Underweight/Neutral/Overweight

	UW	N	OW
Cash			>
DM Gov.			>>
DM Credit		=	
DM H. Yield		=	
EM Debt		=	
DM Equity			>
EM Equity		=	
Gold		=	
Hedge Funds	<<		
Real Estate		=	

TAA – 2025 INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

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Fixed Income Update

Tariffs as promised by President Trump were rolled out last weekend. 25% tariffs were announced on Mexico and Canada along with a 10% tariff rate on China. The levies are set to take effect on Tuesday barring any last-minute deals. The reaction of US Treasury yields has been interesting. Initially there was a flight to haven as 10-year yields dropped 4bps to trade around 4.5%. However, once London trading opened on Monday, yields were back at their Friday levels. However, the front-end 2-year yields climbed 7bps to 4.27% as these measures are expected to impact inflation, even though as in 2018 the effects may prove to be temporary. We expect long-dated yields to start going up once the dust settles in the short term as supply disruptions also affect capital flows.

While the Fed had stated in the past that it would look through any tariff-induced inflation, it has shown reluctance to stick to this playbook this time around and no longer displays the dovish bias it had last year. Post the January FOMC meeting pause, Chairman Powell had tried to turn the statement towards a dovish tilt even though markets have taken this clearly as a hawkish outcome. Markets now price in only 38bps of rate cuts by the end of this year compared to 42bps a week earlier.

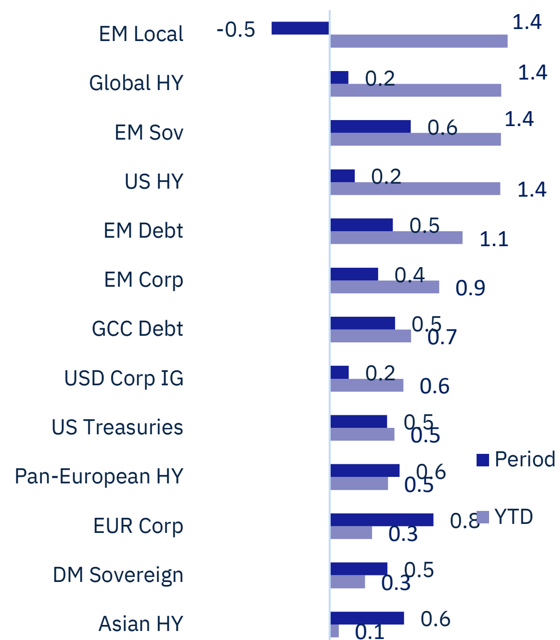
YTD fixed income returns have been positive. Both High Yield and EM debt have generated more than 1% returns. Spreads have compressed significantly in both the segments. Mexican CDS spreads have widened by 50% in the last 9 months as the market factored in the impact of tariff hikes. However, Chinese CDS spreads have compressed responding to the efforts of the Government to boost the economy. The onset of the tariff war should put a dent in EM Debt rally. HY spreads remain hostage to growth and inflation fears. At this moment we like a defensive positioning where IG spreads even though tight provide a safer alternative to other segments during periods of uncertainty.

Turkey's annual inflation eased less than expected by analysts in January. Consumer prices rose 42.1% year-on-year, compared to 44.4% in December. The median forecast in a Bloomberg survey of analysts was 41.1%. The monthly inflation rate also surprised, climbing to 5% from 1% in December. That was the highest figure in a year and worse than the survey expectation of 4.3%. Traders expect the central bank to cut by 250 basis points at each of its seven remaining monetary policy committee meetings this year. YTY has dropped 0.6% to 35.96 early Monday.

FIXED INCOME KEY CONVICTIONS (2024)

DEVELOPED MARKETS
Overall overweight DM FI
OW Government Bonds
Neutral corporate (IG & HY)
EMERGING MARKETS
Neutral EM Debt
Favor quality and selectivity
Including in GCC

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

Equity Update

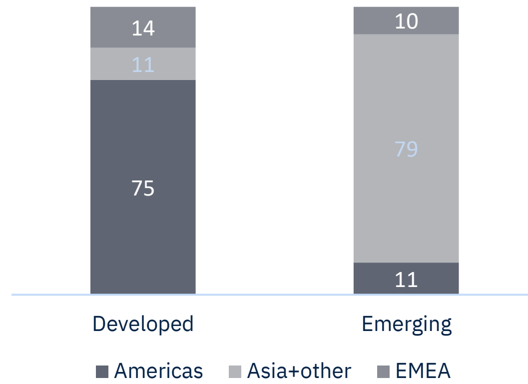
Global equities were caught in a push-and-pull last week, as trade tensions resurfaced and the AI sector faced a reality check. Stocks tumbled towards the end of the week after President Trump announced new tariffs on Canada, Mexico, and China, reigniting fears of a prolonged trade war. Exacerbating the turmoil, the AI-driven rally that has powered markets for over a year stumbled, with concerns over China's DeepSeek challenging US tech dominance. The S&P 500, which had been grinding higher to fresh all-time highs, faced a sharp pullback (-1.0%) as renewed tariff threats rattled markets. Chipmakers were hit particularly hard after. The AI sector itself came under pressure following the emergence of DeepSeek, a Chinese AI startup that launched a lower-cost model, raising questions over the sustainability of current valuations. Nvidia tumbled 17% in one session, erasing $589 billion in market value—the largest single-day loss in history. The selloff extended to other AI-related names, with cloud and semiconductor stocks underperforming. AI-services such as ServiceNow and Salesforce gained as they are direct beneficiaries of lower cost AI models.

Earnings season remained a key focus, with 36% of S&P 500 companies having reported Q4 2024 results to date. Of these, 77% have exceeded EPS estimates, in line with the five-year average but surpassing the ten-year average of 75%. The index is on track to post its strongest year-over-year earnings growth rate in three years. Four of the "Magnificent Seven" tech giants—Apple Microsoft, Meta, Tesla—reported earnings last week. Apple beat sales estimates and issued a reassuring forecast, though China revenue lagged. Microsoft fell 7% as cloud growth slowed due to data center constraints, even as Azure AI services rose 157%. Meta (+6.4%) Q4 revenue topped expectations, but weak Q1 guidance weighed on sentiment. Tesla (-0.5%) missed on revenue but Elon Musk announced plans for affordable EVs, FSD licensing, and an autonomous ride-hailing pilot. AI remains a key topic in this earnings season. SoftBank is reportedly in talks to invest up to $25 billion in OpenAI. Microsoft and OpenAI are investigating whether DeepSeek-linked groups illicitly accessed proprietary data. Meta is doubling down on AI investments, planning to spend as much as $65 billion on infrastructure projects in 2025. Following DeepSeek's low-cost AI model rattled the U.S. tech sector, Microsoft and Meta's CEOs defended their aggressive spending, emphasizing its necessity for staying ahead in the evolving industry.

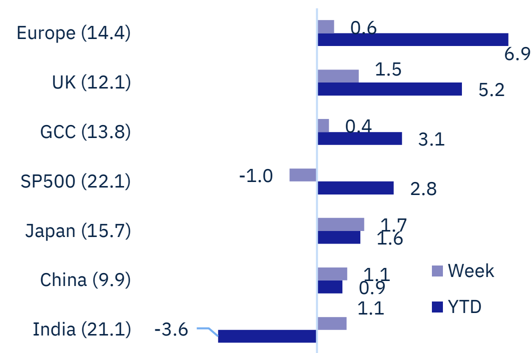
European equities moved higher, with the MSCI Europe Index up 1.8%. ASML posted a strong order backlog, reducing concerns over semiconductor demand. LVMH saw its revenue rising just slightly beating estimates but disappointing expectations after strong results from Richemont and Burberry. Sales in China fell 10%, with CEO Bernard Arnault warning that recovery in the region will take time due to economic headwinds.

While mainland China markets remained closed for the Lunar New Year holiday, the MSCI China Index still rose 1.1%, supported by gains in H-shares. DeepSeek's debut of its latest R-1 reasoning model also challenged the perception that China's AI technology significantly lags behind the US. Japan's TOPIX added 1.3%, with auto and industrial stocks rising as a weaker yen provided support. Toyota among the key names set to report next week.

EQUITY RECOMMENDED REGIONAL POSITIONING

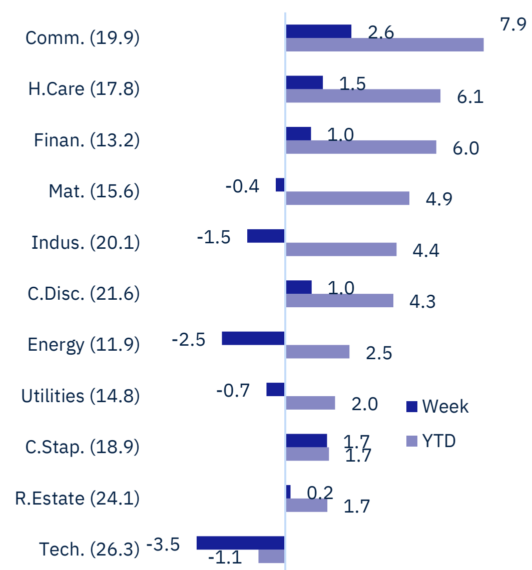


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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