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MARKET OVERVIEW FEBRUARY 2025

By Dominique Marchese, Head of Equities & Fund Manager

2025: INVESTORS WILL NOT BE BORED!

The world's major stock markets have started 2025 in a good way, despite the uncertainties surrounding Donald Trump's new presidential term. The technology sector has nevertheless been shaken by announcements about a Chinese startup, DeepSeek , which has become the symbol of the technological war between Beijing and Washington in AI (artificial intelligence). European stocks have benefited from the benefit of the doubt: the Commission's presentation of the "compass for competitiveness" was rather well received by the markets, despite many question marks.

TRUMP 2.0: TOWARDS A TRADE WAR?

Upon his inauguration, Donald Trump signed a slew of decrees that demonstrate his willingness to act diligently before the midterm elections that will be held in less than two years – let's keep in mind that the United States is a country in a quasi-permanent election campaign. **So far, his first decisions have been more or less in line with what his electoral platform announced. The markets have therefore not shown any particular nervousness, to the extent that investors, in their vast majority, are convinced that the measures that could revive inflation or threaten the excellent health of Wall Street would be quickly watered down.** Donald Trump is still seen as a pragmatist with the wealth effect induced by financial markets as his compass, which benefits American households – a factor that played a key role in the good performance of private consumption in 2024. **However, this broad consensus will not prevent sudden bursts of volatility, such as on Monday, February 3, after the announcements of a** 25% increase in customs tariffs against Mexico and Canada (decisions since postponed) and a 10% increase against China – accompanied by a rise in the dollar that absorbs part of the increase in the price of American imports. What is certain: investors will not be bored in 2025, the first year of the presidential term that will undoubtedly see the peak of turbulence in terms of political decisions on the part of the new Administration.

The American central bank (Federal Reserve or Fed) will therefore not have an easy task. If the disinflation process continues with the continued normalization of wages, it must be recognized that the measures affecting customs tariffs and labor immigration are inflationary in nature. While the economy is running at full capacity (GDP in volume +2.7% in 2025 according to the IMF), at a rate significantly higher than its potential growth thanks to household spending (around ¾ of GDP growth in 2024) and investments (+4% over one year), the Fed has little reason to continue its easing policy in the coming months, and should adopt a cautious wait-and-see position in order to observe more precisely the concrete effects of Donald Trump's macroeconomic policy. It will thus focus its attention on inflation expectations, which for the moment have only slightly increased since last November's elections. Let's not forget that Washington is still betting on deregulation, lower energy prices, and tax cuts as powerful contributors to disinflation. **Expectations for a Fed rate cut in 2025 are now limited to 25 basis points (0.25%). It would not be surprising if the Fed ultimately remains immobile throughout the year.**

We note that long-term interest rates in dollars (USD) have stabilized (10-year Treasury bond at 4.55%, unchanged since January 1 , i.e. a real rate – after inflation – of 2.10%), **which reflects the great serenity of the bond markets.** A sudden rise in long-term rates above the symbolic 5% mark (real rates above 2.5%), would be likely to seriously weaken American stocks given their high valuation. We recall that equilibrium long-term rates – according to economic theory – correspond to the addition of potential growth, anticipated inflation and a term premium supposed to compensate the investor for the volatility of interest rates. The long end of the USD yield curve should therefore be between 4.5% and 5% (potential GDP close to 2%, inflation 2% to 2.5%, term premium 0.5%), which is precisely its current level. If Donald Trump were to accentuate the volatility of the bond markets through his policy, the risk would be an increase in the term premium demanded by investors and/or an increase in inflation expectations. **USD rates should therefore be watched like a hawk because they greatly influence the American and global financial markets.**

THE EUROPEAN UNION: TOWARDS A SALUTARY CHANGE OF DIRECTION?

Pure Capital S.A., société de gestion régulée par la CSSF (Luxembourg)
www.purecapital.eu | info@purecapital.eu

Siège social Luxembourg
2 rue d'Arlon, L-8399 Windhof | T : +352 26 39 86

Succursale Belgique
Sneeuwbeslaan 20, B-2610 Wilrijk | T: +32(0)3 246 04 65

Albert Einstein gave the following definition of madness: it consists of doing the same thing over and over again and expecting different results. This definition has been in keeping with the European Union for a good ten years, and especially since Ursula von der Leyen came to the head of the Commission in 2019. In our previous monthly letters, we have discussed at length Mario Draghi's long thesis on European competitiveness – which mainly focuses on its weaknesses – a report which last September was given a rather frosty reception by political leaders clearly implicated in the economic decline of the Union in the face of the United States and China. The election of Donald Trump finally seems to have convinced the highest authorities of the need to reframe Community policies deemed excessively bureaucratic. The Commission has thus unveiled its programme entitled **"compass for competitiveness"** and its agenda for the next two years (fifty texts to be adopted). We would like to express our greatest scepticism regarding this initiative, which for the moment seems to be a simple communication exercise and not an act of contrition, since most of the subjects addressed in the Commission document do not bring anything revolutionary compared to past declarations of intent, for example concerning the need for a single market for financial services – the name of which has been changed to the "Savings and Investment Union" –, the diversification of supply chains, or even aid for start-ups. First question : are those who are at the origin of the current slump the best equipped intellectually to review, sometimes 180 degrees, the directives that have accentuated the relative downgrading of the Old Continent? Second question : is the announcement of a cataract of new Community texts the most opportune response to the economic sclerosis due to the excess of standards and bureaucracy? Third question : while the new Commission is reproducing the previous centrist coalition identically with a slight shift to the right (socialists, *Renew* , EPP conservatives), who will be able to guarantee the abandonment of counterproductive ideologies at the origin of the most criticized texts (taxonomy, Green Deal, Farm to Fork, AI act , CSRD and CS3D which increase the administrative burden on companies, etc.), to finally give priority to the economic prosperity of the Union? Fourth question : the major flaw in European political construction is the refusal of federalism – which allows decisions to be taken and, above all, to be corrected much more quickly –; how can we convince people of its absolute necessity after having weakened entire sections of European industry through Kafkaesque regulations (telecommunications, energy, chemicals, mining, automobile, investment banking, etc.)?

As an illustration, the **Lisbon Treaty,** which came into force on 1 December 2010, gave each EU member state the objective of reaching 3% of their GDP in research and development expenditure by 2020. It was well understood by the public authorities at the time that potential growth could only be sustained by a significant effort in innovation and the dissemination of technical progress in society. Fifteen years later, the figures are disastrous and demonstrate the Union's inability to effectively implement what was decided at the top: public and private R&D spending barely exceeds the 2% mark (compared to 3.5% in the United States), with significant gaps between, for example, Germany (3.1%, but with more than 40% concentrated in its moribund automobile sector) and the southern countries, Italy and Spain, which barely reach 1.5%, and France, which spends 2.2% despite the indisputable quality of its leading engineering schools. Will the "compass for competitiveness" be enough to resolve this crucial problem for competitiveness? We allow ourselves to doubt it. We recall that the legislative process is far too long: **on average forty months for the European Parliament to adopt a text at second reading** (compared to twenty-four months twenty years ago, according to Le Point magazine, January 30, 2025)! An eternity in the race for AI and quantum computing!

By accumulating regulations, the EU has managed the feat of stacking policies that have become contradictory. The wave of deregulation and opening up to competition in the 1990s and 2000s, which aimed to dismantle state monopolies in order to promote competition and therefore lower prices for the greater happiness of citizen-consumers, has gradually given way to inflationary regulations (a clear increase in production costs), counterproductive protectionism (recent taxation of Chinese electric vehicles while the success of the energy transition requires a massive drop in car prices for the middle classes), and ideological choices that are more than questionable (taxonomy that slows private investment in the European defense industry to the great delight of American suppliers; recent mission letter to the Energy Commissioner that weakens the nuclear sector), and very far removed from the original objectives of the founders of the European project. During Ursula von der Leyen 's first term as head of the Commission, there was little talk of prosperity in the corridors of the Berlaymont ; the little music of sobriety, a false nose for degrowth and general impoverishment, gradually imposed itself to the great displeasure of European industry. While it holds all the cards, the EU is far from having made its aggiornamento. Time is running out.

DEEPSEEK: GOOD NEWS FOR THE SUCCESS OF AI

On Monday, January 27, technology stocks were shaken by news about a Chinese startup, DeepSeek , which has developed two competing models of American generative AIs such as those designed by OpenAI (ChatGPT-4o and OpenAI-o1 for the recent model with reasoning capabilities). Values linked to the AI ecosystem, in particular semiconductor producers such as the famous Nvidia, suppliers of equipment for *data centers* , as well as energy players, suffered violent corrections, often between 10 and 20% in a single session, before recovering somewhat in the following days. So what happened that was so worrying? The first information that leaked insisted on the ridiculous cost of training DeepSeek models (six million dollars compared to 50 to 100 million dollars for the most recent large language models – LLM – currently available, use of a much more limited number of Nvidia GPU processors, not subject to American sanctions against China), for results comparable to those of the best American models. This was enough to trigger substantial profit-taking in a segment of the stock market that has been particularly consensual for eighteen months. However, not all technology stocks were hit equally. Indeed, software producers, IT services and manufacturers of consumer electronics such as *smartphones* have often even seen their prices increase. Since January 27, the information circulating seems to indicate that the performances announced by DeepSeek are largely questionable. We will not go into technical considerations here; Given that DeepSeek 's model architecture is based on the same foundations as LLMs, it seems

Pure Capital S.A., société de gestion régulée par la CSSF (Luxembourg)
www.purecapital.eu | info@purecapital.eu

Siège social Luxembourg
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Succursale Belgique
Sneeuwbeslaan 20, B-2610 Wilrijk | T: +32(0)3 246 04 65

highly unlikely to us that American *hyperscalers* , which spend tens of billions of dollars per year to build their AI infrastructure, have fallen so far behind in terms of optimizing models and their investments. We humbly attempt to draw the more obvious consequences of this event. **To begin with, the high volatility of technology stocks is a reflection of the high valuation of this segment of the market and the highly consensual nature of AI in investment strategies. This once again argues for greater diversification of portfolios outside of the large, ultra-concentrated indices (active management).** The second conclusion that we can draw from DeepSeek is that the speed of diffusion of AI – we should rather talk about AIs – and the multiplication of use cases in companies and within the population obviously depend on a significant reduction in costs. If the game of healthy competition makes it possible to drastically reduce the costs of training models and that of inference (use), and in particular energy consumption – the real bête noire of generative AI –, this will only be profitable for all users. In other words, if DeepSeek does not turn out to be a " *deep fake* ", **we can hope for a faster increase in the contribution of AI to productivity gains, to the potential growth of the economy and *ultimately* to corporate profits. Finally, with DeepSeek , China would brilliantly demonstrate the futility of American sanctions (export restrictions) in the technological field.** Should we now fear a drop in capital expenditure by *hyperscalers* (Amazon.com, Microsoft, Alphabet, Oracle to name the main ones) in *data centers* (electrical equipment, AI semiconductors)? In the short term we do not think so, but in the longer term, **it is by far preferable for *cloud leaders* to control the envelope of investments devoted to AI and therefore their return on capital employed.** Finally, among the technology leaders, the most endangered stock remains Nvidia given its high valuation.

CONCLUSION

Investors have voted for Donald Trump, which does not mean that they will remain deaf to irrational decisions that would call into question American exceptionalism (strong economic growth, productivity gains, disinflation). The events of January (new Administration in Washington, the DeepSeek affair , the EU's "compass on competitiveness") announce a year 2025 that will certainly be exciting, but which will inevitably remain marked by uncertainties and the upheavals of the financial markets.

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