

Monthly View – February 2025

A positive start to 2025

Despite a turbulent month, global sharemarkets ended January 2025 higher. Better than expected US inflation data, the ongoing resilience of the US economy and solid corporate earnings results provided support for markets. However, concerns that a Chinese startup DeepSeek could disrupt the dominance of American companies in the Artificial Intelligence (AI) race and President Trump's plans to apply tariffs on Canadian, Mexican, and Chinese imports weighed on markets.

In early February, Trump followed through on his threat to impose blanket tariffs on imports from Canada, Mexico, and China. He announced the US will collect new 25% tariffs on goods imported from Canada and Mexico, along with an additional 10% tariff on Chinese goods. Energy products from Canada, including oil, gas, and electricity, will be taxed at a lower 10% rate to minimise the impact on US consumers.

Highlighting the fluid nature of the situation, within 48 hours of the tariff announcement Trump granted a month delay in imposing the tariffs on Mexico and Canada. This followed both countries making promises to commit resources to stem the flow of fentanyl and migration to the US. Both countries have also committed to continuing negotiations on trade and security.

China's initial response has been to take a measured approach. Although expressing their disappointment and threatening to file a complaint with the World Trade Organisation, they have also signalled a willingness to negotiate, hoping to avoid a trade war.

Global Share Markets

Global sharemarkets^[1] rose 3.3% in January, led higher by the European markets. The Euro Stoxx 50 index climbed 8.1% in January. The German market rose 9.2%. Global sharemarkets have gained 8.4% and 22.6% over the last six and twelve months respectively.

Sending a shock wave across markets in late January was Chinese company DeepSeek's announcement that it was able to develop useful AI technology at a much lower cost than had previously been imagined. If Deepseek can achieve this, as claimed, this would suggest AI is on the way to being commoditised and will accelerate the economic benefits of AI as far as improving productivity. On the negative side electricity demand from datacentres may be less than projected and the level of spending on infrastructure, such as datacentres and expensive computer chips, will be lower.

Deepseek's announcement poses a threat to richly valued technology stocks, particularly chipmaker Nvidia, whose shares fell 17% on the announcement wiping US\$600 billion from the company's market value. Amongst the tech companies there will be winners and losers, while a broader set of companies may benefit from cheaper AI.

In this context the current US earnings season has taken on a heightened level of importance as investors seek confirmation that earnings growth will support valuations within the technology sector and whether there is a broadening of earnings outside of this sector.

The US and European earnings season have commenced with largely positive results thus far.

In America, the 2024 fourth quarter earnings season started with positive results from the large banks, JP Morgan, BlackRock, and Goldman Sachs recording results better than anticipated. Earnings results across the US tech sector has been mixed. Microsoft marginally beat revenue expectations but disappointed with its cloud growth outlook. Meta demonstrated strength in advertising revenue, surpassing analyst predictions, while providing a cautious outlook for the upcoming quarter. Apple's result was received positively by the market. Although Tesla fell short of expectations, CEO Elon Musk delivered a bullish outlook for 2025. Netflix massively beat expectations on adding new customers, adding a record 19 million over the quarter (the company has over 300 million paid subscribers worldwide).

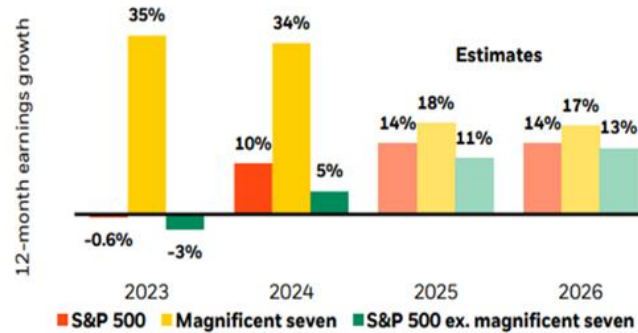
So far 50% of US companies have provided earning updates for the fourth quarter of 2024, and 76% of them have beaten estimates. Year-on-year earnings growth is estimated to be 13.2%. This is the highest level of year-on-year earnings growth since the fourth quarter of 2021.

US earnings growth is anticipated to broaden out from the Magnificent Seven (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla) over 2025. Changes in government policy (e.g. deregulation is anticipated to boost financial companies' earnings), a low earnings base for the rest of the market, and more non-tech contributors to the AI buildout over time are expected to drive a broadening of earnings growth across the market. As highlighted by the graph below, the gap between the Magnificent Seven earnings growth and those for the rest of the market is expected to shrink in 2025 and 2026.

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Broadening out

12-month change in earnings, historical and estimated, 2023-2026



Source: BlackRock

In Europe, ASML, a Dutch semiconductor equipment manufacturer, delivered a positive report that exceeded market expectations, signalling robust health in the semiconductor equipment sector and boosting investor confidence. LVMH, the world's largest luxury company and owner of brands including Louis Vuitton, Moët & Chandon and Hennessy, reported strong results, as did software firm SAP.

Australasian Equities

New Zealand's sharemarket^[2] fell 0.9% in January. There was little domestic corporate news with profit updates to be published in February. Therefore, global events had a greater impact on the local market over January. Infratil was one of the worst performing stocks over the month, declining 11.0% primarily on the DeepSeek announcement. Cheaper AI may negatively impact on the value of its datacentre investment in CDC. Retailer KMD (Kathmandu) fell 9.0% reflecting the challenging retail environment in New Zealand. The top performers for the month included Oceania Healthcare (+12.3%), and Sanford (+11.8%).

Australian equities rose 3.8%^[3] in January. The prospect of the Reserve Bank of Australia (RBA) commencing interest rate reductions in February boosted the market. Better than anticipated inflation data paves the way for the RBA to start lowering interest rates. Financials, including Banks and insurance companies, led the market higher, National Australia Bank climbed 8.2%. There were mixed results across the commodity and materials companies, gold companies performed on the rising price of gold and the larger mining companies such as BHP (1.0%) and RIO (0.0%) lagged the market.

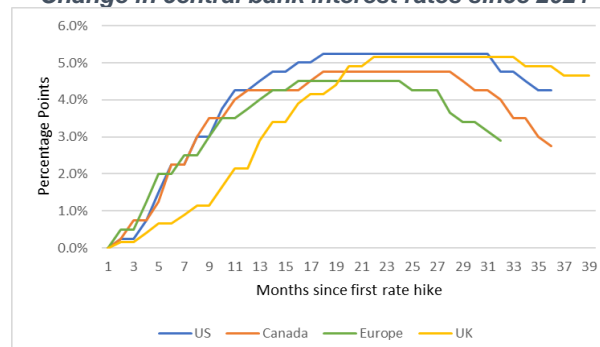
Fixed income and cash markets

The Bloomberg Global Aggregate Bond Index (New Zealand dollar hedged) returned 0.4% in January. After rising sharply over the early part of the month, global bond yields drifted lower on favourable US inflation data, reducing fears the US Federal Reserve (Fed) would raise interest rates. At its January meeting the Fed left interest rates unchanged at 4.3%, having reduced them in the three prior meetings. The Fed is in no rush to lower interest rates and is waiting to see further progress on inflation. The markets are presently anticipating two 25 basis points (0.25%) interest rate reductions by the Fed in 2025.

The European Central Bank (ECB) cut rates by 25 basis points to 2.75%. It was their fifth consecutive interest rate cut. The ECB described interest rates as restrictive and signalled further easing of rates. The market has priced in a further three interest rate cuts by the ECB over 2025.

The Bank of Canada and Sweden's central bank also reduced interest rates in January. The global interest rate easing cycle is expected to continue over 2025.

Change in central bank interest rates since 2021



Source: Bloomberg, JMI Wealth

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The Reserve Bank of New Zealand (RBNZ) cut the Official Cash Rates (OCR) by 50 basis points to 4.25% when they last met in November 2024.

New Zealand's economy fell into recession over the June and September quarters of 2024. The economy contracted a much larger than expected 1.0% in the September quarter, and a heavily revised 1.1% in the June quarter.

Given this economic backdrop, and that inflation is within the RBNZ's 1.0 – 3.0% inflation target range, further reductions in the Official Cash Rate (OCR) are expected over 2025. The OCR is projected to be near 3.0% by the end of 2025.

Current economic conditions remain challenging and at best the local economy has stabilised after a deep trough. Although the rise in business and consumer confidence and lower interest rates offer hope for domestic economic growth in early 2025, activity will be weak.

New Zealand's fixed income market^[4] was flat for the month and is up 6.3% over the last twelve months. Local longer-term interest rates drifted higher in January primarily on global events.

Conclusion

The outlook for global equities has become more mixed with US economic policy uncertainty. Against this backdrop the US economy remains strong and corporate earnings robust. The Fed also has room to reduce interest rates if US growth slows. Also supportive of global equities, economic growth excluding the US is expected to be higher in 2025 compared to 2024 and several central banks (e.g., European Central Bank and Reserve Bank of Australia) will reduce short-term interest rates.

The RBNZ is also expected to cut interest rates further in the months ahead. Lower short-term interest rates and the likelihood that domestic corporate earnings are at cyclical lows provide the opportunity for the local sharemarket to perform solidly in the year ahead.

Both domestic and global bonds offer stability of income and the potential for capital gains from further reductions in interest rates as inflation continues to decline and central banks progress interest rate cuts.

The anticipated decline in shorter term domestic interest rates in the months ahead is negative for people looking at term deposits to provide them with income.

In this environment, we recommend investors continue to focus on their long-term goals while acknowledging that in the short-term returns may be volatile. In time, this approach should reward investors.

1 MSCI ACWI Index in local currencies

2 S&P NZX 50 gross index

3 S&P ASX 200 total return Index

4 Bloomberg NZ Bond Composite 0+ Yr Index

Indices for Key Markets

As at 31 January 2025	1 Month	3 Months	6 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	-0.9%	2.9%	5.2%	10.3%	3.9%	2.9%
S&P/ASX 200 Index (AUD)	4.6%	5.1%	7.3%	15.2%	11.4%	8.0%
MSCI ACWI Index (Local Currency)	3.3%	5.8%	8.4%	22.6%	10.0%	12.0%
MSCI ACWI Index (NZD)	1.8%	10.0%	12.4%	30.6%	13.8%	14.0%
S&P/NZX 90 Day bank bill Total Return	0.4%	1.2%	2.6%	5.5%	4.5%	2.9%

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