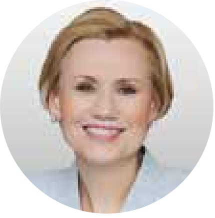
Chinese stocks surge, concerns about US inflation grow

Weekly Market Compass | February 20, 2025



Kristina Hooper
Chief Global Market Strategist

Key takeaways

Chinese equities

Chinese stocks have had attractive valuations for years, but the appearance of some important catalysts has sparked a rally.

US inflation

Expectations for US inflation have risen, and the Federal Reserve has historically paid attention to these key indicators.

10-year US Treasury yield

My base case is that the 10-year yield won't pierce 5% this year, although I do think we will see some volatility given increased uncertainty.

We're more than halfway through the first quarter, and it seems that clients have more questions by the day as the news flow intensifies. The rise in Chinese stocks, concerns about US inflation, and the direction of 10-year US Treasury yields are among the things we'll be watching as we head into the back half of the first quarter — and beyond.

Chinese equities

Chinese stocks have been on a tear this year, continuing their strong performance that began later in 2024.[1] Year-to-date as of Feb. 14, the MSCI China Index has risen 13.9%, dramatically outperforming the MSCI USA Index's 4.4% gain.[2]

One initial catalyst for last year's rally was significant stimulus from Chinese policymakers. In recent weeks, the rally was largely driven by excitement around DeepSeek's artificial intelligence (AI) advances. My colleague Raymond Ma has argued that various benefits brought by DeepSeek — higher efficiency, cost savings, stronger computing power and a much lower barrier for various industries to use AI — could benefit many Chinese companies and cause a re-rating of Chinese stocks. I couldn't agree more.

And it's not just DeepSeek. It's also companies such as BYD, which has caused a paradigm shift for electric vehicles. Chinese companies are moving up the value-added chain and offering very competitive products in some industries. Chinese stocks have had attractive valuations for years, but the appearance of these important catalysts has made the difference. Chinese stocks, especially Chinese tech stocks, could have a long runway, in my view.

US Inflation expectations

There is growing concern about a resurgence in US inflation. One way to gauge that risk is through inflation expectations. There are two kinds: survey-based and market-based.

Survey-based

There are several different surveys that capture what consumers expect in terms of future inflation. This is important because the Federal Reserve (Fed) pays attention to these surveys and has been known to act on them. As I've previously noted, there has been a large jump in consumer inflation expectations in the University of Michigan Survey of Consumers. We haven't seen as big a jump in the New York Fed Survey of Consumer Expectations, which showed that consumer inflation expectations for January were unchanged at 3.0% for the one-year ahead and three-year ahead periods.[3] However, inflation expectations for five-years ahead rose by 0.3 percentage points to 3.0%, which is material. Ditto for Conference Board consumer inflation expectations. For one year ahead, they rose from 5.1% in December to 5.3% in January.[4]

Consumer inflation expectations are particularly important because they can become a self-fulfilling prophecy. If a consumer expects prices to go up enough in the next year, they are likely to purchase an item now, thereby helping to drive up the price of the item because of increased demand for it.

Market-based

One key indicator is the spread between yields for Treasury Inflation-Protected Securities (TIPS) and Treasuries of the same maturity, which is called the breakeven rate of inflation. Five-year breakeven inflation has risen significantly in the last several months, from 1.86% on Sept. 6, 2024 (just as US President Donald Trump began climbing in the polls) to 2.62% on Friday.[5]

We will want to pay close attention to market inflation expectations and consumer inflation expectations because they matter to the Fed. In June 2022, for example, the Fed signaled in advance of the Federal Open Market Committee meeting that it would likely hike rates by 50 basis points, and then it surprised markets by hiking rates 75 basis points. When asked in the press conference what had altered the Fed's course, Chair Jay Powell said a few recent data points had changed the Fed's mind, including the Consumer Price Index and University of Michigan inflation expectations. So, especially as some investors worry that the Fed will stay on pause this year — or even hike rates — it's important for us to pay attention to inflation expectations for clues about what is to come.

The 10-year US Treasury yield

The 10-year US Treasury yield has been the focus of a lot of interest this year, with many wondering if it will rise to the psychologically disturbing 5% level. Interest in it has only risen since US Treasury Secretary Scott Bessent indicated that the Trump administration will focus on bringing down the 10-year yield rather than trying to push the Fed to cut rates on the short end. In the last week, Trump seemed to suggest a similar sentiment, posting "Interest Rates should be lowered, something which would go hand in hand with upcoming Tariffs!!! Lets Rock and Roll, America!!!"[6]

As I've said before, I don't believe the 10-year US Treasury yield will climb much higher — unless there is a resurgence in inflation or concerns about the fiscal deficit grow and bond vigilantism takes hold. This of course will depend on the Trump administration's policy agenda and execution. There has definitely been a focus on cost cutting, but it is dramatically different than the Simpson-Bowles Commission's approach. Thus far investors seem to be comfortable with the current strategy, although I am seeing some skepticism about how much money will truly be saved. We could also see heightened nervousness about fiscal spending when the spotlight falls on attempts to raise the debt ceiling by $4 trillion.

Having said that, my base case is that the 10-year yield won't pierce 5% this year, although I do think we will see some volatility in the yield given increased uncertainty. I do think there could be periods where concern over fiscal deficits moves the yield higher, but not dramatically higher. We want to follow the 10-year Treasury yield closely because historically it has had a significant impact on stocks, with higher valuation stocks typically coming under pressure when the 10-year US Treasury yield has risen.

Cracks in the US economy

A recession is certainly not my base case for 2025. However, we have said since the Fed began its aggressive tightening cycle that we need to look carefully for signs that the tightening has materially damaged the US economy. Thus far it hasn't happened. However, mass layoffs of federal workers have begun, and some high-profile companies have announced substantial layoffs. This could be a significant problem for the economy given that Fed Chair Powell already flagged low job growth as a concern if layoffs were to increase.

We will want to follow the situation closely, especially as consumer sentiment has declined recently. I think it's important to note several findings from the most recent NY Fed Survey of Consumers. First of all, median household spending growth expectations declined to the lowest level since January 2021. And the survey showed the mean perceived probability of losing one's job in the next 12 months increased by 2.3 percentage points to 14.2% in January.[7]

The price of gold

Gold has rallied year-to-date, hitting new highs.[8] This is the continuation of a longer-term rally and has been fueled by several different drivers. Geopolitical uncertainty — driven by concerns about a tariff war created by the US — has driven demand for gold's "safe-haven" qualities. Other demand drivers include concerns about excessive fiscal spending in the US, price-insensitive central bank buying, and more vehicles for investors to purchase gold. In the US, Costco began selling physical gold bars to customers in 2023; Wells Fargo estimated in April 2024 that Costco was selling up to $200 million in gold bars each month.[9] A new gold ETF launched in India recently, and Chinese authorities are now permitting insurance companies to invest in gold.

Of course, gold prices could ease if central banks start purchasing less and/or a peace deal in Ukraine comes to fruition. But from my perspective, the direction of travel for the price of gold is most likely up given that the European Union would likely feel threatened and perceptions of geopolitical risk could even rise as a result of any peace deal negotiated exclusively between the US and Russia.

The direction of the stock market

I've had a number of clients marvel at the intestinal fortitude of stock market investors, who have overlooked all the tumult going on in the US and continue to send stocks higher. They whisper, "When is the stock market finally going to become unhinged and sell off?"

The answer is: We don't know. The stock market has a way of ignoring risks and then suddenly reacting to them in a rather dramatic way — we've seen this before when it comes to high valuations. However, for those with a long time horizon, this is rather irrelevant — it's all about staying the course. And in fact, the AAII Bull/Bear Sentiment reading, generally viewed as a contrarian indicator, suggests a US stock rally could gain momentum. Bearish sentiment has risen from 29.4% right after the US presidential inauguration to 47.3% last week. Bearish sentiment is unusually high, well above its historical average of 31.0%.[10] Bearish sentiment was last higher on Nov. 2, 2023, at a whopping 50.3%.[10] Interestingly, late October 2023 saw the start of a strong stock market rally.[11]

Pair-wise correlations

We have seen a significant decrease in pair-wise correlations for the S&P 500 Index. Pair-wise correlations are a measure of how closely correlated individual stocks within an index are to each other; in other words, it indicates how much stocks move in tandem with each other.

Generally, higher pair-wise correlations suggest less opportunity for stock picking. Conversely, a decrease in pair-wise correlations suggests that it may be a good time to be a stock picker. As Standard & Poor's noted, "Correlations within and across equity markets continued near historical lows and the associated diversification effects have played a significant part in dampening both realized and implied index volatility."[12] This suggests active management will be increasingly important.

Looking ahead

This coming week, we will still be getting earnings. We will also get the FOMC meeting minutes from January and a few central bank decisions. I will also be interested in seeing the University of Michigan Survey, which comes out this Friday.

Dates to watch

Date	Report	What it tells us
Feb. 18	UK Unemployment	Indicates the health of the job market.
	Eurozone ZEW Economic Sentiment	Measures economic sentiment in the eurozone for the next six months.
	Canada Consumer Price Index	Tracks the path of inflation.
	Reserve Bank of New Zealand Monetary Policy Decision	Reveals the latest decision on the path of interest rates.
Feb. 19	UK Consumer Price Index	Tracks the path of inflation.
	UK Producer Price Index	Measures the change in prices paid to producers of goods and services
	Federal Open Market Committee Meeting Minutes	Gives further insight into the central bank's decision-making process.
	Australia Unemployment	Indicates the health of the job market.
Feb. 20	Germany Producer Price Index	Measures the change in prices paid to producers of goods and services
	US Leading Economic Indicators Index	Provides an early indication of significant turning points in the business cycle and where the econo my is heading in the near term.
	Japan National Core Consumer Price Index	Tracks the path of inflation.
	Japan Manufacturing and Services Purchasing Managers' Index (preliminary)	Indicates the economic health of the manufacturing and services sectors.
Feb. 21	UK Retail Sales	Indicates the health of the retail sector.
	Eurozone Manufacturing and Services Purchasing Managers' Index (preliminary)	Indicates the economic health of the manufacturing and services sectors.
	UK Manufacturing and Services Purchasing Managers' Index (preliminary)	Indicates the economic health of the manufacturing and services sectors.

Dates to watch

Date	Report	What it tells us
Feb 21	Reserve Bank of India Monetary Policy Committee meeting minutes	Gives further insight into the central bank's decision-making process.
	Canada Retail Sales	Indicates the health of the retail sector.
	US Manufacturing and Services Purchasing Managers' Index (preliminary)	Indicates the economic health of the manufacturing and services sectors.
	US Existing Home Sales	Indicates the health of the housing market.
	University of Michigan Survey of Consumers	Provides indexes of consumer sentiment and inflation expectations.

With contributions from David Chao

Notes

[1]Source: Bloomberg, as of Feb. 14, 2025. The MSCI China TR Index (USD) returned 15.61% between July 31, 2024, and Dec. 31, 2024

[2]Source: MSCI, as of Feb. 14, 2025

[3]Source: New York Federal Reserve Bank Survey of Consumer Expectations, Feb. 10, 2025

[4]Source: Conference Board, as of Jan. 28, 2025

[5]Source: Bloomberg, as of Feb. 14, 2025

[6]Source: Truth Social post by President Trump, Feb. 12, 2025

[7]Source: New York Federal Reserve Bank Survey of Consumer Expectations, Feb. 10, 2025

[8]Source: Bloomberg, as of Feb. 14, 2025. Gold spot prices closed at a record high of $2928 per ounce on Feb.13, 2025.

[9]Source: Wells Fargo, April 2024

[10]Source: AAII Investor Sentiment Survey, Feb. 12, 2025

[11]Source: Bloomberg, as of Feb. 14, 2025. The S&P 500 Index returned 16.21% between Oct. 27, 2023, and Dec. 31, 2023

[12]Source: S&P Dow Jones Indices, Index Dashboard: Dispersion, Volatility & Correlation, Jan. 31, 2025

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

Fluctuations in the price of gold and precious metals may affect the profitability of companies in the gold and precious metals sector. Changes in the political or economic conditions of countries where companies in the gold and precious metals sector are located may have a direct effect on the price of gold and precious metals.

The American Association of Individual Investors' AAII Investor Sentiment Survey offers insight into the opinions of individual investors by asking them their thoughts on where the market is heading in the next six months.

The New York Fed's Survey of Consumer Expectations is a nationally representative, internet-based survey of a rotating panel of approximately 1,300 household heads.

The Survey of Consumers is a monthly telephone survey conducted by the University of Michigan that provides indexes of consumer sentiment and inflation expectations.

The Conference Board's US Consumer Confidence Survey® is published monthly, based on a survey of US consumers' buying attitudes and buying intentions.

The Consumer Price Index (CPI) measures the change in consumer prices and is a commonly cited measure of inflation.

The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips, and foreign listings (e.g., ADRs).

The MSCI USA Index measures the performance of the large- and mid-cap segments of the US market.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

A basis point is one-hundredth of a percentage point.

Breakeven inflation is the difference in yield between a nominal Treasury security and a Treasury Inflation-Protected Security of the same maturity.

Correlation is the degree to which two investments have historically moved in relation to each other.

Dispersion measures the degree of uncertainty, and thus risk, associated with a particular security or investment portfolio.

Diversification does not guarantee a profit or eliminate the risk of loss.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

The Federal Open Market Committee (FOMC) is a committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

Inflation is the rate at which the general price level for goods and services is increasing.

The short end of the yield curve refers to bonds with shorter maturity dates.

Spread represents the difference between two values or asset returns.

Tightening monetary policy includes actions by a central bank to curb inflation.

Treasury Inflation-Protected Securities (TIPS) are US Treasury securities that are indexed to inflation.

The opinions referenced above are those of the author as of **Feb. 18, 2025**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.