



In this week's update, Kevin Quinn discusses:

- What's inflation got to do with it?
- Middle East truce
- Oil price rises
- US – tariffs, inflation & retail sales
- UK – retail sales, inflation & GDP
- Euroarea – Spanish property, French budget deficit and Euro area inflation
- Chinese – economy and trade

Latest update from markets (to 17.01.25)

	YTD	2024
Global shares	2.1%	2.2%
US shares	2.6%	2.7%
European shares	2.4%	3.2%
European government bonds	0.7%	-0.8%
Global commodities	0.8%	5.7%
Magnificent 7*	1.7%	2.5%

Source: Bloomberg, 20.01.25. All returns expressed in euros.

*Apple, Alphabet, Amazon, Meta, Microsoft, NVIDIA, and Tesla.

The long and short

Investing requires a long-term focus but shorter term events can take most of our attention. In this series of updates, we place current events into a longer term perspective.

The long...

What's inflation got to do with it? ...

The S&P 500, or at least parts of it, enjoyed a sugar rush in the immediate aftermath of the US election result on 05.11. After gains of 7.5% in one month after the election¹, markets pulled back in late December and started 2025 on a weak footing. They have made positive gains in the second half of this past week, in response to slightly weaker US inflation data, bringing the S&P 500 over 6,000 still left the market marginally down on the 12.12 high.

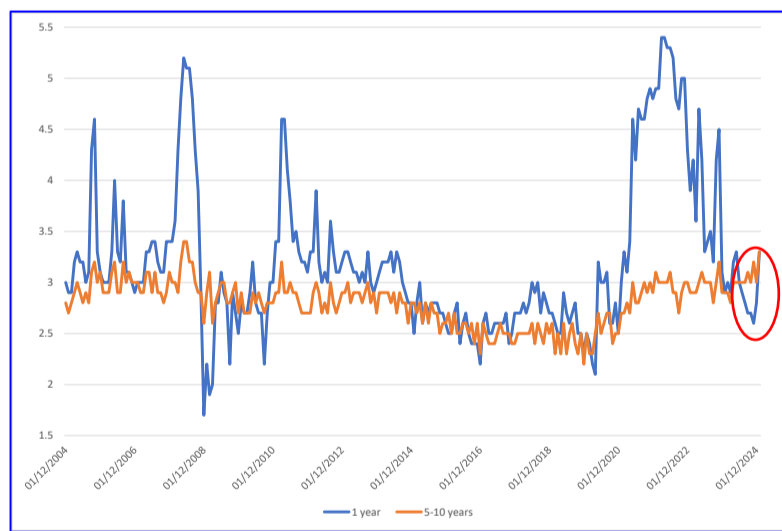
Figure 1: the S&P 500 since the US election (in US \$ terms)



Source: Bloomberg 17.01.25

There are many reasons behind this but a significant one is what's happening to US inflation expectations. While inflation as measured by the Core Consumer price index improved marginally to 3.2% (from the 3.3% of the past three months) it remains sticky. We have however also seen evidence that US consumers expectations of long-run inflation have moved up from 2.6% to 3.3% - the highest level since 2008.

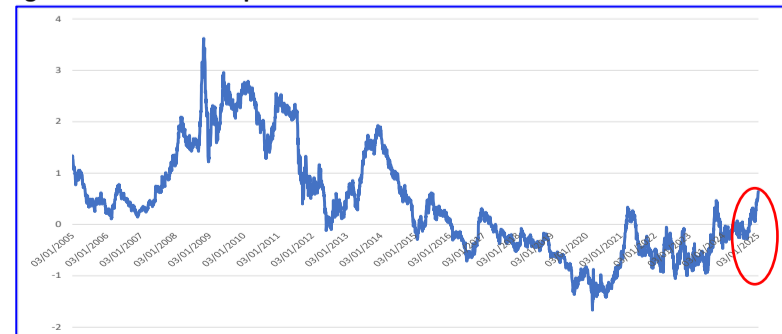
Figure 2: Changing US consumer inflation expectations (University of Michigan Survey)



Source: Bloomberg 14.01.25

This is significant because the US Federal Reserve (Fed) will be less likely to cut interest rates if they believe inflation expectations are changing. It also means that investors will demand a higher "term premium" – the additional return investors need to take on risk if inflation looks less anchored. It's probably too early to judge it as a resurgence in inflation expectations though, as this data tends to be quite noisy. However the focus on what the Fed might elect to do in terms of interest rate cuts has changed significantly since the US election results, as too has the yield on longer term US debt. At time of writing, the market expects about 0.38% in rate cuts from the Fed Funds in 2025 (meaning 1-2 cuts) and there's been a rapid increase in the term premium.

Figure 3: The US Term premium¹



Source: Bloomberg 14.01.25

Bottom line, investors want to be paid more for holding longer dated instruments including both bonds and in turns equities.

1. Measured by the Crunch & Moench 10 year Treasury Term premium. Source: New York Federal Reserve 14.01.25

The short...

Market news

Peace deal in middle east as the Israeli cabinet approves a ceasefire and hostage deal, including a 6 week truce. The agreement was mediated by the US, Qatar, and Egypt, paving the way for further negotiations to end the conflict.

Oil prices rose over \$81 a barrel on foot of fresh US sanctions against Russia which threatens to further tighten supply. Energy stocks are responding positively.

US tariffs are under discussion by the incoming US administration with suggestions this week that they may introduce them in a more phased way to avoid a spike in inflation. The impact of this report during the week was to ease the pressure on markets modestly as it remains to be seen if President Trump will agree to this (some suggesting he just wants "one big beautiful bill").

US Producers Price index (PPI) came at +0.2% month-on-month or 3.3% year-on-year, below estimates which on average had expected 0.4% for the month.

US consumer price index (CPI) rose to 2.9% year-on-year, in line with expectations while Core CPI, which excludes energy and food, fell to 3.2%, (having been stuck at 3.3% for the past three months). The softer than expected core CPI brought expectations of the next US rate cut to June from September and saw a relief rally in equity markets.

US retail sales expanded by 0.4% month-on-month in December, which was below consensus expectations which had expected, on average, a 0.6% expansion.

UK inflation unexpectedly cooled for the first time in 3 months, with the December Consumer Price index at 2.5% year-on-year, down 0.1% from the previous month. This drop was mostly down to volatile air fares and hotel prices so it could reverse. Nonetheless it helped bring UK benchmark bond yields down slightly from 17 year highs. 5 year UK bond yields dropped from a high of 4.61% per annum (p.a.) to 4.51% p.a. on the news.

UK GDP expanded by 0.1% month-on-month in November, below the expected 0.2% as a expansion in services was partially offset by a contraction in manufacturing. UK retail sales fell 0.3% in December contrary to expectations of a 0.4% rise.

Spain's property market faces supply challenges and its Prime Minister has proposed a 100% tax on non-EU citizens purchasing property, to help retain availability for Spaniards. Roughly 20% of property is bought by foreigners but mostly in holiday developments that tend not to focus on locals (the largest groups are UK (8.5%) and Germany (6.4%) of the foreign buyers). It remains to be seen whether it will pass through Spain's fractured parliament.

Eurozone inflation was confirmed at 2.4% year-on-year for December, with core inflation (ex energy & food) at 2.7%. Services Consumer Price Index is at 4% year-on-year.

The French budget deficit target for 2025 was announced by new Prime Minister Bayrou at 5.4% of GDP, higher than the previously announced 5% target from ex-Prime Minister Barnier. Bayrou also confirmed intentions to reduce the deficit to 3% by 2029.

Chinese economy exceeded expectations by growing at a 5.4% rate in the last quarter of 2024, bringing the full year growth to 5%, in line with President Xi's statement at year end. Exports and a response to the policy measures explain most of the pick-up in growth. That said domestic consumption remains at pre-pandemic levels, property investment contracted and when adjusted for falling prices, nominal GDP only expanded by 4.2%, the slowest rate since the 1970's.

Chinese trade surplus rose to \$104.9bn for December, circa. 5% higher than expected as exports increased significantly. Possible explanation is a rush by exporters to get ahead of any tariffs from the incoming US White House administration and to make up for weak domestic demand.

Source: Bloomberg, BCA Research, PIMCO 13-17.01.25

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Table 1: 5 year historic performances

	2020	2021	2022	2023	2024
Global equities	6.7%	27.5%	-13.0%	18.1%	25.3%
US equities (S&P 500)	8.7%	38.2%	-13.0%	22.2%	33.6%
European equities (Stoxx 600)	-1.4%	25.8%	-9.9%	16.6%	9.6%
Emerging market equities	9.1%	4.9%	-14.9%	6.6%	15.4%
Global bonds	4.9%	-2.6%	-15.1%	4.5%	0.9%
US government bonds	8.3%	-2.0%	-12.5%	5.8%	0.3%
European government bonds	4.3%	-3.7%	-18.4%	7.2%	1.9%
Emerging market debt	-3.4%	6.4%	-9.8%	5.4%	15.1%
Broad commodities	-13.1%	37.0%	20.7%	-10.9%	7.0%
US corporate bonds	7.8%	-1.9%	-17.1%	5.8%	2.1%
European corporate bonds	2.4%	-1.2%	-14.0%	8.4%	4.6%
UK Gilts	8.9%	-5.3%	-25.1%	3.6%	-4.0%

Source: Bloomberg 10.01.25. All returns expressed in euros bar UK Gilts expressed in Sterling.

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Warning: If you invest in these funds you may lose some or all of your investment.

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