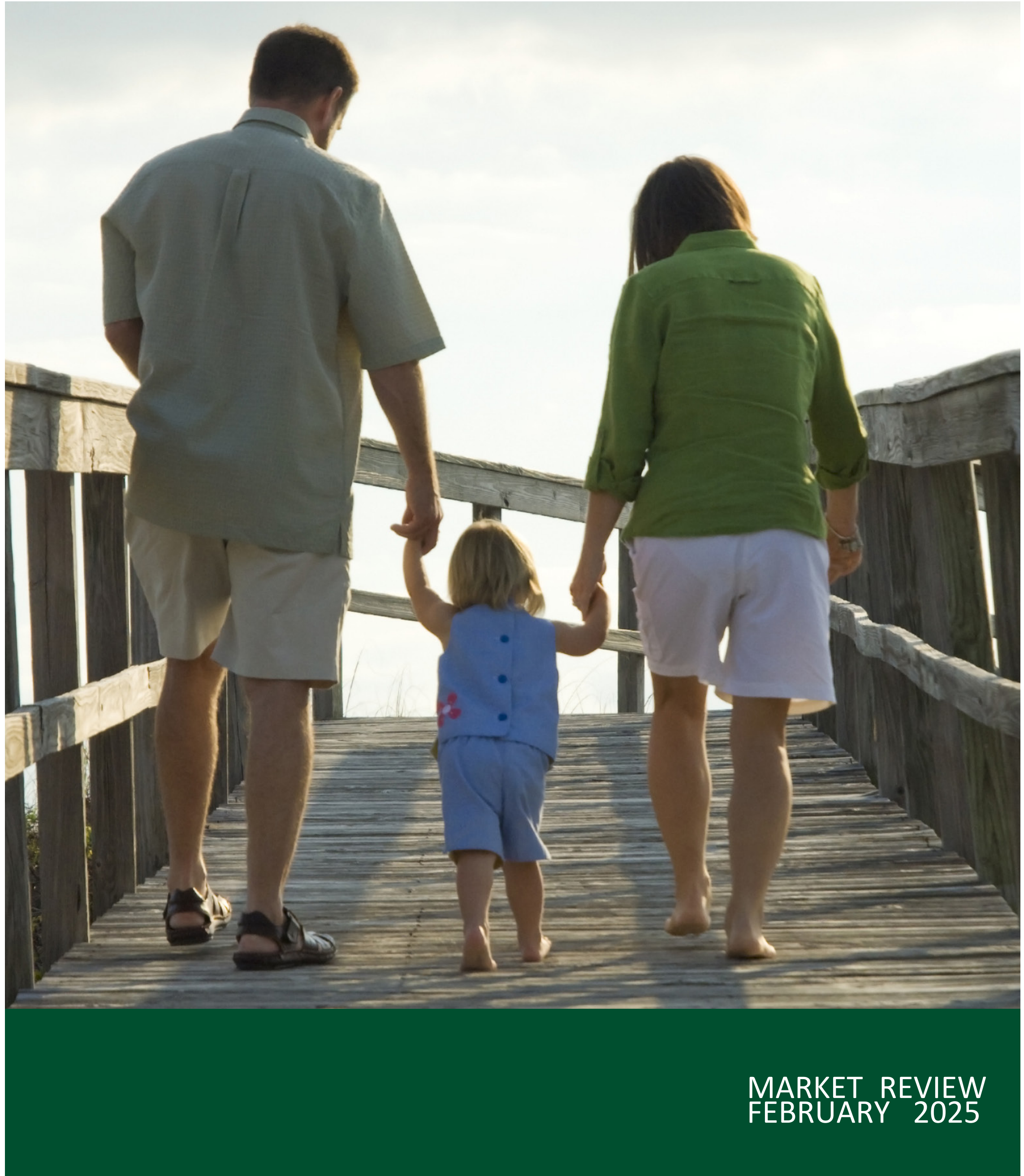

MARKET REVIEW
FEBRUARY 2025

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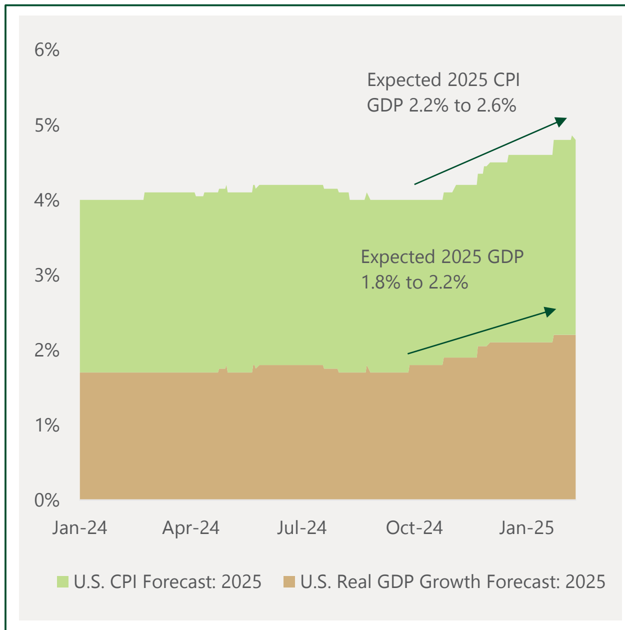
Growth and Inflation Forecasts Creep Higher

GDP and Consumer Price Index Expectations



Source: Bloomberg. Past Performance does not guarantee future results.

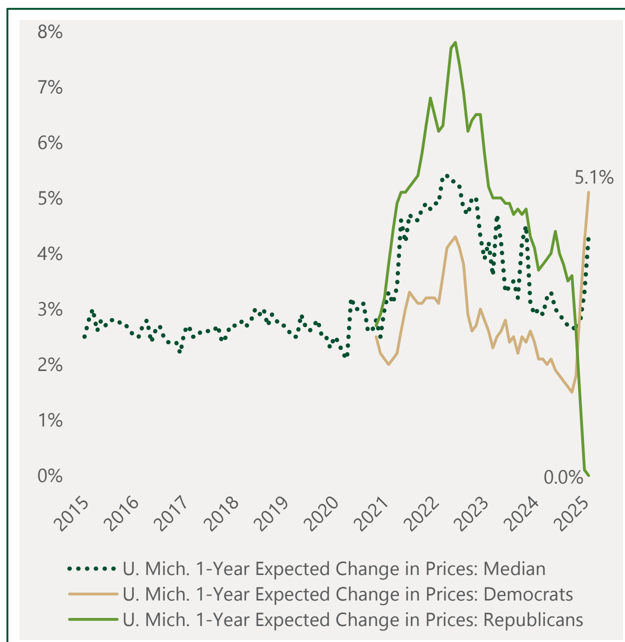
According to the median estimate in an early-February Bloomberg survey of economic forecasters, U.S. gross domestic product (GDP) is expected to grow at a clip of 2.2% in 2025. This is up from a forecast of 1.8% growth in October. Real GDP growth of 2.2% this year would mark a deceleration from 2.5% in 2024 and 3.2% in 2023. Yet, it would still be above the 1.5%-2% long-term potential growth rate cited by a majority of economists.

Current expectations are for the consumer price index (CPI) to climb 2.6% in 2025, up from a forecast of 2.2% in October. An increase of 2.6% in the headline measure of consumer prices would be a downshift from 2.9% in 2024 and 3.4% in 2023. But it would still be above the Federal Reserve's stated target of 2% average annual inflation over an economic cycle. Year-over-year CPI has not been below 2% since February 2021.

The combination of expectations for stronger growth and higher inflation in 2025 compared to four months ago could be influenced by the Trump administration's policy priorities, including deregulation, tax-cut extensions, tariffs, and stricter immigration controls.

Inflation Views Diverge Sharply

Consumer Expectations for 1-Year Inflation by Political Party



Source: Bloomberg Economics. Past Performance does not guarantee future results.

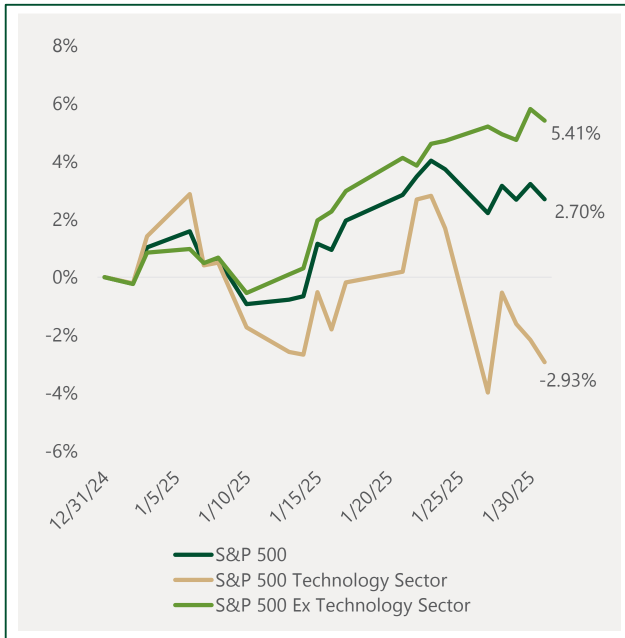
The preliminary University of Michigan consumer sentiment index reading for February (released February 7) was weighed down by a sharp jump in 1-year inflation expectations to a 16-month high of 4.3% from 3.3% the prior month (see dotted line in the accompanying chart). Elevated uncertainty around the potential impact on prices of the Trump administration's tariff agenda seemed to drive the upward shift in inflation expectations.

A glaring gap emerged between the expectations for inflation over the next year from survey respondents who said they are affiliated with the Democratic party (5.1%) and those affiliated with the Republican party (0.0%). Just eight months ago, the roles were reversed, with Republicans expecting 4.4% inflation over the next 12 months compared to 1.9% for Democrats.

Encouragingly, long-run (10-year) expectations for inflation in the University of Michigan survey only ticked up slightly to 3.3% from 3.2% in January. This suggests that while consumers may expect an acceleration in the level of prices during 2025, elevated inflation is likely to cool off in following years.

Strong Start to the Year Ex Technology

January 2025 Performance



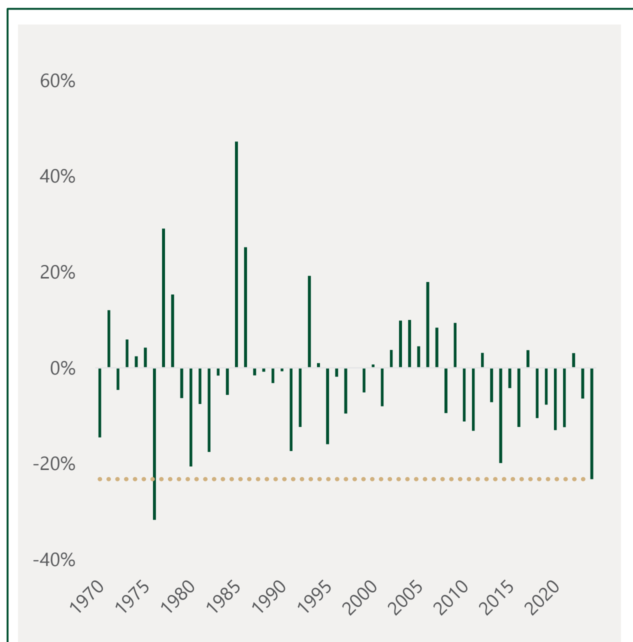
Source: Morningstar. Past Performance does not guarantee future results.

The U.S. stock market began the year on a strong note despite intermittent volatility. The S&P 500 posted a monthly gain of 2.78%, marking its 9th monthly advance over the past year. January's performance was led by the communications, healthcare, and financials sectors, which posted gains of 9.12%, 6.79%, and 6.56%, respectively. A strong start to fourth quarter earnings reporting season supported stocks and contributed to better equity market breadth.

Technology was the only S&P 500 sector with a monthly decline as the disruptive news of China's DeepSeek AI model efficiency raised concerns about the need for U.S. technology companies massive spending on data centers for AI computing. NVIDIA (NVDA) was a notable laggard with a 10.59% decline in the month. Despite the concerns about AI spending, mega cap technology companies recently confirmed their plans to spend significantly more on their data center buildout this year because AI demand exceeds their current computing capacity. The combined capital expenditure forecast from Microsoft (MSFT), Amazon (AMZN), Alphabet (GOOGL), and Meta (META) exceeds $300 billion this year, an annual increase of more than 30%.

Europe Lags U.S. By 2nd Largest Annual Gap in History

MSCI Europe Annual return vs S&P 500



Source: Morningstar. Past Performance does not guarantee future results.

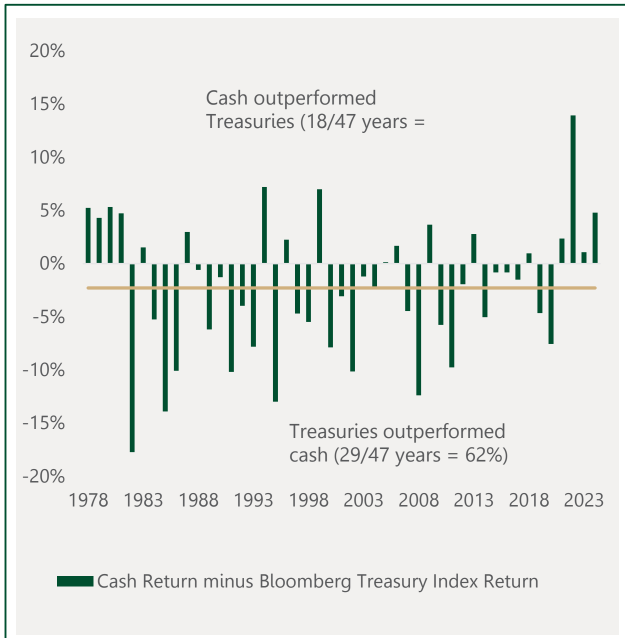
European stocks rebounded in January following three consecutive monthly declines and a challenging 2024. The MSCI Europe index's 23.23% underperformance versus the S&P 500 last year (1.79% vs 25.02%) was its second-largest annual underperformance in history behind 1976. The MSCI Europe index recouped some of its recent underperformance with a 6.89% gain last month, its largest monthly outperformance versus the S&P 500 since December 2022.

Europe's outperformance was mostly attributed to having less technology exposure relative to U.S. stock indexes. The MSCI Europe index has less than 8% weight in the technology sector, well below the S&P 500's 32% weight in the sector. Europe's performance last month was less impressive compared to the S&P 500 ex-technology's 5.41% gain.

European stocks also received some support from hopes that recent economic data might be tentatively signaling a slight improvement in Europe's stagnant economy. The HCOB Eurozone Composite Purchasing Managers' Index (PMI) showed that business activity returned to positive growth in January for the first time since last August. The modest upturn was driven by the Manufacturing PMI's nearly three-year contraction easing to its best level in nine months.

Cash Tops Treasury Index Four Years in a Row

1-Month U.S. T-Bill vs. Treasury Index: 1978-2024



Source: Bloomberg. Past Performance does not guarantee future results.

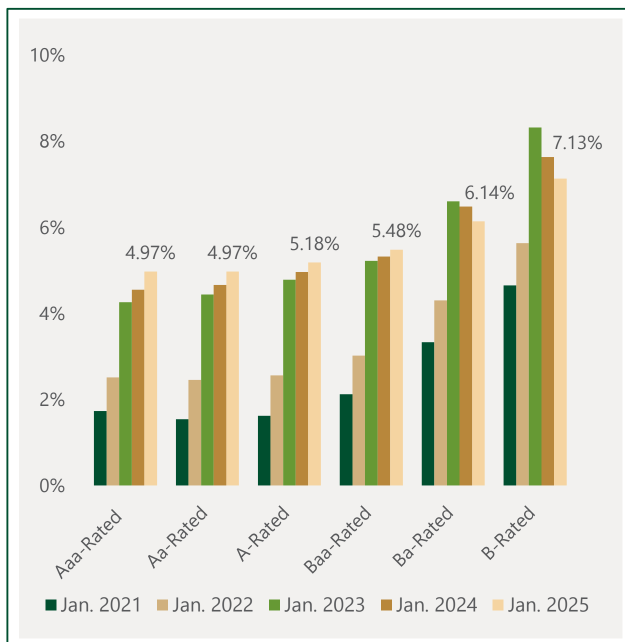
Cash (as proxied by an index of 1-month Treasury bills) outperformed a broad index of U.S. Treasuries in four consecutive years (2021-2024) for the first time since the 1978-1981. The origins of this four-year dominance of cash can be found in the historically-low interest rates of 2020-2021 and the aggressive Fed rate-hike campaign of 2022-2023.

Coming out of the 1978-1981 period, a broad index of U.S. Treasuries outperformed cash in four of the next five years and eight of the next ten years as interest rates trended lower throughout the 1980s. Higher starting yields and a shift in the Federal Reserve's policy bias toward easing could make it difficult for cash to continue outpacing the broad U.S. Treasury market in 2025 and beyond.

Over the 47 years shown in the accompanying chart, U.S Treasuries generated better returns than cash 62% of the time. Treasuries outperformed cash by an average of 2.29% per year during this nearly five-decade stretch.

Corporate Credit Yields Remain Attractive

Yields-to-Worst by Credit-Rating Groups: 2021-2025



Source: Bloomberg. Past Performance does not guarantee future results.

Investors can access annual yields between 4.9% and 5.5% across most of the investment-grade corporate bond universe. As of January 31, the yield-to-worst (YTW) on an A-rated Bloomberg Index of U.S. corporate bonds was 5.18% compared to yields between 4.35% and 4.55% in the 5-to-10-year portion of the U.S. Treasury yield curve. YTW is a measure of the expected annualized yield of a bond or group of bonds held to maturity, adjusted for the impact of call features.

Corporate issuers have generally enjoyed strong demand for their new debt as investors remain comfortable with trends in earnings growth, leverage, and interest coverage. The current demand for yield from high-quality corporate bonds seems likely to persist in 2025.

Today there is less additional yield available to investors to by going down the quality spectrum. At the end of January, the YTW of a B-rated index (7.13%) was about 195 basis points (bps) above an A-rated index (5.18%). One years ago, the YTW of a B-rated index (7.63%) was 267 bps higher than the A-rated index (4.96%)