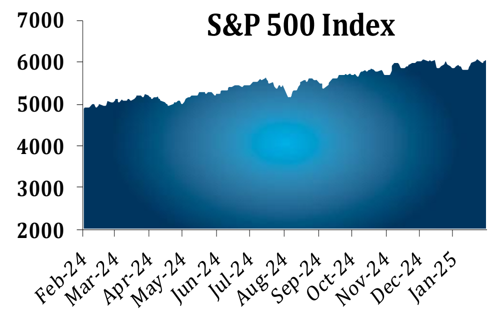
This Month in the Markets

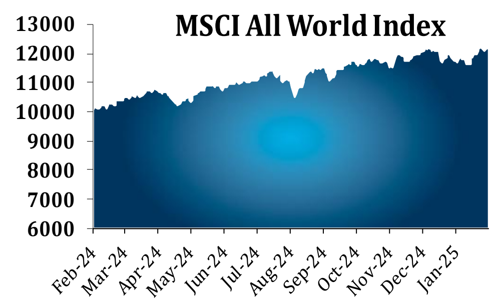
January 2025

Equity Commentary: DeepSeeking

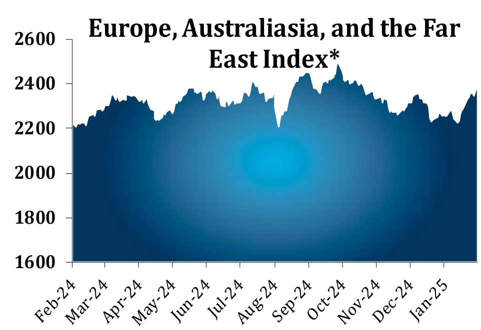
January saw a strong start to the year. The MSCI ACWI Index rose 3.4%. The MSCI EAFE Index led the charge with a gain of 5.3% due to a robust return in European shares. The S&P 500 Index climbed 2.8% and hit record highs. The MSCI Emerging Markets Index was the notable relative laggard with a gain of 1.8%. Value outperformed growth in terms of investment styles, with the MSCI All Country World Growth Index up 2.6% while the MSCI ACWI Value Index was up 4.3%. The MSCI ACWI Communication Services Index led gains with a jump of 7.9%, driven by gains in Alphabet and Meta Platforms. Conversely, the MSCI ACWI Information Technology Sector Index declined by 1.1%, primarily due to dramatic sell off associated with the Chinese Large Language Model ("LLM") DeepSeek and its reverberation across various sectors of the technology market.



Below are some considerations about the January meltdown in artificial intelligence shares related to the DeepSeek announcement, known as the "sputnik moment":
1. Broad Supply Chain Demand Effects: DeepSeek's AI models appear to require significantly less computing power compared to those of competitors like OpenAI, potentially reducing demand for high-end AI chips and affecting companies like Nvidia, whose shares dropped 17% during the market rout. The possibility of reduced chip demand has affected a range of businesses across the AI supply chain—from data-center operators and networking gear makers to energy firms and chip designers, with several companies experiencing notable share price declines.



2. Mixed Outcomes for Tech Giants: Cloud leaders such as Alphabet, Amazon, and Microsoft, which run across the entire AI supply chain, face uncertain prospects. Their software applications could become more profitable with cheaper models, yet their significant investments in model development and data centres might be undercut by low-cost competitors entering the space. Microsoft, in its latest quarter, mentioned it saw 157% year-on-year growth of its AI cloud revenue, which was constrained by supply, not demand.



3. Changing AI Demand Dynamics Create Uncertainty: While cheaper AI could spur broader adoption and increased productivity—especially if training costs drop—the demand might be offset by higher computing needs during the inference stage and ongoing challenges like security and privacy, leaving overall AI demand dynamics complex and uncertain.

4. Long-Term Industry Winners and Losers: Companies solely reliant on monetizing large language models may be the biggest losers due to lower barriers to entry by cheap competitors. Long-term winners may be cloud infrastructure providers and firms offering application-layer integration and performance enhancements. The companies that can create a killer-app and lock in many users stand to make sizable returns.

The economic concept that has been tweeted and discussed revolves around the comment made in 1865 by British economist William Jevons. Jevons observed that improved efficiency in coal use led to greater consumption of it. This has become known as the Jevons paradox. Proliferation of cheaper AI is likely positive for the global economy, as it can create opportunity for faster/broader AI-driven productivity gains. From a capex perspective, this could mean that we see more AI investment in diverse levels rather than only in the hyperscaler companies. Cheap models could accelerate adoption more widely.

The biggest detractor in the month was Nvidia Corp., which slid ~10% for the month on the concerns surrounding a potential lower demand for high-end chips because of efficiency gains seen in the DeepSeek model. The biggest winner was Meta Platforms Ltd. Investors applauded better than expected fourth quarter results and were encouraged by management's guidance of continued strong growth driven by their artificial intelligence software leadership.

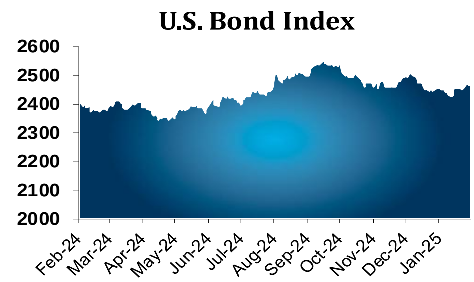
Fixed Income Commentary: Tariffs & Central Bank Uncertainty

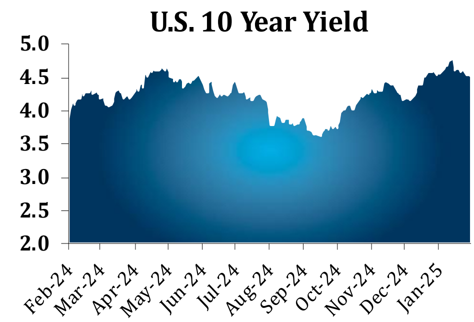
As expected in late January, the Federal Open Market Committee (FOMC) left the fed funds rate range unchanged at 4.25%-4.50%. FOMC meetings and press conferences are widely watched affairs where every word written and spoken are scrutinized by Fed watchers and pundits alike. On this note, the FOMC's press release was initially considered a hawkish hold because the press statement reworked some phrasing around inflation. Specifically, "inflation has made progress on the Committee's 2 percent objective" from the prior release was replaced with "inflation remains somewhat elevated." When asked about the rephrasing at the press conference Chair Powell suggested it didn't represent a wholesale change in the FOMC's inflation view, so shouldn't be considered a focus point. With regards to future interest rate cuts Chair Powell conveyed that they "will be focusing on seeing real progress on inflation, or some weakness in the labor market before we consider making adjustments." He also suggested that being on hold also made sense given the uncertainty around President Trump's potential actions surrounding tariffs, immigration, fiscal policy and regulatory policy. As such, at the present time it could be said that the FOMC is both data dependent and Trump dependent.

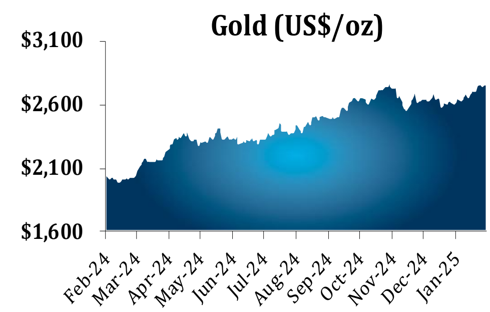
President Trump related uncertainty wasn't isolated to just the U.S. After cutting their policy rates, European Central Bank President (Lagarde) and Bank of Canada Governor (Macklem), both expressed considerable uncertainty with regards to the impact of potential tariffs on their respective countries. President Trump had initially instituted a 10% tariff on energy imports from Canada and 25% tariffs on all other imports from Canada from February 1st citing illegal immigration and fentanyl trafficking, but this has been delayed a month after Canada met some of Trump's demands. President Trump has also announced that there will be a 25% tariff on imports from Mexico from March 1st – this deadline was pushed back from February 1st. The change in date came after President Trump's conversation with Mexico's President, Claudia Sheinbaum, after which Sheinbaum agreed to send 10,000 National Guard officers to the border. Tariffs are (or would be) an unwelcome occurrence for both countries. The U.S. is Canada's largest trading partner accounting for 77% of Canada's 2023 exports and half of its imports. The U.S. is also Mexico's largest trading partner representing 83% of Mexico's exports in 2023 and 43% of its imports. President Trump's tariff threats extend beyond the U.S.'s continental neighbors to its economic rival, China. Effective from February 1st, President Trump placed a 10% tariff on Chinese imports. This led to the Chinese government to implement counter tariffs on U.S. companies and commodities.

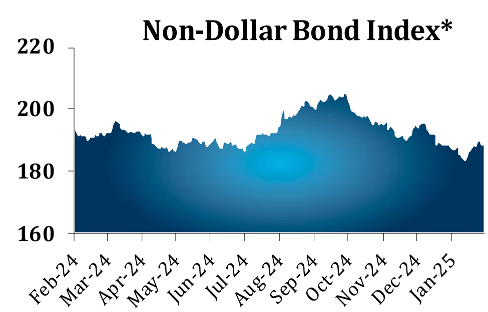
Lastly a word on the Bank of Japan (BOJ) who raised the policy rate by 0.25% to 0.50%. The BOJ has been at the epicenter of accommodative monetary policy as shown by a myriad of asset buying programs, negative interest rates, and yield curve control. For example, in December 2020 there was over $18 trillion (USD equivalent) in negative yielding debt globally, much of which was JPY denominated. However, with inflation running at 3.6% year-on-year and the Japanese Trade Union Confederation (Japan's largest trade union) calling for wage hikes of "5% or more" the ultra-loose monetary era now looks like a thing of the past. Overnight index swaps suggest the market expects the BOJ to hike by another 0.25% in the September or October meeting. Meanwhile, at the time of writing other major central banks are expected to modestly cut policy rates over the course of the year.

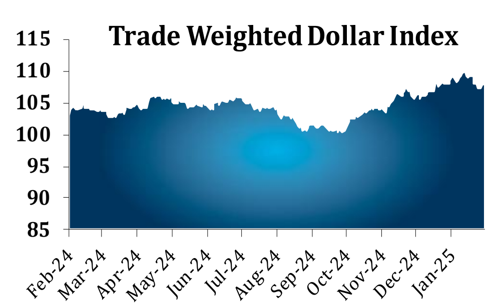
Due to geopolitical uncertainty and historically tight interest rate spreads, Anchor continues to limit credit risk in the fixed income portfolio.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

Disclaimer

Disclaimer: This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. Past performance is no guarantee of future results. The opinions expressed may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by the authors to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. There is no guarantee that any forecasts made will be correct. Reliance upon information in this material is at the sole discretion of the reader. Investment involves risks. Readers should consult their financial advisors prior to any investment decision. Index performance is shown for illustrative purposes only. You cannot invest directly in an index. Sources may include MSCI, Bloomberg, and S&P Global. Information contained within this report is private and confidential and for the sole use of clients of Anchor Investment Management Ltd. ("AIM"). AIM respects the intellectual property rights of others. If you see a copyright or trademark of yours which is being infringed, you may notify AIM at info@anchor.bm. We will contact you to obtain details of your claim.