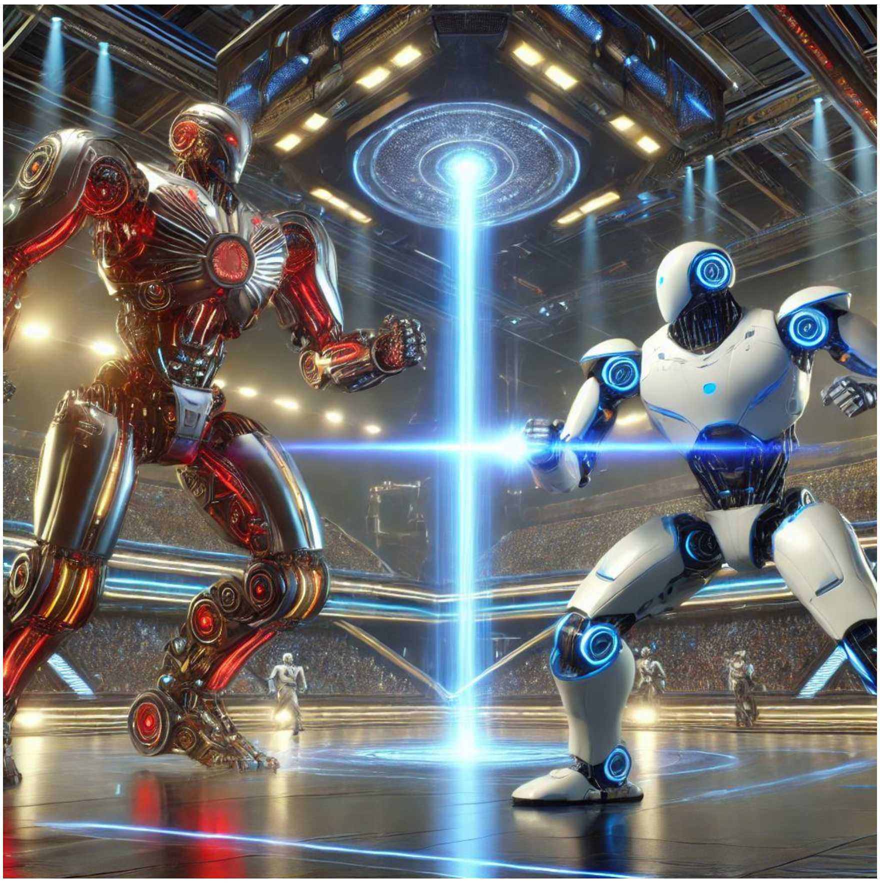
Deepseek challenges US AI Supremacy

The most significant event of the week was the emergence of DeepSeek, a Chinese rival to ChatGPT, of its latest, free to use, Chatbot. This was allegedly launched at a cost of just USD5.6m, which is a drop in the ocean compared to the cost of other AI Chatbots, such as ChatGPT and Google's Gemini. This is because it uses fewer advanced chips than its American counterparts, despite a US ban on exports of these advanced chips to China.

The latest version of the Deepseek was actually launched on the 20th of January, but within a week it became the number one download on Apple Store and the investment world started to take notice.



The most obvious initial shock was with Nvidia's share price, whose 17% drop marked the biggest one-day loss of capital (close to $600bn) in history. Broadcom, the other big US chipmaker, also fell by 17%.

With an AI using fewer advanced chips this also had a ripple effect on company's that build data centres (where the actual chips live). This also throws into question the push from governments to build data centres to try to compete in the hotly contested AI boom.

Speaking of tech, three of the largest tech companies reported later on in the week, perhaps giving a sense of solid figures amongst the speculation. Microsoft lost 4% on the results with markets musing on the outlook for the company's cloud business. Meta, however increased by 4% with the market generally please about the earnings report. Apple (now the world's largest company after Nvidia's difficult week) also reported a strong quarter overall, despite revenue from China falling. So following a general mad Monday so far it is business as usual for America tech.

In other news, the divergence of Central Bank policy continues with a marked difference in stance by the US Federal Reserve and the European Central Bank, where the former opted to maintain the official policy rate in the US at 4.25% - 4.5%, whilst the ECB chopped another 25 basis points (or 0.25%) of its rate, bringing it down to 2.90%.

The Bank of England is widely expected to follow in the ECB's steps next Thursday by also taking 0.25% of its policy rate, bringing it down to 4.5%.

This divergence has two main drivers behind it. For the US, their economy has been very resilient with robust GDP growth, a strong labour market and all other indicators showing that not only is recession highly unlikely, but that reacceleration is now the base case. On top of that we have a newly inaugurated President whose policies by their very nature are inflationary.

As a result, the independent Federal Reserve has taken the view that the economy doesn't need any stimulus right now and in fact action to curb inflation again may be necessary sooner rather than later.

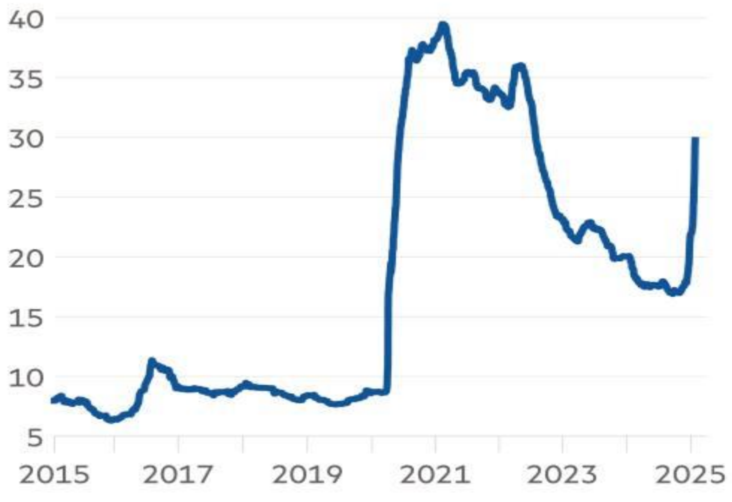
For Europe the opposite is true where the economy is weak and growing weaker, with growth at best, anaemic and inflation, whilst not quite whimpering in a corner, certainly nowhere near the problem it once was.

Similarly, the UK is suffering from poor growth and productivity, and whilst inflation remains elevated above European levels, the need to boost the economy trumps (excuse the pun) any fears of inflation.

This divergence also produces another contradiction; President Trump berated the Federal Reserve and indeed all other Central Banks for interest rates being "too high, everybody knows it, they're the highest in history" and he said this because he knows that the USD strength is giving everybody else the opportunity to export cost effectively to the US / buyers in the US the opportunity to buy foreign goods cheaper.

The paradox is that his solution to this is to impose (or at least threaten to impose) tariffs, which are beyond any doubt inflationary, which is likely to cause the Federal Reserve to increase rates rather than reduce them. This is yet another paradox that doesn't seem to trouble the whirring of the President's mind.

Within the market volatility, and further tariff threats, the gold price hit an all-time high on Friday. Robert Armstrong of the Financial Times wrote a piece analysing the large shift of physical gold from London to New York. The graph below shows Comex (the US exchange) gold inventories:

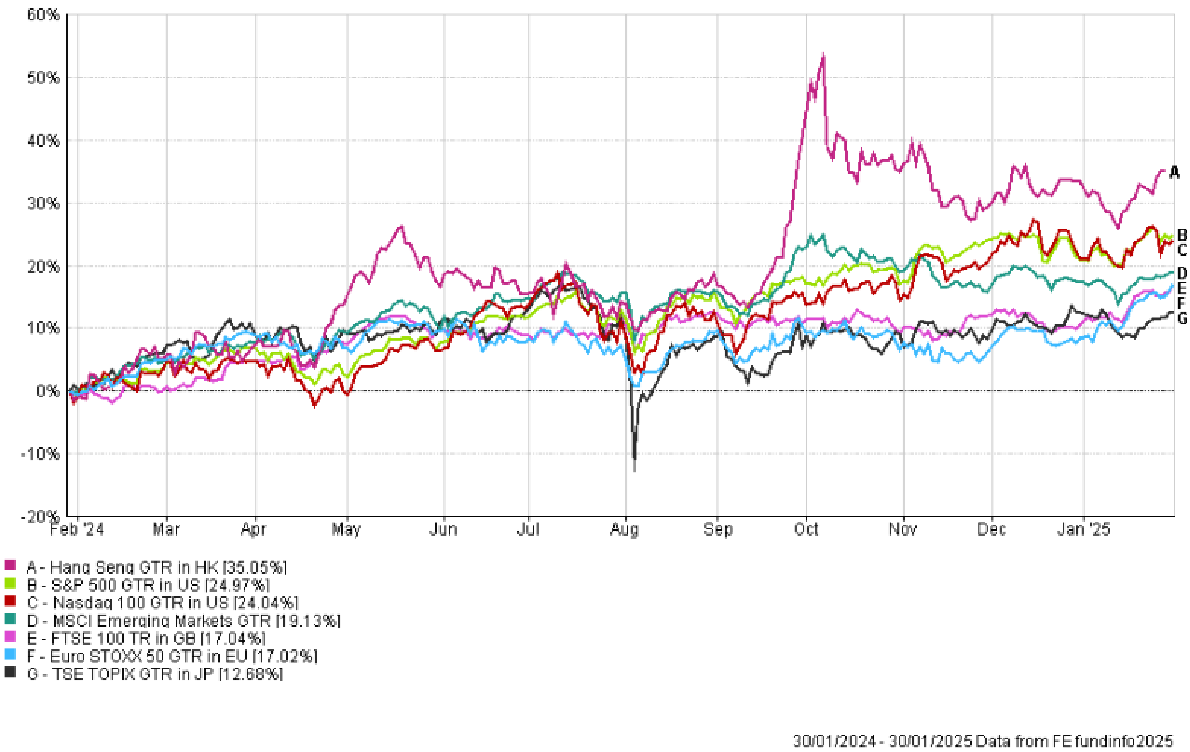


Source: Comex

The incredible thing is how the gold is moved. He spoke with John Reade, a market strategist at the World Gold Council, who explained that financial investors often take long futures positions, which are usually settled in New York. However, banks hold offsetting long positions in London which can result in the need to move the gold at the end of the contract. The physical settlement of gold requires different bar sizes in London (400oz) and the US (100oz or 1kg bundles), necessitating conversion at Swiss refineries. So the gold is flown from London to Switzerland, melted down, recast and then flown to New York. There was a spike in 2020 as the pandemic disrupted this process, causing a rush to buy gold in New York and driving up prices.

Where are markets up to?

The rolling 12 month % cumulative returns in local currency from various indices is shown in the following chart:



Where are the portfolios up to?

The portfolio performance, net of fees, to close of business on Thursday is as follows:

	1 week	1 month	3 months	12 months
Cautious	-0.47%	+2.07%	+3.12%	+7.75%
Balanced	-0.77%	+2.57%	+4.13%	+10.17%
Adventurous	-1.06%	+2.57%	+4.39%	+11.02%

As ever, if you would like to discuss any aspect of your portfolio, please do not hesitate to contact us on service@blythefinancial.com.