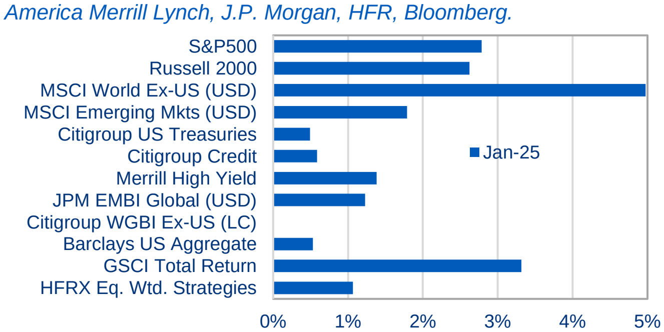
Strategic Investment Group®

Global Market Review

Despite a mounting sense of foreboding, global markets were relatively placid in January. U.S. equities rebounded from December's downdraft, and developed and emerging markets also rose. U.S. Treasury yields across the curve ended the month little changed. However, real interest rates declined, and inflation expectations rose. Credit markets were also calm with investment grade and high yield spreads remaining tight. Towards month-end, growing concerns over the impact of sweeping tariffs began to weigh on sentiment. This was most evident in the currency markets, with the Canadian dollar and the Mexican peso experiencing increased volatility. The U.S. dollar fell slightly against major currencies in January, following its appreciation last year. The dollar's real effective exchange rate remains elevated, however. Commodity prices, including oil, rose in January. Reflecting the market's unsettled nature, gold ended the month at yet another record high.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



Global equity markets bounce back in January.

Tariffs?!

The prospect of tariffs of 25% on imports from the U.S.' closest trading partners accounting for 29% of total U.S. imports have heightened market uncertainty. If ultimately imposed, the sweeping nature of the tariffs is likely to increase unintended harmful consequences for U.S. industries and consumers as their impact flows downstream. The effect on Canada and Mexico is potentially devastating. The deep integration of the Canadian, Mexican, and U.S. economies after 30 years of free trade raises the risk of significantly higher costs and production bottlenecks, especially in the automobile industry. Moreover, tariffs on imports from China, tied with Canada as our second largest trading partner accounting for 14% of total imports, are set to increase by 10% and imports from the EU are said to be next.

It is natural to expect an immediate dramatic impact on prices and output from the imposition of across-the-board tariffs. This is unlikely. The U.S. is a relatively closed economy, with imports accounting for only 11% of GDP. If imposed, the impact of tariffs on prices will be meaningful, and enough to influence the direction of Fed policy, but will be felt with a lag of several months and may be limited to staggered step increases in the price level rather than an inflationary spiral. The cumulative impact of slower long-term growth and supply chain disruptions as a result of higher tariffs is likely to be much more pernicious, persistent, and unpredictable. For the present, contradictory signals on the timing and scope of tariffs are making it difficult for markets to discount their ultimate impact, contributing to the sanguine price action in January.

U.S. Equities Extend Last Year's Spectacular Gains

Despite the looming specter of tariffs, the S&P 500 index rose 2.8% in January, further stretching valuations. The gains were widespread across all market segments and capitalizations and most sectors. Reversing recent trends, value outperformed growth stocks in January, rising 4.5% versus growth's 2.0% gain. High-flying tech stocks tumbled in January on fears of competition from a more efficient AI model developed by a Chinese start-up. NVIDIA dropped 16% on the day of the news, wiping out a record $600 billion in market value. Other sectors registered positive gains in January, with the telecom, financial, and healthcare sectors performing especially well.

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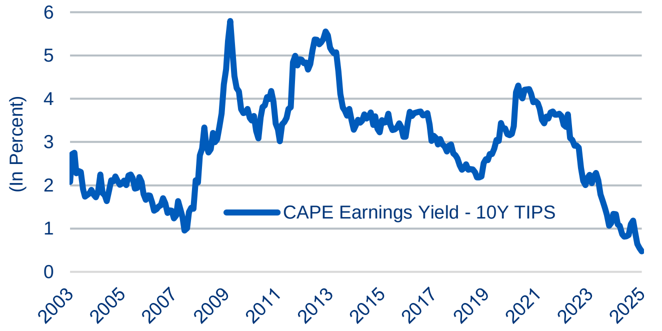
Investor sentiment and positioning is quite bullish, notwithstanding high U.S. equity market valuations. The equity risk premium calculated as the trailing cyclically adjusted real earnings yield of the S&P 500 relative to the real yield on 10-year TIPS is at historic lows. Although the price gains and valuations of the Magnificent 7 mega-cap Tech stocks grab the limelight, high valuations are widespread across U.S. stocks. The earnings growth needed to justify these valuations appears overly optimistic, especially in an environment of exceptionally high policy uncertainty.

Exhibit 1. U.S. Equity Risk Premium Falls to Lows

Sources: Bloomberg, Shiller Data, and Strategic calculations. Earnings yield is the inverse of Shiller Cyclically Adjusted Price Earnings ratio (CAPE) calculated using 10-year smoothed real earnings per share.

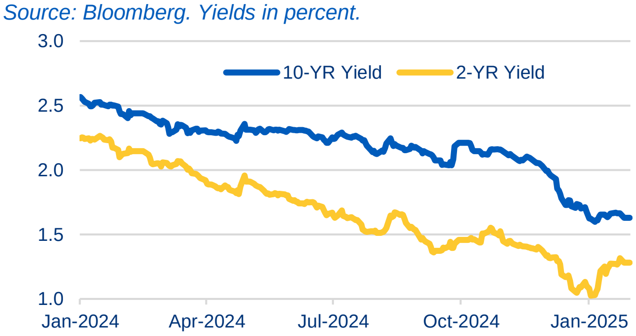


Despite Economic Woes European Equities Rise

The MSCI World ex-U.S. index of advanced economy stocks rose 5% in January. European equities performed especially well, rising 6.9%, notwithstanding deep-seated economic stagnation caused by high energy costs, low levels of investment, and subpar productivity growth. The euro area's largest economy is also its worst performing one. German GDP has contracted in each of the past two years, with manufacturing and exports posing the main drags on output.

Exhibit 2. Chinese Bond Yields Reflect Debt Deflation

Source: Bloomberg. Yields in percent.



Emerging equity markets gained 1.8% in January. Chinese equities lagged other markets. The Chinese economy remains mired in debt deflation following a giant property bubble. The inflation rate has been below one percent over the past two years and is now hovering near zero. Bond yields have fallen sharply (Exhibit 2). Depressed consumer sentiment and spending are weighing on domestic demand, making the Chinese economy increasingly dependent on exports as an engine of growth in a time of rising trade tensions.

Specter of Tariffs Spook Central Banks

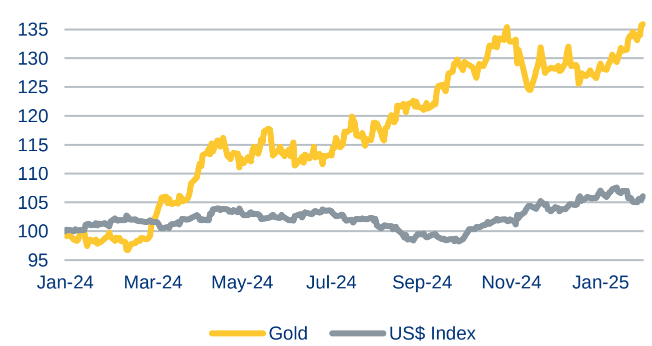
While focused primarily on domestic economic conditions, major central banks are increasingly weighing the potential impact of tariffs on the prospects for output, employment and prices. The Bank of Canada trimmed rates by 25 basis points to 3% in January and reduced its growth forecast, citing the devastating impact of a trade war on the Canadian economy. The ECB also cut rates by 25 basis points bringing its policy rate to 2.75%. The ECB forecast continued economic weakness, citing fragile consumer and business confidence and the prospect of rising trade tensions with the U.S. The FOMC, meanwhile, after cutting rates in December left rates unchanged at 4.25% in its January meeting. Continued strong economic growth, stubbornly high inflation, and the potentially inflationary impact of tariffs were the main factors leading to the Fed's decision to keep rates constant following three successive cuts since September last year.

Currency Markets React to Tariff Uncertainty

The initial market manifestation of tariffs is usually in the currency markets. The currency of the country imposing the tariffs rises, while the currencies of the countries whose exports face the new tariffs typically depreciate. This dynamic was evident in the increased volatility of the Canadian dollar and the Mexican peso in January. The U.S. dollar, in contrast, was little changed for the month after having risen last year. It remains near record highs in nominal and real effective terms. The unsettled nature of the policy mix, combined with geopolitical instability continues to push gold prices higher. They reached another record in January (Exhibit 3).

Exhibit 3. Gold Hits Another Record High

Source: Bloomberg. Index. January 1, 2024 = 100.



Performance of Major Market Indices through 01-31-2025

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	2.8%	2.8%	2.8%	26.4%	11.9%	15.2%
Russell 2000	2.6%	2.6%	2.6%	19.1%	5.6%	8.7%
MSCI World Ex-US (USD)	5.0%	5.0%	5.0%	9.4%	5.1%	6.5%
MSCI Emerging Mkts (USD)	1.8%	1.8%	1.8%	14.8%	-0.7%	3.0%
Citigroup US Treasuries	0.5%	0.5%	0.5%	1.4%	-2.1%	-1.0%
Citigroup Credit	0.6%	0.6%	0.6%	2.9%	-1.0%	-0.1%
Merrill High Yield	1.4%	1.4%	1.4%	9.7%	4.4%	4.3%
JPM EMBI Global (USD)	1.2%	1.2%	1.2%	8.3%	0.6%	0.2%
Citigroup WGBI Ex-US (LC)	-0.1%	-0.1%	-0.1%	1.7%	-2.8%	-2.2%
Barclays US Aggregate	0.5%	0.5%	0.5%	2.1%	-1.5%	-0.6%
GSCI Total Return	3.3%	3.3%	3.3%	8.0%	6.8%	10.3%
HFRX Eq. Wtd. Strategies	1.1%	1.1%	1.1%	5.7%	2.3%	2.8%