Summary

Economic news for the week included the FOMC keeping short-term interest rates unchanged, while U.S. GDP for Q4 came in above-trend but below the prior quarter, and personal income/spending positive. Gains in new home sales accompanied continued positivity for home prices. Durable goods and consumer sentiment fell back.

Equities were mixed globally last week, with most regions down, although a few countries bucked the trend. Bonds were up slightly, as interest rates ticked down. Commodities were also mixed, related to uncertainty over upcoming tariff policy and a strong U.S. dollar.

Economic Notes

(0) The **FOMC meeting** ending on Wed. resulted in no change, as markets expected, with commentary pointing to improved labor but also still-elevated inflation, when combined, takes away the urgent need for near-term rate cuts. While the formal statement changed, in an apparent more hawkish tone, Chair Powell noted at the post-meeting press conference it was due to just some language cleanup as "we just chose to shorten that sentence." He proceeded to highlight economic strength being at "quite a good place," "solid" conditions in labor markets "at a really good level," while noting inflation has eased in the last few years but remains "elevated" relative to their goals. Acknowledging the appropriateness of last year's -1% of total cuts, he presented both sides of their mandate being now "in balance" they aren't "in a hurry" to adjust their policy stance. In short, he kept a steady message that the FOMC stands ready to act in the direction the data dictates and "not in a pre-set course." The assessment of rates being "meaningfully restrictive" has softened, and policy is now "well-calibrated," partially due the impact of rate cuts as well as higher long-term rates, which do some of the FOMC's work for them. In terms of tariffs, the FOMC continues to wait for further articulation before formally assessing their impact, although there were several mentions of various models running "good" and "bad" scenarios behind the scenes. In response to where current Fed funds are compared to the long-term neutral rate, Powell acknowledged that they're "meaningfully above it," relative to all FOMC member estimates, although he has "no illusion" that anyone knows precisely where the neutral rate should fall today.

(0/+) The advance release of Q4-2024 **U.S. GDP** showed annualized real growth rate of 2.3%. This was below the 2.7% expected, and a deceleration down from the 3.1% rise in Q3. The total 2024 rate of GDP growth was 2.8%, just a tenth down from 2.9% in 2023. In Q4, personal consumption grew by over 4% (contributing 2.8% to the total GDP figure), mostly in durable goods, followed by gains in government (2.5%, contributing 0.4%). Weaker areas that pulled down the overall number included gross private fixed investment (-6%, detracting -1% from the total) and private inventories (detracting -1% as well). Inventories tend to be volatile and mean reverting from quarter-to-quarter, so are often discounted as less critical, unless extreme.

In the inflation statistics, the GDP price deflator rose at a 2.2% annualized rate in Q4, a few ticks up from Q3; for 2024 as a whole, it was down over a percent from the prior year to 2.4%. The PCE price index rose

by 2.3% in Q4, from 1.5% in Q3; core PCE ex-food and energy rose 2.5% in Q4, up from 2.2% in Q3. For 2024, year-over-year headline and core PCE rose by 2.5% and 2.8%, respectively, each at least a percent below the pace of 2023.

The Atlanta Fed's GDPNow tool appeared to be ultimately correct again, as the over-3% estimate the prior week had been downgraded to 2.3% a day before Friday's announcement but shows the sensitivity of real-time measures to ongoing data releases. For Q1-2025, the initial GDPNow forecast is growth of 2.9%, which exceeds the Blue Chip consensus of economists, which again calls for just over 2%. In that first estimate, consumer spending accounts for 70% of the rise, accompanied by gains in non-residential fixed investment (more tech-related, no doubt), government, and a reversal back upward for inventories.

(0) **Personal income** for December rose by 0.4%, a tenth below the prior month, but on par with expectations, led by proprietors' and rental income. **Personal spending** rose 0.7%, exceeding the forecast of 0.5%, and a tenth higher than the prior month, with spending on goods outpacing that of services. Personal income rose 5% in the past year, while spending was up 6%. The personal saving rate fell by -0.3% to 3.8%. The PCE price index rose by 0.3% on a headline level, and just under 0.2% for core, removing food and energy prices, some of which was pushed upward by a rise in airfares. These monthly readings were largely in line with consensus expectations. Year-over-year, headline PCE increased by 2.6%, a tick up from the prior month, while core rose 2.8%, largely unchanged from November. Ironically, some of the stickier PCE core inflation in recent months has been due to 'financial services fee,' which are tied to financial market performance—mostly from stocks, which had an exceptionally strong 2024. Overall, this was seen as not good/not bad by markets, reinforcing the Fed's choice to keep rates steady.

(-) **Durable goods orders** for December fell by -2.2% on a seasonally-adjusted basis, similar to the prior month, and below the 0.3% increase expected. The bulk of the decline was driven by a -$7 bil. (-46%) drop in non-defensive aircraft orders, an extremely volatile industry group month-to-month. Removing that, ex-transport orders increased 0.3%, and core capital goods orders rose 0.5%. Core capital goods shipments rose 0.6%, which exceeded expectations of only 0.2%. For the past year, total durable goods orders fell by -3.9%. In the core segment, this was led by double-digit gains in computers/related products, tied to CHIPS Act spending and AI.

(+/0) The **S&P Case-Shiller 20-city home price index** for November rose by 0.4% on a seasonally-adjusted basis, in keeping with the same pace of the prior month, while it fell -0.1% on an unadjusted basis. Year-over-year, the index picked up by a tenth to 4.3%. Of the twenty cities within the index, New York led with a 7% gain for the 12 month period, followed by Chicago and Washington, while Tampa came in last place, seeing prices fall by about a half-percent.

(+/0) The **FHFA house price index** rose 0.3% in November on a seasonally-adjusted basis, a tenth below expectations, along with an upward revision for the prior month. By region, results were led by a 0.9% rise in New England (CT north) and West North Central (ND/MN south to KS/MO), while East South Central (Great Lakes) fell by -0.9%. For the trailing year, national prices rose 4.2%, with every region seeing gains; these were led by New England up 7.7%, while West South Central (OK, AR, TX, LA) gained 1.8% to bring

up the rear. Under the surface, though, per the FHFA, there were signs of slowing, at least comparing the Nov. 2024 year-over-year gain being just over half the Nov. 2023 ending year's pace and blamed on higher mortgage rates.

(+) **New home sales** rose 3.6% in December to a seasonally-adjusted annualized rate of 698k, above the expected rise of 1.7%, in addition to a substantial revision higher for the prior month. By region, sales rose in the West and Northeast but declined in the South and Midwest. Year-over-year, sales rose nearly 7%. The median new home sales price rose by 2% over the past year to $427,000 but is down -7% from the peak in the fall of 2022 (almost in lockstep with the decline in per house square footage, in efforts to improve affordability). Inventory fell to 8.5 months' supply.

(-) The Conference Board's **index of consumer confidence** for January fell by -5.4 points to 104.1, below the 105.7 median forecast, although the Dec. number was revised a bit higher. Assessments of current conditions declined by nearly -10 points, while expectations for the future fell by -3 points. The labor differential fell by -6 points with those reporting that 'jobs were plentiful' declined a bit. The Conference Board noted the "sideways" movement of sentiment in a "narrow range" since 2022, with more recent pessimism about future employment prospects being a more recent change. Bearishness about inflation has also been rising (seemingly tariff-related), as has greater negativity reported by higher income groups, while lower income respondents have seen a sharper rise in mood.

(+) **Initial jobless claims** for the Jan. 25 ending week fell by -16k to 207k, below the little expected change of 225k. Continuing claims for the Jan. 18 week fell by -42k to 1.858 mil., well below the 1.902 mil. median forecast and reversed the jump from the prior week. Despite the effects of year-end seasonality and fires in CA, overall levels remain indicative of a healthy labor market.

Question(s) of the Week

How was the technology sector impacted by the news from DeepSeek?

U.S. stocks started off poorly on Monday as tech companies were rocked by reported advancements in artificial intelligence output from a little-known Chinese company/hedge fund called DeepSeek. The firm claimed to have built an AI LLM (large language model) at a fraction of the cost compared to the massive spend of large U.S. mega-scalers (much of the 'Magnificent 7' group). While some tech leaders initially referred to this as AI's 'Sputnik moment' potentially, later debate centered around the questionable process and origins of DeepSeek's data. (As in, how could this platform be so good for so cheap?) At face value, the initial concern was that open-source AI platforms could be built using lower-cost and less-advanced semiconductor chips and processes than is currently assumed to be the case (as opposed to only the highest-end specialized hardware sold by Nvidia, which lost nearly $600 bil. in market cap on Mon.), based on unique workaround methods that stemmed from U.S. chip bans to China. As the week wore on, though, it was found that DeepSeek results had piggybacked significantly on already-existing U.S. technologies and AI training models, rendering it more a refinement of current processes rather than reinventing the wheel, which helped markets recover a bit by the end of the week. (When 'it' was asked

about its origins during the week, well-known U.S. tools were given as the answer, which undermined the significance of the breakthrough a bit.) The accuracy of the quoted all-in cost of under $6 mil. was also questioned. Per data from The Vanguard Group and Stanford University, more than 5,500 public and private AI-related firms have been formed in the last decade; as they can't all be winners, markets continue to trudge through the process of figuring that out. Cases like this are an example of the sensitivity that financial markets are feeling for a leading single sector, especially one with richer current valuations. One result might be increased scrutiny of currently very high tech sector spending on AI hardware, software, and data center facilities in an ongoing 'arms race' of sorts felt by these firms to avoid falling behind to competitors. With so much unknown about the potential for and implementation of AI, this uncertainty may continue for some time, especially the magnitude of capital infrastructure needed. As with many new technologies, costs to users are expected to shrink over time.

What are these new tariffs on Canada and Mexico about?

The mood in financial markets soured again by Friday as the likelihood of incremental 25% tariffs on Canada and Mexico (the two largest trading partners of the U.S.). This turned into reality over the weekend, to be put into place this Tuesday, and leading to sharp declines in stock futures markets Monday morning. Canadian energy imports will be subject to a less punitive 10% rate, while an incremental 10% was also placed on Chinese imports.

While tariffs normally require Congressional approval, the President used the International Emergency Economic Powers Act, which allows the executive branch to impose these in emergency situations (described in this case as to combat immigration and drug trafficking). There will likely be a legal challenge to that authority, arguing the original legislation was not intended for more sustained policy. The President's tough persistent stance of calling for tariffs on both Canada and Mexico by the weekend were a surprise to many. Canada was quick to announce retaliatory tariffs, in addition to the social reaction of the U.S. national anthem being booed at several Canada-U.S. sporting events over the weekend (per several polls, there seems to be mixed support here as well).

The consensus expectation continues to be, ultimately, a more tempered approach toward only certain sectors and/or a delayed implementation, to provide time for negotiation and progress towards terms to be met. Early economist estimates on full effects are hazy but point to effects of up to a half-percent erosion to GDP growth for the coming quarter and a half-percent rise in PCE inflation if these remain intact on a longer-term basis. (Tariffs have tended to generate a larger one-time bump in price levels, in keeping with the tariff increase, with a less dramatic long-term impact on inflation's rate of change.) The magnitude of impact obviously depends on the length of the time they're kept in place. The general thinking is that these will be a temporary measure, but this has obviously added to market uncertainty about GDP growth, inflation, and corporate earnings looking forward. Many are asking, why are these being implemented in the first place? The administration has tied these to demands for efforts to stop the flow of fentanyl into the U.S., which has mainly been an issue with Mexico, but has also been tied to chemical precursor products shipped from China, with tariffs on Canada also imposed to retain a level of

‘fairness’ across the North American continent. It may also be a tactic to renegotiate the USMCA (successor of the earlier NAFTA) for better terms between the three countries.

While the President has also noted broader efforts to close the large trade deficits with North American countries, this thinking could carry over to other regions as well. This adds to economic uncertainty globally, with the next target being perhaps the EU (notably auto manufacturers). More directly, tariffs have tended to result in foreign currency weakening, as these adjust to become more competitive due to the weight of the tariffs, and a corresponding stronger U.S. dollar. Though, as the U.S. dollar has already been quite strong for years, considered by some as ‘overvalued,’ the impact is in question. With the exception of targeted policies for specific industries or for national security reasons, many economists tend to frown up on tariffs used in a broad-scale manner and for long stretches. Negative impacts tend to be higher prices for imported goods (ultimately borne by consumers, albeit if even a one-time adjustment) and lower economic growth (from less efficient production and trade), although these can be offset by targeted benefits for selected domestic sectors (often the point) and some degree of additional revenue generation. Then again, if tariff threats are used more as a negotiating tactic and result in minimal implementation, news like this could be a non-event.

Market Notes

Period ending 1/31/2025	**1 Week %**	**YTD %**
DJIA	0.27	4.78
S&P 500	-0.99	2.78
NASDAQ	-1.63	1.66
Russell 2000	-0.86	2.62
MSCI-EAFE	0.80	5.26
MSCI-EM	0.32	1.79
Bloomberg U.S. Aggregate	0.44	0.53

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2024	4.37	4.25	4.38	4.58	4.78
1/24/2025	4.35	4.27	4.43	4.63	4.85
1/31/2025	4.31	4.22	4.36	4.58	4.83

U.S. stocks started off poorly on Monday along with the news from DeepSeek, noted earlier, although some of the surprise faded later in the week as markets absorbed the news as being perhaps less earth-shattering as it first appeared. By Friday, concerns over North American tariffs, also noted earlier, pulled down sentiment. Sectors were mixed for the unusual week, with gains in communications, health care, consumer staples, and financials; energy and technology each fell by 3-5%, due to different drivers. Real estate was down slightly, with little change in interest rates. Earnings reports from several technology firms appeared to offer mixed results, with much of the corporate discussion focused on the promise of AI as opposed to current earnings trends. In one of the bigger weeks for U.S. company earnings, per

FactSet, just over a third of S&P 500 companies have now reported for Q4. Over three-quarters of these have noted a positive earnings surprise, and over 60% a positive revenue surprise, with the blended earnings growth rate having improved to 13.2% (which would be the best quarter since 2021 if it holds out).

Foreign stocks were mixed, with gains of a percent in the U.K. offset by declines in Europe, Japan, and emerging markets—despite a rise in the value of the U.S. dollar generally. Earnings results were decent, and the European Central Bank cut interest rates by -0.25% due to subdued economic growth, as did the Bank of Sweden, and Bank of Canada, with the latter largely due to the fear of U.S. tariffs. In EM, the Brazilian central bank raised rates by 1.00%, to combat ongoing inflation, which prompted a 4% rise in stocks. Chinese stocks also gained (at least in offshore terms, as the bulk of domestic markets were closed for the Lunar New Year), offsetting declines in Mexico and South Korea, with a variety of influences such as tariffs for the former and AI-related concerns as noted earlier for the latter. As markets are quick to adjust to new realities, a typical reaction to tariffs is currency devaluation to one degree or another, which can at least partially offset the impact of the new higher costs of those exports.

Bonds were slightly higher as interest rates across the U.S. Treasury yield curve fell back just slightly. Traditional governments and investment-grade corporates gained, while high yield and floating rate were little changed. Foreign bonds were mixed, as the U.S. dollar rose about a percent.

Commodities were mixed to lower for the week, with gains in precious metals and agriculture offsetting declines in energy and industrial metals, much of which was due to concerns over the net currency-translated impact of tariffs and the strengthening of the dollar. Crude oil prices fell by -3% last week to $74/barrel.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.