January 31, 2025

Weekly Viewpoint

DeepSeek Crashes the AI Party While Fed Says It Is in No Hurry to Cut Rates

Performance for Week Ending 1.31.2025

The Dow Jones Industrial Average gained 0.3 percent, the S&P 500 Index lost 1.0 percent, and the Nasdaq Composite Index fell 1.6 percent. Sector breadth was mixed, with five of the S&P sector groups closing higher and six closing lower. The communication services sector was the best performer at 2.7 percent, while the Technology sector was the weakest at -4.6 percent.

Index*	Closing Price 1/31/2025	Percentage Change for Week Ending 1/31/2025	Year-to-Date Percentage Change Through 1/31/2025
Dow	44,544.66	0.3%	4.7%
S&P 500	6,040.53	-1.0%	2.7%
Nasdaq	19,627.44	-1.6%	1.6%

Market Observations: 1/27/25 – 1/31/25

The S&P 500 finished modestly lower after a brutal start to the week, but gained 2.7 percent overall in January, the best start to a New Year since 2023. Stocks plunged on Monday following developments that suggested a China-backed AI chatbot could outperform U.S. rivals with a lower cost base and fewer high end processors. DeepSeek, a startup that reportedly used Nvidia's lower-end H800 chips to build an AI training model for less than $6 million, overtook OpenAI's ChatGPT as the world’s most-downloaded AI tool on the Apple App Store. The Hangzhou-based group claims its free to use, open-sourced chatbot can outperform U.S. rivals at a small fraction of the cost, a statement that seemed to cast doubt on the business models of tech giants such as Microsoft, Meta, Amazon, and Google parent Alphabet, which have collectively committed around $300 billion in capital spending over the past year. Power companies, which are expected to see a surge in demand from energy-intensive data centers needed to develop AI technology, also fell sharply. As the week wore on, stocks pared a good portion of their losses following quarterly earnings updates from Meta and Microsoft, which both stated that they remain committed to building their AI platforms and that their capital plans remain unchanged. Last week’s generally uneventful Federal Open Market Committee (FOMC) meeting, combined with a batch of solid fourth quarter earnings reports, also helped sooth investors' nerves.

FOMC Meeting: As widely expected, the FOMC left the target range for the fed funds rate unchanged at 4.25–4.50 percent. The FOMC updated its statement to note that the unemployment rate had "stabilized at a low level," and the labor market remained "solid." The FOMC also dropped a clause from the statement noting that inflation had "made progress" toward the Federal Reserve's (Fed) 2 percent target and continued to note that inflation "remains somewhat elevated." At the subsequent press conference, Fed Chair Jerome Powell downplayed the likelihood of a rate cut at the March meeting, saying "We don't need to be in a hurry to adjust the policy stance," calling economic growth "solid," and the labor market strong. While above the Fed's 2 percent target, inflation is trending lower, he added. Powell, however, did note that the policy stance was still "meaningfully restrictive," suggest the rate cutting cycle will continue. Bloomberg's World Interest Rate Probability tool shows the first rate cut this year is not expected to come until the June FOMC meeting. For the overall year, the market is currently forecasting 47 basis points of easing.

Economic Roundup: The U.S. economy expanded at a solid pace at the end of 2024, fueled by a generous tailwind from consumer spending that more than offset drags from a strike at Boeing and much leaner inventory investment. Inflation-adjusted gross domestic product (GDP) increased an annualized 2.3 percent in the fourth quarter after rising 3.1 percent in the third quarter. Consumer spending, which comprises the largest share of economic activity, advanced at a 4.2 percent pace—the first time since late 2021 that outlays have exceeded 3 percent in consecutive quarters. On the inflation front, the month-over-month increase in the core Consumer Price Index deflator of 0.2 percent was consistent with expectations, but marked a step up from the reading of 0.1 percent from a month ago. On a 12-month basis, core inflation increased by 2.8 percent, also matching consensus expectations and the reading of 2.8 percent a month ago. On a three-month annualized basis, core inflation fell to 2.2 percent (the lowest level since July) from 2.6 percent a month ago, a welcome sign after seeing near-term annualized trends accelerate last fall. Meanwhile, U.S. consumer confidence fell to a four-month low in January as optimism about the labor market and the outlook for the broader economy declined. Sales of new homes ended 2024 on a high note as customers took advantage of incentives from builders, leading to a second straight year of increased purchases. For the full year, customers purchased 683,000 homes, up about 2.5 percent from 2023's total.

Q4 Earnings: Through Jan. 31, 2025, 178 members of the S&P 500 had released fiscal quarter results, with 78 percent beating expectations. Aggregate earnings for this group are up 7.3 percent, only modestly behind the 10 percent projected growth rate for the overall quarter. On the sector level, communications and financials topped earnings estimates, while technology and consumer staples beat estimates the most on a revenue basis. Earnings season will remain in high gear this week, with 124 members of the S&P scheduled to report. Amongst these will be Dow-components Merck, Amgen, Walt Disney, Honeywell, and Amazon.

Market Viewpoint – As January Goes, So Goes the Year? While the market is off to a solid start, over the intermediate- to longer-term, fundamentals—the economy, earnings, and interest rates—are what drive stock prices. The good news is that the macroeconomic environment is expected to remain supportive in the coming quarters: The U.S. economy remains on firm footing and the Fed is easing, and while the path forward could prove uneven, rates are likely to drift lower over the next year. Importantly, the earnings growth outlook remains strong. Consensus expectations from Bloomberg for S&P 500 earnings growth are 11.6 percent and 14.0 percent in 2025 and 2026, respectively. The combination of an accommodative Fed and brisk earnings growth creates a favorable backdrop for risk assets and should continue to drive the bull market. Still, with valuations elevated, earnings growth will likely drive performance, meaning that gains in the year ahead may be more modest compared to the past two years.

The Week Ahead: The focal point this week will be the January jobs report on Friday. According to Bloomberg, economists expect payrolls to grow by 165,000, down from 256,000 in December. Economists also forecast the unemployment rate to hold steady at 4.1 percent. Other labor market reports that will be watched closely include the JOLTS and ADP reports, out on Tuesday and Wednesday, respectively. The ISM indexes, released on Monday (manufacturing) and Wednesday (services), will also be in focus, especially the prices and employment components. The Fed speaking calendar will be busy, with 13 Fed officials scheduled to speak throughout the week.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.