HYMANS ROBERTSON

Monthly Market Brief

January 2025

JANUARY HIGHLIGHTS

- US growth slowed in Q4, but strong consumer spending offset weak investment, so the economy still expanded at a strong annualised pace of 2.3%. The eurozone economy unexpectedly stalled, while Chinese GDP growth accelerated to 1.6% quarter on quarter, aided by previously announced stimulus measures.
- January's Composite Purchasing Managers' Index (PMI) data suggest that robust growth in the US eased. A slower expansion in the service sector offset a rebound in the manufacturing sector, following six months of contraction. Meanwhile, UK and eurozone PMIs point to modest improvement, driven by faster expansion in services.
- As forecast, headline CPI rose for the third consecutive month in both the US and eurozone, to 2.9% and 2.4%, respectively, while it unexpectedly fell to 2.5% in the UK. Core inflation eased more than expected to 3.2% in both the US and the UK, while it remained steady at 2.7% in the eurozone.
- The US Federal Reserve (Fed) held rates at 4.25–4.5% pa in January. The European Central Bank (ECB) cut rates by 0.25% pa to 2.75% pa, adjusting its updated inflation outlook. In contrast, the Bank of Japan (BoJ) hiked rates by 0.25% pa to 0.5% pa, the highest in 17 years.
- Global sovereign bond yields surged in early January as concerns over deficits, heavier bond issuance and inflation came to the fore. Yields subsequently eased following the equity-market sell-off towards the end of the month. Global credit spreads continued to tighten amid strong yield-driven institutional demand.
- Global equities rose 3.2%, despite the US technology-led sell-off in late January. Advancements made by a Chinese AI startup, DeepSeek, raised questions about the potential return on investment from expensive US tech stocks. European and UK equities outperformed as investors favoured cheaper, value-oriented sectors.
- Investors showed relief as the immediate imposition of tariffs was avoided, which contributed to the trade-weighted US dollar's 0.5% decline. Equivalent sterling and euro measures declined 1% and 0.2%, respectively, while the trade-weighted yen rose 0.5% on the back of BoJ's rate hike. Gold prices surged 7%, reaching all-time highs.

Market performance to end January 2025

UK	Jan 25	Q1 25	2024
EQUITIES	5.5	5.5	9.5
BONDS			
Conventional gilts	0.8	0.8	-3.3
Index-linked gilts	1.3	1.3	-8.3
Credit	1.1	1.1	1.7
PROPERTY**	1.1	n/a	7.0
STERLING			
v US dollar	-0.8	-0.8	-1.8
v euro	-1.2	-1.2	4.8
v Japanese yen	-2.2	-2.2	9.5

GLOBAL	Jan 25	Q1 25	2024
EQUITIES	3.2	3.2	20.6
North America	3.1	3.1	25.0
Europe ex UK	7.1	7.1	8.2
Japan	0.1	0.1	20.6
Dev. Asia ex Japan	3.2	3.2	3.4
Emerging Markets	0.8	0.8	17.4
GOVERNMENT BONDS	0.2	0.2	0.0
High Yield	1.2	1.2	8.9
Gold	7.0	7.0	27.1
Oil	2.8	2.8	-3.8

Percentage returns in local currency ($ for gold and oil). All returns to 31/01/2025, *apart from property 31/12/2024
Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, North America, AW Developed Europe ex-UK, Japan, Developed Asia Pacific ex-Japan, Emerging, Fixed Gilts All Stocks, Index-Linked Gilts All Maturities, iBoxx Non-Gilts, S&P GSCI Light Energy, Crude Oil BFO, ICE BofA Global High Yield, Gold Bullion LBM, MSCI UK Monthly Property and BBG Aggregate Government Total Return.

Fixed income markets

Yields surge in early January before retracing

Global sovereign bonds yields rose sharply in early January, led by US bond yields, before easing later in the month. This came on the back of a resilient US economy, stickier inflation and the expectation of higher fiscal spending under the new administration, keeping borrowing costs high. US 10- and 30-year yields spiked to 4.8% pa and 5.0% pa, respectively, before retreating to end the month slightly below their starting levels, at 4.5% pa and 4.8% pa. The tech-led sell-off helped pull yields back down towards the end of the month.

UK gilt yields followed a similar trajectory, as much of the UK financing comes from foreign investors but concerns about the October budget's impact on future borrowing needs added further impetus. UK 10- and 30-year gilt yields peaked at 4.9% pa and 5.4% pa, respectively, before easing to 4.5% pa and 5.1% pa by month-end. A downside surprise in December's inflation print, released in January, helped lower yields.

Equivalent 10-year German and Japanese yields both rose 0.1% pa, to 2.5% pa and 1.2% pa, respectively: expectations that Germany might finally loosen fiscal rules are increasing, while the BoJ's rate hike is anticipated to be part of broader normalisation amid signs of persistence in domestic inflation.

Market-implied inflation, as indicated by the difference between inflation-linked and nominal bonds of the same maturity, crept higher: rising 0.1% pa in the UK, US and Germany, to 3.6% pa, 2.4% pa and 1.9% pa, respectively.

Global credit spreads tightened amid strong yield-driven demand

Global investment-grade credit spreads eased modestly, to 0.8% pa. US speculative-grade bond spreads fell a further 0.3% pa, to 2.7% pa. In Europe, where speculative-grade bond defaults are higher, spreads fell a smaller 0.1% pa to a still-low level of 3.0% pa. Investment- and speculative-grade credit spreads are close to historic lows, reflecting strong yield-driven demand and a benign default outlook from major credit rating agencies. US speculative-grade loan spreads also fell by 0.1% pa to 4.3% pa.

Weaker dollar boosted emerging market debt returns

Hard-currency emerging market debt, as measured by the J.P. Morgan EMBI Global Diversified Index, returned 1.4% in dollar terms, as spreads and US Treasury yields both fell modestly. Local-currency emerging market debt, as measured by the J.P. Morgan GBI-EM Global Diversified Traded Index, returned 2.1% in dollar terms, as yields fell and index currencies, in aggregate, strengthened against the US dollar.

Global equities

Europe ex-UK and UK stocks outperformed

In January, the FTSE All World Total Return Index rose 3.2% in local-currency terms. Europe ex UK was the best-performing region globally, driven by relief over US tariffs and lower index exposure to the worst-performing technology sector. Investors discernibly shifted from highly valued US technology stocks towards value-oriented stocks, like financials, basic materials and industrials, which outperformed in that order. Given Europe's relative overweight to these sectors and its wide discount to the US, Europe ex UK equities enjoyed their most robust monthly performance since November 2023.

UK stocks also outperformed, benefiting from a similar index composition. The depreciation of sterling is likely to have bolstered gains further, as a significant portion of UK companies derive most of their revenues from international markets. However, the UK's above-average exposure to consumer staples and energy sectors, which both lagged during this period, tempered overall gains.

US stocks gained, but trailed European peers

North American equities experienced a modest underperformance, mainly due to the market's substantial exposure to the technology sector, which weighed on the region's overall returns. A Chinese AI startup, DeepSeek, introduced a large language model and claimed it operates at a fraction of the cost of existing models, with comparable capabilities. This sparked a sell-off in US technology stocks, as investors began to question the sector's massive investments in AI infrastructure and the potential for future returns. That said, strong economic data and the promise of deregulation and tax cuts supported a broad-based performance across US sectors.

Japan, emerging markets and Asia-Pacific ex Japan all underperformed, in that order. The BoJ's rate hike and the subsequent strengthening of the yen proved challenging for export-oriented Japanese equities. US dollar weakness and the avoidance of day-one tariffs on Chinese imports were a relief for emerging and Asian equities. However, investor caution, uncertainty over future US trade policy, lacklustre performance from Indian equities and mixed economic data from China dampened overall returns.

Value outperformed growth, and tech stocks brought up the rear

In general, value stocks outperformed growth and cyclical stocks fared better than defensives as investors sought cheaper ways to capitalise on decent US and global growth, amid the tech-driven sell-off. Cyclical value sectors, such as financials, basic materials and industrials all outperformed. Financials benefited from anticipated deregulation and a pick-up in deal-making. Basic materials and industrials were aided by improved US and Chinese manufacturing PMIs and increased new orders. The cyclical consumer discretionary sector also fared well, buoyed by strong consumer spending and expectations of extended tax cuts. Healthcare was the only defensive sector to outperform.

Technology was the worst-performing sector, though it did manage to deliver a modest positive return. The defensive consumer staples, utilities and telecoms sectors also underperformed, in that order, as optimism about strong consumer health and expectations of decent economic growth ahead weighed on defensives. Given the vast energy requirements from AI-driven demand, utilities and energy stocks were perhaps also affected by some of the same factors driving the technology sector's underperformance.

Currencies, commodities and property

Amid relief that the immediate imposition of tariffs was avoided, the US trade-weighted dollar declined a modest 0.5%. Equivalent sterling and euro measures declined 1% and 0.2%, respectively. The Japanese yen appreciated by 0.5% on a trade-weighted basis, bolstered by the BoJ's recent rate hike, which narrowed interest-rate differentials with other major developed economies.

Oil prices rose by 2.8% over the month, rebounding from multi-week lows, as the US imposed stricter sanctions on Russian oil. However, gains were tempered by lacklustre Chinese demand, increased US crude inventories and anticipation of OPEC+ maintaining its plan to gradually increase production. Gold prices reached an all-time high in January, surging 7.0%, sparked by safe-haven demand amid US policy uncertainty, lingering inflation concerns and a weaker US dollar.

The global economy

Initial estimates suggest that the **US economy** grew at an annualised 2.3% in the fourth quarter (Q4). While below Q3's 3.1% pace and prior expectations, the data still signal robust consumption growth. A 4.2% surge in consumer spending, its largest gain two years, more than offset a (possibly temporary) contraction in business investment. Timelier PMI data point to moderate private-sector growth, with manufacturing rebounding after six months of contraction and services still expanding, albeit at a slightly slower pace. Business optimism stayed high, especially in manufacturing, buoyed by optimism about the new government's policies. Hiring rose at the fastest pace in two-and-a-half years, but inflationary pressure intensified, with input and output prices rising at the fastest pace in four months.

The **eurozone economy** unexpectedly stalled in Q4, its weakest quarter of 2024, following Q3's 0.4% expansion. But the provisional PMI data suggest a modest rebound in private sector activity, the first expansion since last August. The UK's PMI also rose to a three-month high. The service sector drove marginal improvement in both regions, while manufacturing was weak. Employment declined in both regions, business confidence for the year ahead was subdued and inflationary pressures returned: input price inflation hit its highest since early 2023, while UK output price inflation rose at its fastest pace since July.

Chinese GDP growth accelerated to 1.6% in Q4, the strongest since early 2023, fuelled by stimulus measures. However, weak domestic demand and external headwinds are risks. At a global level, manufacturing production nudged above the neutral 50 mark following a mild contraction in December. Solid growth in new orders points to improved growth momentum at the start of the year, but regional disparities remain.

As forecast, **US and eurozone headline CPI** rose for the third consecutive month to 2.9% and 2.4%, respectively, in December. Meanwhile, UK CPI unexpectedly fell to 2.5%. The year-end rise was partly due a less negative impact from energy prices relative to last year's steep declines. Annual core CPI, which strips out volatile energy and food prices, fell more than expected to 3.2% in both the US and the UK, while it remained steady at 2.7% in the eurozone.

The Fed held rates at the 4.25–4.5% pa range in January, as expected. The decision follows three consecutive cuts amounting to 1% pa in 2024. Officials signalled patience, awaiting clearer inflation and labour market trends before easing monetary policy further. Despite recent inflation upticks, the ECB proceeded with a 0.25% pa cut, lowering its deposit facility rate to 2.75% pa. The decision comes on the back of stagnant growth, a lacklustre outlook and policymakers' confidence in inflation returning to target. By contrast, the BoJ raised rates by 0.25% pa to 0.5% pa, the highest in 17 years, reflecting sustained wage growth and steady inflation progress. At the end of January, markets still expected just two cuts from the Fed in 2025. Markets expect around three cuts from the BoE and ECB over the same period, pricing in an additional cut from the BoE since end-December.

For and on behalf of Hymans Robertson LLP

Chris Arcari
Head of Capital Markets
chris.arcari@hymans.co.uk
0141 566 7986

Robert Kotlar
Investment Research Analyst
robert.kotlar@hymans.co.uk
0141 566 7793

Important Information