Quarterly review

for the three months to 31 December 2024

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Global equities rose 6.15% in sterling over the final quarter of 2024 and 20.13% over the year. US stocks outperformed over the quarter, rising 9.68% in sterling, with technology stocks leading the way, rising 13.99%, taking their annual gain to 40.77% as investors grew exuberant about the commercial prospects for artificial intelligence (AI).

At the year end, the 10 largest US stocks by market value, of which eight were in information technology or communications, accounted for 32% of the market. This historically-high concentration left Wall Street vulnerable to news in January that DeepSeek, a Chinese AI company, had released an open-source model built at a much lower cost in terms of hours of processing time using graphics processing units (GPUs) than US-developed models. This may be a game-changer in terms of the potential demand and cost of GPUs, which have fuelled the strong gains made by shares in Nvidia, the leading GPU supplier. DeepSeek's model, which is available to other developers, may challenge the dominance of US AI-related companies. Donald Trump, the US president, described it as a "wake-up call" for America's AI industry.

The US Federal Reserve reduced its official interest rate by a quarter percentage point to 4.25-4.5%. The personal consumption expenditures index, the Fed's preferred inflation measure, rose from 2.1% in September to 2.4% in November, the latest month for which data is available. The Fed confirmed that the market-implied path of interest rates had edged higher since the US presidential election in response to recent data and the potential impact of Trump's policy changes. In December, the Fed's minutes suggested that the pace of rate cuts could slow in 2025, with surveys indicating a three-quarter point cut over the year. The dollar rose on expectations that rates would stay higher for longer, gaining 7.10% against sterling. Global bonds fell in dollar terms but gained 1.64% in sterling because of currency movements.

UK stocks underperformed, falling 0.60%. In December, the Bank of England kept Bank Rate on hold at 4.75% despite weakening economic growth. UK inflation rose from 1.7% in September to 2.6% in November before easing to 2.5% in December. Wage increases, which the BoE expects to be 3-4% in 2025, may lead to inflation persisting above the 2% target and interest rates remaining higher for longer. Government bonds and UK sterling corporate bonds fell 3.50% and 0.16% respectively over the quarter. Brompton continues to avoid dedicated UK government bond investments on behalf of clients because of concerns about government borrowing.

Equities in Europe excluding the UK also lagged, falling 4.16% in sterling. Eurozone inflation rose from 1.7% in September to 2.4% in December but the European Central Bank (ECB), in contrast to the Fed and the BoE, said disinflation was "on track", expecting consumer prices to rise 2.1% in 2025 and 1.9% in 2026. The ECB reduced its key policy interest rate in December by a quarter point to 3%. Lower eurozone interest rates relative to US rates may boost economic growth. This in turn may improve sentiment towards Europe ex-UK equities despite political uncertainty in Germany and France and the negative impact of cheap Chinese electric vehicles on the German automotive sector, traditionally regarded as the country's economic powerhouse.

Equities in emerging markets and Asia excluding Japan fell 1.29% and 0.84% respectively in sterling, dragged lower by the stronger dollar and investor concerns about Trump's mooted tariffs of 25% on Canadian and Mexican imports and an additional 10 % on Chinese imports.

As the chart below shows, Chinese policymakers have steadily increased stimulus through successive cuts in the key reserve requirement ratios that govern the amount of capital Chinese banks must retain on their balance sheets. Chinese gross domestic product (GDP) growth of 5.4% year-on-year over the quarter surpassed analysts' expectations and contributed to

Quarterly review (continued)

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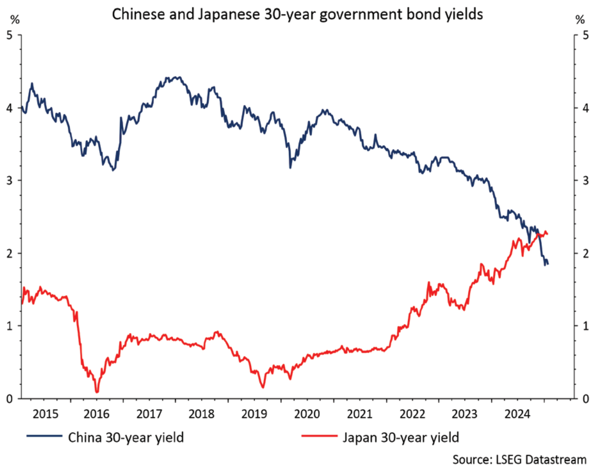
growth of 5% for 2024 as a whole. The stronger-than-expected fourth-quarter figure may, however, prove a short-lived boost ahead of Trump's trade tariffs.

Investors fear that China may be entering a period of exceptionally low inflation or even deflation. As the chart above shows, Chinese consumer price inflation is close to zero. The chart below shows that Chinese 30-year bonds are now yielding less than Japanese 30-year bonds. By contrast, Japan raised interest rates in 2024 for the first time since 2007 as the Bank of Japan concluded that inflation was sustainably on track to meet its 2% target.



There are grounds to be positive about the prospects for equities in 2025. In the US, Trump's policies of trade protectionism, immigration control, on-shoring of manufacturing, deregulation and lower taxes are likely to stimulate economic growth although they may prove inflationary, leading to higher interest rates and weaker growth in the longer term. Given the predominance of big technology stocks in the main US indices, equally-weighted US passive investments may outperform conventional index trackers should technology stocks disappoint. Equities in the UK and some emerging markets ended 2024 on low valuations compared to history and may prove defensive should markets fall overall.

In fixed income, shorter-dated and inflation-linked bond investments may outperform, particularly in the US and UK, where rates may remain higher for longer given the persistence of above-target inflation. Gold may also provide diversification given concerns about the unpredictability of US policy-making under the Trump administration and heightened geopolitical risks.

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