

MARKET MINUTE

With McGAREL



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Interest rates and earnings...keep your eye on the ball.

On 11 February 1990, Mike Tyson, then the most dominant boxer in the world, was knocked out in a fight in Japan by an unknown named Buster Douglas and the United States woke up in shock. On 27 January 2025, NVIDIA, currently the most dominant company in the world, was “knocked out” by an unknown AI company from China named DeepSeek and the United States woke up in shock.

In the last week of January, NVIDIA fell 16% while the S&P 500 Index only fell 1%. Other stocks trading as Artificial Intelligence (AI) “plays” were generally clobbered as well during the week. The source of this tumult was the release of a new AI model out of China that is seemingly much cheaper and more efficient to run. That release called into question the need for massive AI capex and future energy needs. What had been a market of momentum and speculation fueled by the perceived clarity of future AI related spending, ended with much greater uncertainty for investors.

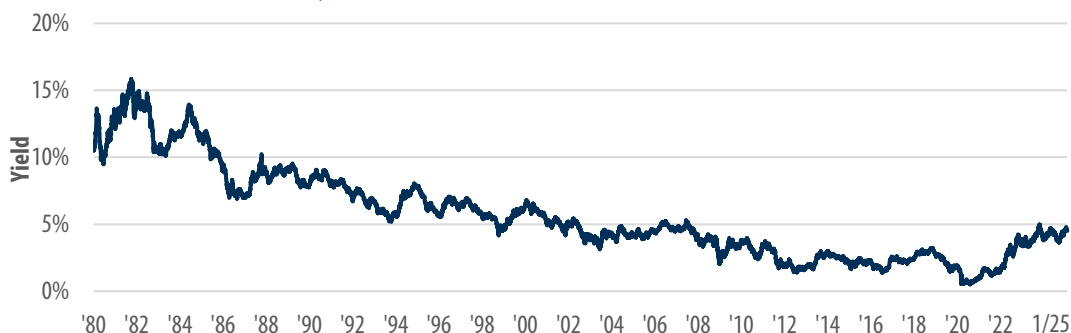
In addition, President Trump and the new Administration are making news every day with rhetoric and actions on trade wars, tariffs, taxes, potential Bitcoin reserve funds, and all kinds of other policy initiatives the market is trying to absorb.

For all the noise and focus on AI, tariffs, etc., it's important to remember that stocks will ultimately be priced based on interest rates and earnings forecasts. Currently, interest rates are relatively stable [Chart 1] with the market expecting modest cuts in the Federal Funds rate this year. Earnings growth of low double digits is still forecasted in 2025 and nothing reported in the first few weeks of Q4 earnings season has done anything to sour this view. But, the message is clear. If the single most impressive company in the world can fall 16% in 5 days based on a risk no one yet truly understands, it may be time to review concentration risk in single stocks and industries.

To us, the current AI fallout is just a reminder, that after a 62% return in the S&P 500 Index over the last 25 months, stocks are still risk assets. The largest correction in 2023 (S&P 500 Index up 26%) was only 10% [Chart 2]. The largest correction in 2024 (S&P 500 Index up 25%) was just 8%. With the market at its highest valuation since early 2000 (except for a brief spell post Covid) and lots of expected changes from a new Administration, higher volatility is almost certain to show up this year, in our view.

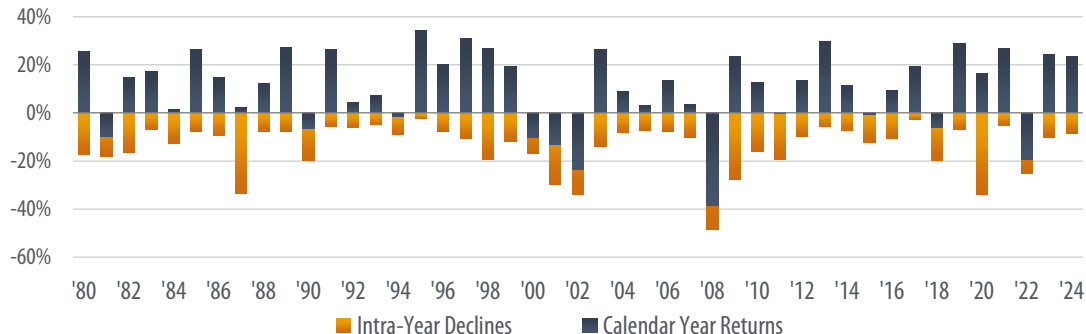
The economic data in the U.S. continues to be resilient and we believe there are currently plenty of opportunities to diversify equity exposure to help mitigate the potential risk for increased uncertainty and volatility.

Chart 1: 10-Year U.S. Treasury Yield Since 1980



Source: Bloomberg. Data from 31/12/1979 – 31/1/2025. The **10-Year U.S. Treasury Yield** is represented by the U.S. Generic Government 10 Year Yield Index.

Chart 2: Intra-Year Declines vs. Calendar Year Returns



Source: Bloomberg. As of 31/12/2024. The benchmark used for the above chart is the S&P 500 Index.