MARKET FLASH: CHINA AND THE US RACE FOR GLOBAL LEADERSHIP IN TECHNOLOGY

- **The arrival of DeepSeek, an AI aiming to be more efficient and cost-effective than ChatGPT, created a buzz among investors.**
- **The reductions in public spending and the size of the federal administration planned by Donald Trump could have negative repercussions on economic activity and the labor market.**
- **The ECB has lowered its key interest rates due to the slowdown in inflation and weak growth.**

Diplomatic tensions surfaced at the beginning of the week between the US and Colombia after Bogota initially refused to accept migrants expelled on orders from the Trump administration. The stand-off showed that Donald Trump was prepared to use customs tariffs to leverage discussions over his trade and migrant strategy. He also confirmed that the US was to impose 25% tariffs on Mexican and Canadian imports. A decision on Chinese imports is pending.

GDP in the US grew by a reassuring 2.3% over 12 months in the fourth quarter thanks to vigorous household consumption but the new federal government's fight against increased spending and its determination to shrink the federal administration could hit the economy and the labour market. The total freeze on federal aid programmes, even if temporarily suspended by a judge, and invitations to civil servants to resign showcase Donald Trump's drive to slash spending to bring government finances under control. As for US consumer confidence, the index declined for the second month in a row due to rising worries over the labour market, inflation and high interest rates. Nevertheless, the Fed left benchmark rates unchanged because of resilient growth and sticky inflation.

In Europe, the ECB cut its rates by 25bp, citing slowing inflation and zero growth in the fourth quarter. Germany and France are faltering while peripheral countries are doing rather well. The Bank Lending Survey provided a mixed picture: households are borrowing more, underpinning growth as consumption recovers, but corporate loan demand is still soft due to light order books.

In China, PMIs showed both industry and services slowing. And yet China is seeking to compete with the US in technological innovation. This week's announcement by DeepSeek triggered a big buzz among investors. The Chinese start-up claims to have developed a more efficient artificial intelligence model than ChatGPT and, what's more, after spending only $6m compared to more than $100m for ChatGPT. DeepSeek's architecture promises to be more time and energy efficient, with no need to use the advanced chips which have made NVIDIA so successful. The start-up still needs to prove itself worthy but the news triggered a temporary sell-off in tech stocks, with NVIDIA and the Nasdaq falling the most.

Today's uncertainty over the Trump administration's policies and the impact on other countries as well as on the Fed, have led us to be neutral on both equities and bonds. We prefer protected equities and companies less exposed to US tech. We are also cautious on US duration and prefer corporate debt to government bonds.

EUROPEAN EQUITIES

Several major European countries released preliminary GDP figures over the week. Quarterly growth for Germany (-0.2%), France (-0.1%) and Italy (flat) all came in slightly below expectations. Spain confounded expectations by growing 0.8%, or more than the 0.6% pencilled in by economists. Annual inflation in France came in at 1.4%, or slightly less than expected. With inflation generally falling in Europe, the ECB cut rates by 25bp as expected. European markets overall ended the period 2% higher.

Announcements from China's **DeepSeek** affected European markets. **Schneider Electric**, which has strong exposure to the energy efficiency theme, tumbled 16% but managed to recoup some of its losses afterwards. **Legrand** was also hit but not by as much. Europe's tech sector lost more than 3% to start the week but rebounded thanks to strong results from **ASML**. The Dutch group's quarterly results beat expectations thanks to high net bookings. The group also sounded encouraging notes on China.

The communication services sector jumped by an impressive 6%, mainly due to **Deutsche Telekom** which gained close to 10% on upbeat results at its US subsidiary **T-Mobile**. In contrast, Holland's **KPN** reported a mixed bag of results but the share price resisted.

Fourth-quarter sales at the Fashion and Leather division of France's luxury giant **LVMH** fell 1% when expectations were high following upbeat figures from other sector players. The operating margin also missed expectations. Despite CEO Bernard Arnault's optimistic take on the beginning of this year, the stock fell 6% on the news.

US EQUITIES

For the second week in a row, Wall St made solid returns. The Nasdaq gained 1.80%, the Russell 2000 1.03% and the S&P 500 ended 0.98% higher. It was a busy week for results and dominated by tech stock figures, with major plays like Microsoft, Meta, Tesla and Apple reporting. Amazon, NVIDIA and Alphabet will announce results from next week.

The week started on a complicated note for semiconductor stocks and GenAI companies after China's **DeepSeek** undermined valuations for semiconductor, suppliers, software and energy stocks connected with tech by announcing cheap AI model solutions. The news wiped out close to $600bn in **NVIDIA**'s market cap at the opening on Monday but the stock ended 5.26% higher. It was the same story for **Ciena** (+10.96%). The episode reflected investor nerves when faced with rather hazy announcements.

Among hyperscalers and data centres, **Microsoft** ended the period 4.5% down. Its results were satisfactory but the contribution from its cloud division missed expectations. **Meta**, on the other hand, gained 4.11% thanks to strong results and Mark Zuckerberg's upbeat comments on AI in 2025, with in particular an indication that the company was about to make a significant breakthrough. Both companies said they were going to press ahead with heavy infrastructure investments.

In telecoms, **AT&T** (-0.50%) and **Verizon** (-2.88%) both announced slightly higher fourth-quarter EPS in a less competitive trading environment. Their FCF margins improved so gradual deleveraging should now be possible. Elsewhere, **T-Mobile** (+5.84%) beat expectations, thanks to good execution. In addition, the group guided on higher growth targets than its rivals.

In the autos sector, **GM** (-9.87%) appears to have been punished for not including the risk from potential Trump administration tariffs **Tesla** (+0.79%) advanced thanks to Elon Musk's upbeat comments on the strong potential for AI-driven products and services like robotaxis and humanoid robots. He also said his robotaxis would begin tests in Austin next June. **Waymo** (**Alphabet**:+4.72%) also announced it would be launching in 10 new US cities. These announcements hit **Uber** (-3.17%) and **Lyft** (-2.16%) as the risk of autonomous vehicles to their business models took shape.

In freight news, **UPS** (-15.68) was hit by the loss of 50% of its contracts with its biggest client Amazon, but the situation in rail transport showed signs of improvement. For example, **CPKC** (+9%) had a good fourth quarter and its guidance for this year suggested the cycle was going to turn higher.

In construction, slightly better-than-expected housing permits in the US pointed to an improvement in trading. **Pulte Home** (+0.39%) said it saw signs things would improve in the spring but it also questioned bank funding for residential builders.

EMERGING MARKETS

The MSCI EM index had added 0.5% to its rebound as of Thursday's close. Most APAC markets were closed this week for the Lunar New Year holidays. DeepSeek was the centre of focus. The MSCI China index gained 1.35% while India edged 0.2% lower. Brazil (+4%) continued to outperform. Mexico closed the week flat.

In **China**, macro data remained mixed: industrial profits rose 11.0% YoY in December, vs. -7.3% in November and -10% in October. The step-up in policy support for equipment upgrade and consumer goods trade-ins helped improve sales and profits in equipment upgrade and home appliance sectors. However, both January manufacturing and non-manufacturing PMI came in below expectations, at 49.1 and 50.2, respectively. In the tech sector, **DeepSeek** made headlines for its competitive open-source reasoning large language model R1, benchmarked close to ChatGPT-o1, which showed that China continued to make progress in AI despite restrictions on high-end semiconductors. **Alibaba** also launched its latest multi-model, vision-language model Qwen 2.5VL and high performing general-purpose model Qwen 2.5Max. Shenzhen's government vowed active support after the **Vanke** management shake-up, addressing concerns over one of China's largest property developers. China iPhone sales fell 11% YoY to $18.5bn. Apple grew in every region apart from China this quarter partly due to the lack of **Apple** Intelligence functions versus the competition. With mixed macro data and continued policy efforts, investors remained focused on potential further stimulus measures to support growth and market confidence in the coming months.

In **Korea**, **Samsung Electronics** reported fourth-quarter earnings; management expects memory demand to recover in the second quarter. To avoid competition with Chinese suppliers, it plans to dramatically scale down its DDR4 DRAM output.

In **India**, investor focus remained on the Union Budget on February 1st. The RBI injected INR 1.5trillion ($18bn) in liquidity. **ICICI Bank** reported another good quarter with better than expected 15% PAT growth on lower credit costs. All three top quality banks – **ICICI**, **HDFCB** and **Kotak**- maintained asset quality even in the current tough macro environment and good deposit growth. **Bajaj Finance**'s results showcased strong loan growth and moderation in credit costs. **TVS** delivered solid performance with record high EBITDA margins, despite the adverse domestic market. **DLF**'s quarterly results showed record performance in urban luxury projects. It was a mixed picture in electronic manufacturing, with **Kaynes** cutting guidance due to execution delays while **Syrma** remained on track.

In **Brazil**, the central bank increased interest rates by 100bp as expected but with dovish comments. Lula's popularity fell below 50% for the first time in two years.

Mexico's GDP rose 0.6% in the fourth quarter, or well below the 1% expected. An energy reform bill is to go before Congress. Results at **Banorte** were in line, with stable asset quality and an acceleration in loan growth.

CORPORATE DEBT

CREDIT

Credit markets edged higher over the week with IG returning 0.33% (+0.09% YTD) and HY 0.31% better (+0.36% YTD). Both the Fed and ECB meetings reassured investors that the fight against inflation was advancing.

Demand for fixed income remained very strong: IG took in €951m and HT €573m. And yields are still attractive compared to the last 10 years: IG is yielding 3.2% and HY 5.5%.

The start to the earnings season has been robust for financials with no surprises.

New deals from **OVH**, **Ineos** and **Engineering** (at 4.625%, 5.625% and 8.625%, respectively) were all easily oversubscribed with average allotments running at 30%. And the issues performed very well when trading, gaining between 1-2%.

GLOSSARY

• Investment Grade: bonds rated as high quality by rating agencies.

• High Yield: corporate bonds with a higher default risk than investment grade bonds but which pay out higher coupons.

• Senior debt benefits from specific guarantees. Its repayment takes priority over other debts, known as subordinated debt.

• Debt is considered to be subordinated when its redemption depends on the earlier payment of other creditors. To offset the higher risk, subordinated Senior debt has priority over other debt instruments.

• Tier 2 / Tier 3 : subordinated debt segment.

• Duration: the average life of a bond discounted for all interest and capital flows.

• The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.

• The so-called "Value" stocks are considered to be undervalued.

• EBITDA: Earnings before Interest, Taxes, Depreciation, and Amortization.

• Quantitative easing describes unorthodox monetary policy from a central bank in exceptional economic conditions.

• Stress Test: a process which simulates extreme but possible economic and financial conditions so as to assess any impact on banks and measure their resilience to these events.

• The PMI, for "Purchasing Manager's Index", is an indicator of the economic state of a sector.

• AT1s belong to a family of bank capital securities known as contingent convertibles or “Cocos”. Convertible because they can be converted from bonds to shares (or depreciated entirely) and contingent because this conversion only occurs if certain conditions are met, such as the issuing bank's capital strength falling below a predetermined trigger level.

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