



FEBRUARY 2025

The Institutional Strategist
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GLOBAL MARKETS

EQUITY & FIXED INCOME MARKETS

MARKET THEMES AND STOCKS

Featured This Month:

AMERICA'S EQUITY MARKET
**THE DEEP(SEEK) SELLOFF AND THE
DEEPSEEK DRAMA**

EUROPEAN EQUITY MARKET
EUROPEAN OUTLOOK — FEBRUARY 2025

ASIAN EQUITY MARKET
CHINA UPDATE

by TIS Group, Inc.
Editor, Larry Jeddelloh
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TIS Group, Inc.
100 Village Center Dr, Ste 260
North Oaks, MN 55127

Contact:Larry Jeddeloh
E-Mail:tis@tisgroup.net
Telephone: (651) 379-5070
Toll free within U.S./Canada
.....866-527-8698
Fax: (651) 379-5080

PURPOSE:

The Institutional Strategist is a third party, independent, monthly publication, covering geonomics, global stock markets, interest rates, market themes, and currency trends. Our purpose is to present non-consensus, timely analysis designed to call major “turns” and to assess various forms of global risks.

COVERAGE:

Each month we assess investment/ economic risk across major asset classes, and analyze geo-political developments in the world’s top economies and financial markets.

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I. GLOBAL INVESTMENT STRATEGY (EXECUTIVE SUMMARY) I-14

A. MAJOR MARKET THEMES

US

- ▶ Major shifts in US government spending, taxes, regulation and political realignments are coming. What will not change is the direction of tariff policy, up, accompanied by lower tax rates.
- ▶ Another “health-related crisis”, an energy supply problem, a cyber crisis, or expansion of the Mideast / Ukraine wars, would be very damaging for the economy and stocks. Any of these events would also provide the impetus for additional temporary government spending. So too would a 10%-20% equity correction.
- ▶ Great Society 2 spending and Ukraine / Gaza war spending were dominant US policy. It’s over. Inflation has been one of the by-products. The actual inflation rate “feels” higher than reported and according to Shadowstats, is nearer 10% than 3%. Could inflation come down as DOGE reforms government?
- ▶ DOGE estimates are around \$1-2 trillion in savings – a major reduction in government costs.
- ▶ The Fed will continue to have difficulty dealing with inflation as sanctions, embargos and a lack of cap-ex for many years in energy and infrastructure remain problems for the supply side. A supply side economic plan would help but it is not on the horizon, except in energy. An important development is a request by ISDA to the Fed to reduce the SLR on Treasuries to 0% from 5%.
- ▶ Approval would help stabilize the bond market.

EUROPE

- ▶ Europe and EM stocks are cheap vs US stocks. European banks have recently been huge outperformers vs US banks and valuation differentials between Europe, the UK and the US are at attractive levels. Relative performance of Europe vs the US should improve, especially if value investing returns to favor. European small caps are cheap.
- ▶ The out-of-the-box factor for European equities is a sudden end to the Ukraine War which is now under discussion according to Trump and Putin. How involved Europe is in the process will be telling. A ceasefire with a solid peace plan to back it up could be very bullish for Europe. What that means for European energy is as yet unclear.
- ▶ Consensus across Europe is the strong start to the year will soon begin to correct without meaningful fundamental and political changes to address long-term structural deficiencies. The charts suggest otherwise and with changes brewing politically (e.g., a new German coalition) and an underlying push to federalize the continent, Europe can become a very interesting trade.
- ▶ Fundamental limitations cannot be ignored though for the longer term. A lack of energy security at a time when the rest of the world is racing forward with energy hungry A.I build-outs risks that the EU will not be part of that race. The US is pushing for 5% of GDP to be spent on defense as the ECB is very close to the neutral rate meaning that assistance from monetary policy will become more limited putting increased pressure on the politicians to deliver.

CHINA

- ▶ Expansionary fiscal and monetary measures will be announced after the NPC meeting in March. This will probably include the development of key infrastructure projects and policies to stimulate consumer spending.
- ▶ The announced post-NPC meeting policies should lead to rising employment (infrastructure projects are labor intensive) and thus further improving consumer spending.

- ▶ Consumer confidence will return slowly as the housing market whilst not resolving its debt crisis is being cauterized at least and by policies issued post the NPC meeting in March.
- ▶ A tariff / sanctions agreement between China and America won't be so tough as to stopping growth but tough enough to satisfy the Washington hawks.
- ▶ President Trump will attempt to split China away from Russia by offering China a dual alliance with America that would make the duo the global economic powerhouse. Will it succeed? Doubtful given America's intentions over Russia first followed by China.
- ▶ China's consumer spending which has averaged 10.4% a year since, should rebound in the second half of the year.
- ▶ Inflation will also rebound in 2nd half 2025 because of rising food and raw material prices. These two items will feed through the inflation system. Interest rates will therefore recover.
- ▶ The currency is close to bottoming out against the US Dollar at 7.36 and should continue to strengthen to around 6.5 by end-2026, eventually to 5.0 by 2030.
- ▶ China's deflation is the result of a positive supply shock as credit has been redirected from property into advanced manufacturing. Prices in China are amongst the cheapest in the world because of the country's highly efficient supply chains and automated factories. Aggregate supply has risen but prices have fallen.
- ▶ Average per capita disposable income was RMB 41,314 which increased by 5.3% in 2024 according to NBS.
- ▶ China's deflation has been a bonus for consumers; their average disposable income has gone further by RMB 1231.
- ▶ This is how the future battle lines are growing: G7 versus the EM world, or in other words BRICS versus G7. Whoever wins this battle will gain the world throne.

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III. GLOBAL MARKET MODELS

**Global Asset Allocation
USD Reference Currency**

Conventional Allocation		% of Total
CASH	USD	7%
STOCKS	US (20%), Europe (0%), Japan (7%); India (5%), Greece (1%), Argentina (1%)	34%
	Hang Seng Index (HSI)	5%
	Gold Miners in Australia, Canada, US	3%
	India Small Caps	2%
	US Treasuries (2-Year 15% and 10-Year 10%)	25%
* ALTERNATIVES	US TIPs	10%
	Energy Basket (US & Canada)	5%
	US Defense Basket	4%
	Grains (3%)	3%
	Uranium	2%
TOTAL		100%

Unconventional Allocation (Tactical)		% of Total
CASH	Cash (USD)	10%
STOCKS	TIS Energy Security/Infrastructure Basket: LNG, GLNG (3%), NFE (2%), SM Energy (2%), Occidental Petroleum (OXY) formerly Anadarko Petroleum Stock (2%)	12%
	European Equities: EuroStoxx 50 (7%), German Mid-Caps MDAX (3%)	10%
	Russell 2000 (IWM)	10%
	VIX	7%
	Wheaton Precious Metals (WPM) & Galiano Gold (GAU CN)	6%
	iShares US Broker-Dealers & Securities Exch ETF (IAI)	5%
	TIS Tech Basket: Meta (3%)	3%
	VanEck Vectors Gold Miners ETF (GDX)	5%
	Nikkei	4%
	TIS Defense Basket: Palantir (2%), Boeing (2%)	4%
	Argentina Index (ARGT)	3%
	TIS Bank Basket: Wells Fargo (3%)	3%
	Hang Seng Index (HSI)	2%
	Pan Am Silver	2%
ALTERNATIVES	Gold	3%
	Silver	5%
	Palladium	3%
	Bitcoin	3%
TOTAL		100%

IV. CURRENCY OVERLAY 33-40

OVERVIEW:

US Dollar — The major macro event of 2024 in the US was the national election. The major event in 2025 may be how the debt and deficit are handled as well as wholesale changes in tax policy, trade policy, de-regulation, fiscal policy, immigration – and more. The Dollar may be over-owned and on a PPP basis, overvalued. But relative to other world currencies, it backs the strongest profitable economy. Capital is flowing to the US.

An outside the box risk (a Dollar spike) is a liquidity / economic / financial problem coming from Europe, or a recession.

Has the Dollar fully priced Trump 2.0 and the numerous policy changes which are coming? Doubtful. The wild card may be wholesale changes in how the US government funds itself via tariffs and far fewer personal / corporate tax receipts.

Euro / Dollar — An end to the war in Ukraine would be very positive for Europe's economy – and possibly the Euro. Structurally, a stronger Euro is probably in Europe's longer term interest as the EU needs to rebuild its energy supply lines and re-industrialize. If a wider war breaks out between NATO and Russia, the Euro could weaken very quickly. For a number of reasons, Euro / Dollar could be lower by 2026-2027.

Yen / Dollar — The USD / Yuan / Yen triangle is crucial for Asian trade and global growth.

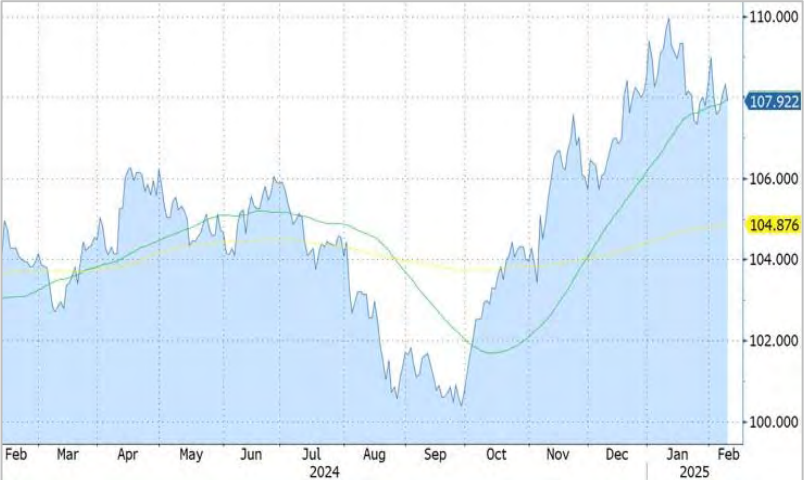
Japan was the first major country to go into deflation. Japan now has a new burst of inflation, +2.3%. As a result, will Japanese interest rates go up? This will be important for global capital flows and for the Yen. Japanese investors are receiving -50 bps in 10 years.

Taiwan's relationship with the USA is becoming a larger and larger issue for Japan. Japan has aligned itself with US defense policy, the Indo-Pacific Trade Agreement and the Quad. Japan's government is in the early stages of designing a more offensive military policy which will be expensive. Foreign FX reserves and other foreign assets may need to be brought home to help fund the defense buildup. In the technology sphere, Japanese companies benefitted from the IRA and the CHIPS Act in the US. But will the Trump administration slow the CHIPS Act spending, forcing Japan to expand in that area?

How events play out in Europe, and a potential conflict in Taiwan are also key issues for the Japanese economy. Finally, the US elections matter to Japan and all of Asia, especially for the long-term security outlook. The Trump administration is likely to put additional trade pressure on China – possibly resulting in a CNY devaluation, which would push Japan to devalue the Yen. How relations develop with the US / China will play the major role, in BOJ policy and the Yen – which is still cheap, but can it become a lot cheaper? Dollar / Yen has been very volatile recently. A wide

trading range between 125-162 is quite possible. On the charts, if Dollar / Yen breaks 165, the next target would be 200, the 250+. Is the Yen a short again?

US Dollar Index



Courtesy of Bloomberg LP

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 Investor’s Business Daily, 2/10/2025
 The Economist, 2/6/2025

S&P 500 Index — Is a Long Term Top Forming?



Courtesy: Bloomberg LP

And They Are Off! Trump 2.0 Gets Underway

What I would like to do is highlight some of the more important Executive Orders being signed by President Trump, and the effect we expect they will have short and long term.

1) A universal tariff may be imposed, but he has not made a final decision yet. This is a negotiating tool, but I also think there will be a UT of some size as it raises revenue. China tariffs will be studied. Trump again called on Europe to buy more US energy to avoid tariffs. South Korea, alarmed by the new tariff proposals, already wants to talk with the US with buying additional US energy and food in mind.

2) Trump said he plans to impose 25% tariffs on February 1st, on goods coming from Mexico and Canada. The auto parts industry claims this could add \$3,000 to the price of a new car. The EV Mandate subsidies are ended. The other new tariff which might be imposed could relate to the energy industry. The Premier of Alberta was in the Rotunda of the Capital for the Inauguration, a coveted seated to have. Alberta sends 4.5 million bpd of oil to the US daily and that could possibly go to 8 million bpd. As I understand, the Canadian provinces control their natural resources. Can Ottawa stop an 8 million bpd deal with the US? Drill, baby, drill, but in this case, it would be buy, baby, buy!

3) TikTok got a reprieve. Control of TikTok and Musk’s ownership of Twitter pretty much changes control of the US media which has the most influence over youth and free speech advocates. Mainstream media is dying. The old-line networks could not get VP Harris over the line. Twitter and TikTok did.

4) The US will leave the WHO and the Paris Climate Accord. The US is one of the main funders of the WHO. This begins overhauling the US Health Care system.

5) The US will “probably” stop buying oil from Venezuela. Who needs it if the US has a deal with Alberta? And if the US regains control of the Panama Canal, my guess is the shipping rates will rise for non-Western Hemisphere countries anyway, including Venezuelan oil shipments. Trump also ordered US waters be opened to drilling.

6) Elsewhere in the energy sphere, the freeze on LNG exports is being lifted. LNG, GLNG, and NFE we have in the Unconventional Model. Conversely, wind power permits are frozen.

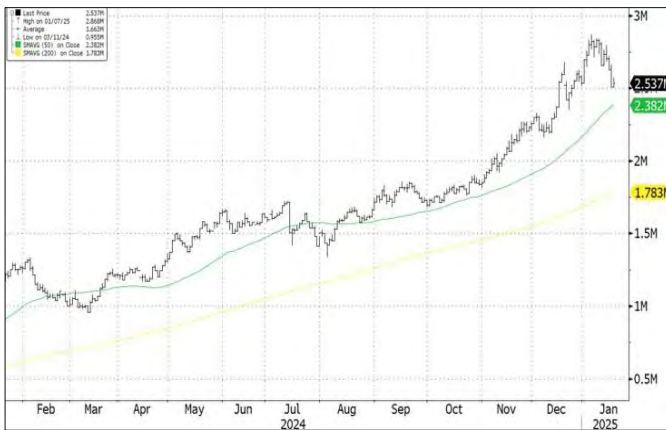
The Future

It seems clear to me that the changes which are about to hit the system will be a shock to the markets, investment managers, and to the system itself. The US is a new nation now and I think this inauguration speech will be seen in the future as the end of an era which started with President Obama, ran through Biden’s

term, and would have been part of the Clinton legacy if she had not lost to Trump in 2016.

The stock market may have a sell-off in the near term, until two things happen. The first is Trump's agenda, especially if the tax and tariff packages are passed and there is certainty as to what the ground rules are. The second "event" is DOGE, which I think many managers believe is unlikely to be effective. A Federal hiring freeze has already been put in place via an Executive Order. Subsidies to the EV market and climate projects will end. This is just the beginning of a downsizing of government, which I see has worked wonderfully in Argentina. The new government in Argentina has reduced government spending, inflation is falling, the Peso is rising, and the Merval Index has doubled over the past year. The President of Argentina, Javier Milei, was at the inauguration. He has met with Trump and Musk. When Musk shows how DOGE can cut a trillion Dollars from the budget, I expect US markets to behave in the same way.

Merval Index



Source: Bloomberg LP

The other shift in power (this one from government to the private sector), will be in the communications sector. The shift to social media will go on and the legacy media is dying. In a recent court case, it was revealed that CNN revenue fell from \$2.2 billion to \$1.8 billion in three years.

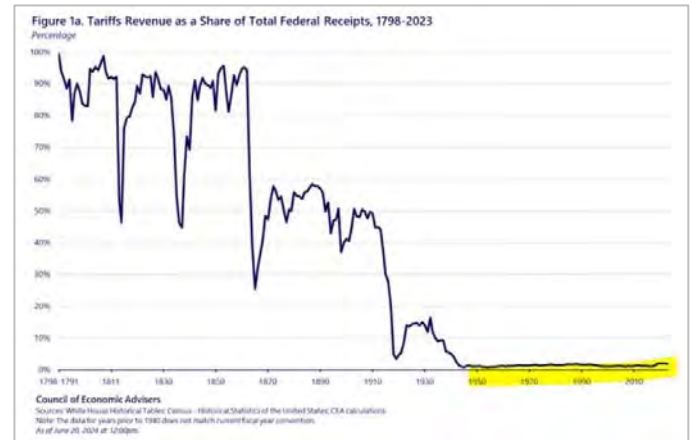
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Finally, Trump noted the US is returning to being a meritocracy. DEI is over. Companies are closing their offices (Wal-Mart, Meta and Lowes) and the government has been mandated to cancel their DEI programs. Even the FBI closed their DEI office in December. Socially acceptable permission has now been granted to the corporate sector.

Sources:
Bloomberg Data
Bloomberg News
NY Post

A Time To Ponder

Tariffs Revenue as a Share of Total Federal Receipts, 1798-2023



Source: <https://x.com/pmarca/status/1873880292043481203>

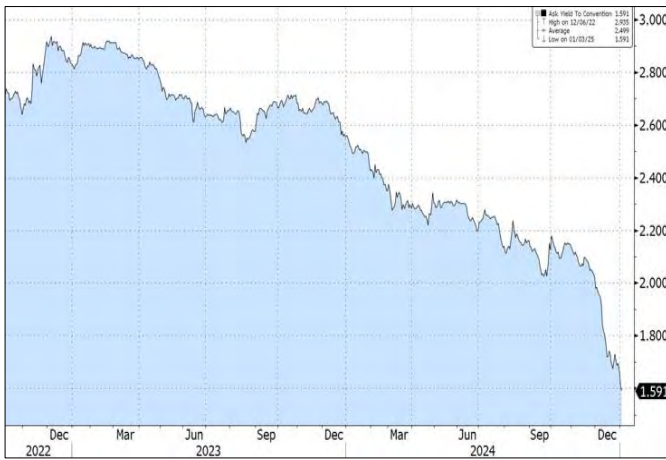
The first graph (above) shows us America's historical tariff revenue as a percentage of total Federal revenue. Until the Income Tax was started in 1913, the country basically funded itself with tariffs. It was during the period from the post-Civil War period to when WWI began (1865-1914) that the economy boomed. Technology expanded rapidly, railroads crossed the Continent, infrastructure developed, electricity capacity boomed etc. It was also a boom time for Wall Street. During that time, the US government was funded by tariffs.

It is important to pay attention to what President Trump is saying about tariffs. I think he is very serious about bringing tax rates down (corporate and individual rates) while pushing tariff income meaningfully higher. He does not need Congressional approval to move tariffs. MAWA, Make America Wealthy Again. That's the goal.

We must pay attention when he says things which may seem unlikely or even outrageous. So when he talks about acquiring Greenland because it is important for national security, pay attention. When he talks about Canada becoming the 51st state, he wants something and is willing to talk about it. I would not want to be in Mexico's shoes right now, because it is what he does not talk about, that could become a major surprise. Mexico is already in serious arrears to several US companies for payments they owe. Mexican-based drug cartels may control part of the southern border, for now. Trump has had a lifelong aversion to drugs and alcohol and countries which owe the US. When he talks about the fentanyl crisis and drugs crossing the border, he means it - he will make a serious effort to stop it.

For China, this is difficult news on several fronts. China's economy is already in major trouble, that is what the price action in the 10-year Chinese sovereign bond suggests. Long-term rates are rising in the West, but in China, they are falling. The Chinese 10-year trades at 1.59%, down 110 bps since January 1st, 2022, when the Fed began to hike rates. The US 10 year has risen 300 bps since then, a massive gap of 410 bps. During that time, Chinese shares fell while SPX rose from approximately 4,800 to 5,950 as of 1/3/25. It was not until late 2023 that SPX recovered from its 2022 losses. The S&P is up only 25% over those three years an annual return of 8%.

China 10-Year Yield



Source: Bloomberg LP

The next chart shows the CSI 300. These are China's top companies, and they are down about 22% over the last three years or a net negative return of about 7% annually. The Chinese credit market has been sending the right signal and stocks are following it. Trump's tariffs will force additional stimulus and/or a change in approach on how China's economy is managed- which we think may be very near. A Chinese currency devaluation is likely to be done, in my view, also possibly soon. This will put even further upside pressure on the USD.

CSI 300



Source: Bloomberg LP

Back to US tariffs. President Lincoln was a protectionist who supported the Morrill tariff. That tariff bill was passed two days before his inauguration, and which raised the average tariff from 15% to 37.5% over an expanded list of items. (1) He was echoing Alexander Hamilton who was the thought leader behind the concept of protecting infant industries - which in his day meant virtually the entire US economy in the years after the Revolutionary War ended in 1783. President Theodore Roosevelt said in his inaugural address "that great prosperity in this country has always come under a protective tariff." (2) These statements and the policies followed by these Presidents and the first Secretary of the Treasury (Hamilton), run counter to the modern mantra that tariffs were the cause of the Great Depression in the US. The global movement toward lowering tariffs for global trade is over. That fashion is in retreat, protecting key industries is now in vogue, not just in America, but also in Europe and increasingly in China.

President Trump has two years, not four years to get done what he wants to do. He faces another mid-term Congressional election and even if the Republicans win a second majority in 2026, he will have less political leverage. Will a shift back toward a tariff financed US fiscal situation, be the solution for the fiscal situation and US Treasuries which markets have yet to price?

Sources:

- (1) F. W. Taussig. Tariff History of the United States. https://cdn.mises.org/Tariff%20History%20of%20the%20United%20States_4.pdf
- (2) <https://www.presidency.ucsb.edu/documents/second-annual-message-16#:~:text=It%20is%20exceedingly%20undesirable%20that,tariff%20changes%20at%20short%20intervals.>

Bloomberg Data
Bloomberg News

Observations & Questions From Readers

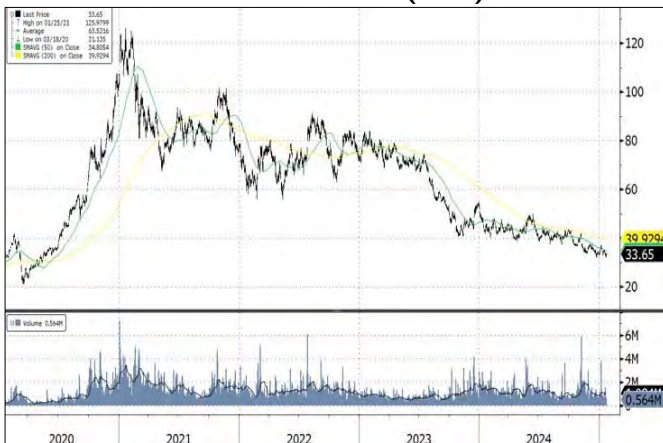
I wrote recently about how much the US and the world have changed since the US election. The scale of the change which Trump is affecting in the US is unlike anything I have ever seen. The Stargate project is an example, despite the competition that will come from DeepSeek which is as powerful as Open AI but costs 3% of the price. Those are numbers I see bandied about and reality may be different but I have to assume that Oracle, Softbank, Microsoft and the rest understand what they are getting into. The one who is not "getting in" is Musk who claims not to have the money. I suspect this has something to do with his own projects, Grok 3 and 4, but we shall see.

My point is two of these three mega AI projects are being run in the US. The new tech world is being created and incubated in the US. This will give the US even more control of the future. If you think tariffs are the

ultimate and only negotiating tactic Trump can and will employ, think again.

Access to technology will be used to gain leverage. Subsidized industries which have been in the last US government's favor, will have a tough go of it in the future. The next chart is the Global Solar ETF in New York. When President Biden entered office, it traded at \$120. Today, it is trading near \$33 with no sign of support on the chart. Some industries will lose their clout.

Invesco Solar ETF (TAN)



Source: Bloomberg LP

Another heavily subsidized industry is EVs. Those subsidies will fall dramatically. I see that in the Netherlands a third of Tesla owners may sell their cars as they experience "Tesla" shame. The "shame" is apparently experienced over Musk's pay package and involvement in politics. There have been a number of questions we have received recently from Europeans who want to know how Musk can be allowed to be so close to Trump, a US President. Rich people near US presidents are not unusual. This is not a new thing. Among Kamala Harris's top 20 contributors, according to Open Secrets were Greylock Partners (10), Ripple (11), Euclidean Capital (12), Sequoia Capital (13), and Alphabet (19). As for President Biden's relationships, I would not say Bezos (via the Washington Post he owns) and Zuckerberg (who put over \$400m into the race against Trump in 2020) were unfriendly to Biden. This is just a fact of American political life. Money buys access and if someone can convince me the same system does not operate in European politics, please let me know. If it helps, I believe Trump's new chief of staff, Susie Wiles will be as effective in the White House as she was in the campaign.

Speaking of Europe, we are also getting feedback from readers about why they should or should not buy European equities. They are cheap. At roughly 14x, they represent value relative to the US market but excluding the banks and the companies located in Europe which sell to the world, there is no catalyst. Worse, the EU is falling behind in the technology race via the Digital Information Act. This ACT is used to hobble

US companies which in turn makes it difficult for the EU to develop its own tech sector. In the new AI world, the EU will have to buy this tech expertise rather than having it home grown. This narrows the number of companies which are clear winners in the New Economy and are located in Europe. That's the problem, there is not a lot of market cap to buy in Europe, in the new world. All is not lost. Italian banks have been cleaned up and look interesting. Aside from the banks, two interesting companies are Siemens Energy and Bank of Ireland (6x PE and 3.5% dividend) which has Mr. Addison's blessing on the chart. If we put the BOI chart up since the European credit problem in 2012, that must be one of the largest head-and-shoulder patterns I have ever seen. That stock was €340 in 2007. Today it is near €9.

Bank of Ireland



Source: Bloomberg LP

Finally, our view on Gold and Silver is not only intact, these metals may be ready to accelerate again, to the upside. Mr. Addison's call is if there is a monthly close above \$2,800, then \$3,200 to \$3,400 comes into view. I agree with the direction but I also think the pressure is going to be piled on Powell to lower short rates. If he complies, I think Gold goes even higher.

Spot Gold



Source: The Institutional View

I see the European press criticizes Trump because he is pushing Powell to cut rates. Sometimes it reads as if such behavior toward the Fed never happens or at least it should never happen. It does happen, and worse has happened. In 1965, President Johnson called Fed Chairman William Martin to LBJ's Texas ranch where he shoved the Fed chairman around his living room while yelling at him, face to face. This seems a lot more aggressive behavior than being criticized on Twitter or listening to a Davos event. Trump did not order interest rates to be cut. He said he will demand that rates be cut. If he could order rates to be cut, that would already have happened. Behind closed doors, my guess is Trump's view would have a lot of support across a wide range of countries. In Europe, where the largest economy, Germany, has had virtually no growth for two quarters. Why not cut rates? Why is the German 2-year at 2.2% when there is no growth?

Sources:
 Bloomberg Data
 Bloomberg News
 The Institutional View, January 24, 2025

An American Payback Theme

It is no secret that in the US, ambassadors are often chosen for the amount of money they contributed to a Presidential candidate's campaign - if they win. Likewise, companies, PACs, and even individuals vie for attention, backing and favors when they contribute to political campaigns - at all levels.

Given the clean sweep which the Republicans had in the 2024 election, Senate, House, and Presidency, they are in a unique position to reward their backers. There are new investment themes a plenty being generated by the new administration, but here is one that is tried and true. Back the companies and industries which supported winning candidates.

Open Secrets is an organization which compiles this information and makes it publicly available at <https://www.opensecrets.org/2024-presidential-race/donald-trump/contributors?id=N00023864>. The following table comes from their website and it shows the organizations, PACS, their individual members, employees or owners and those individual immediate families and what they contributed to the Trump campaign.

Here are the Top 20 Contributors to Trumps 2024 Campaign:

- C \$265 million
- Investor / Timothy Mellon \$150 million
- Adelson Clinic for Drug Abuse Treatment and Research \$106 million

- Securing American Greatness \$67 million
- Building America's Future \$23 million
- Action First America / America First Policies \$21 million
- Hendricks Holding \$15 million
- Bigelow Aerospace \$14 million
- Energy Transfer LP \$12 million
- Laura and Isaac Perlmutter Foundation \$12 million
- ABC Supply \$11 million
- Cantor Fitzgerald \$11 million
- Uline, Inc \$10 million
- Pratt Industries \$10 million
- British American Tobacco \$10 million
- SAG PAC \$9 million
- Southern Waste Systems \$9 million
- Elliott Management \$7million
- Andreesen Horowitz \$7 million
- Vitol, Inc. \$6 million

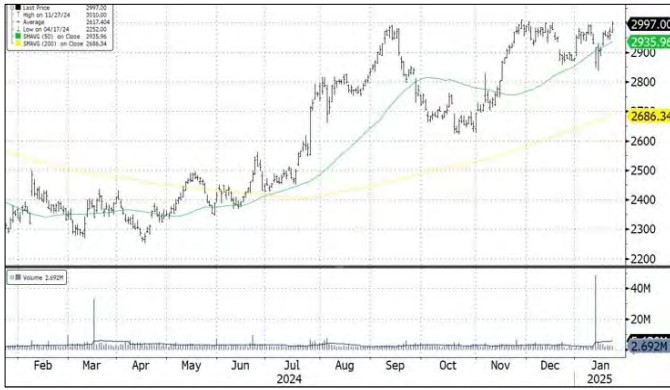
There are two public companies on the list, Energy Transfer (ET) and British American Tobacco. Both sport pretty fancy dividends, 7% and 6%, while their businesses could not be more different British American Tobacco sells cigars, cigarettes, VAPE products while ET is in the transportation/storage business of oil and natural gas. Their charts look great. Why did they contribute?

For ET it may simply be a case of additional volume making them more money. Trump's drill baby, drill mantra is exactly what this company would encourage to be official US policy. BAT is more difficult to call. It may have something to do with their US vaping business. Maybe they are preparing for an acquisition in the US. Perhaps it is simply a defensive move with respect to making cigarettes non-addictive.



Source: Bloomberg LP

British American Tobacco



Source: Bloomberg LP

The “investment” made by SpaceX is understandable given the company’s contracts with NASA and the subsidies which Musk receives from the Federal government. Another beneficiary of the Musk effect is Tesla.

Tesla (TSLA)



Source: Bloomberg LP

There will be other ways to look at how this theme will play out. One area must be the crypto space. Reasonable regulation, which is coming as the crypto folks were also good supporters, will help that industry grow. This may also be in the government’s interest. The US government owns about \$20 billion in Bitcoin at current levels. This stockpile comes from confiscations of assets. If a Bitcoin or crypto reserve is to be built, this will be the seed capital and I suspect it will not be sold. The overhang it may have had in the market should be going, going, gone.

There will be much bigger themes to consider as the Trump administration rolls out its economic agenda. Here are a few thoughts after watching his Davos speech.

The US will not participate in a global minimum tax. If the rest of the world wants to do that, fine, watch the billionaires and their capital head for Uncle Sam.

Trump will ask OPEC and the Saudis to lower oil prices. This may be the excuse they need to boost production and make it even more difficult for Russia to continue the war. This does not conflict with our belief that Trump is looking for leverage over Putin before

negotiations begin. If the Saudis do not increase production (they might to regain market share) in order to lower prices, perhaps some Russian capacity might be disabled in some way, but by Ukraine, rather than the US. Energy prices are his potential leverage with Putin. Trump will use it.

Lower oil prices would lower inflation expectations and put pressure on the Fed to cut rates, another policy point which Trump also brought up. He wants lower rates in the US. The Fed does not have to comply. But will they do so anyway? Where is the deal to be made here?

Trump basically warned of a worldwide trade war. He told non-US companies to produce in the US or pay tariffs, it’s up to you. Free trade is over in Trump’s economy. So is woke politics, DEI and high taxes. I think the SALT deduction in the US will be raised in the next tax bill. For residents in high tax states, this will be a very welcome development, if Trump blesses an improvement in the SALT deduction - he seems to have done. Globally, if other countries want to charge their companies higher tax rates than the US does, he is happy with that. Trump wants a 15% corporate rate in America. This is not what the EU wants, they want the US to raise rates so they will be more competitive. Trump will not do that. The EU is in a pickle on this one and must have a bit of whiplash after four years of Secretary Yellen agreeing to go along with the global minimum tax and then poof, it’s gone.

The EU was also criticized for the fines being charged to American tech companies. He views those fines as a form of taxation. This is where we can see how the US government is now being tech led. US tech firms will benefit from de-regulation, lower taxes, and government supporting projects like Stargate.

Finally, Trump talked about the need for a massive increase in electrical generating capacity due to the AI build out in America. He even mentioned relying on clean coal as a back-up fuel for electrical generation plants. He also noted nuclear is going to be used, while natural gas is likely the lead fuel for now. Peabody Coal anyone?

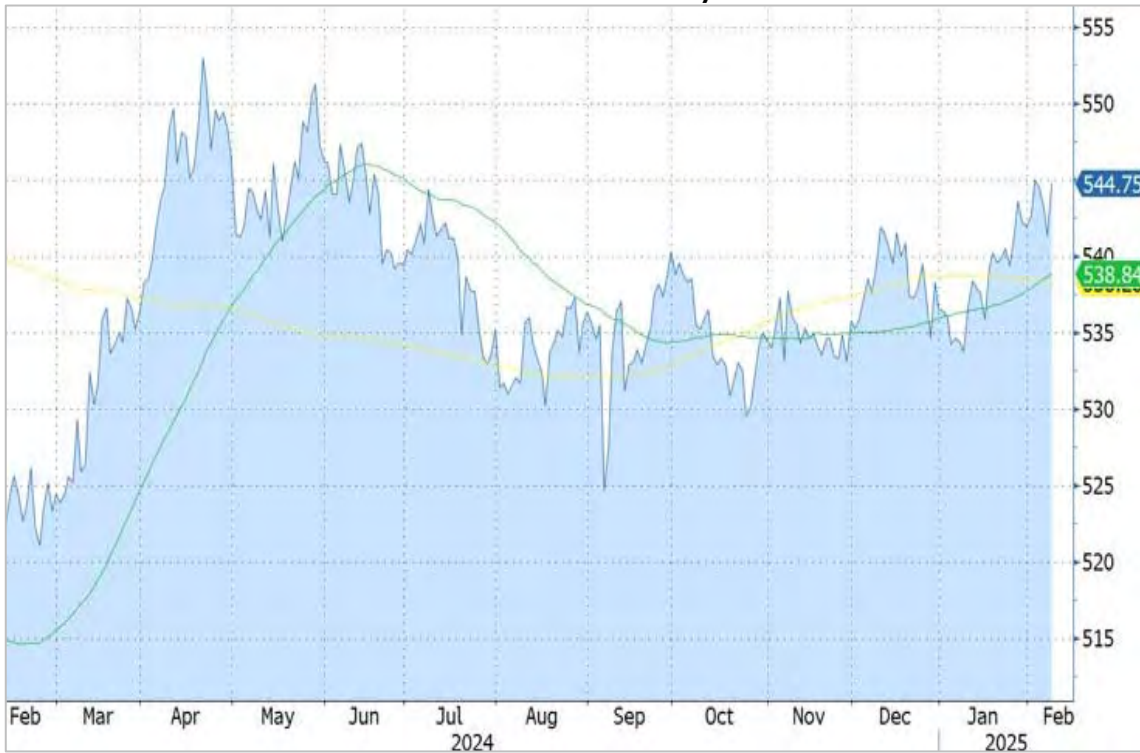
Peabody Coal (BTU)



Source: Bloomberg LP

Sources: Bloomberg Data; Bloomberg News. NI DAVOS

CRB Continuous Commodity Index



Courtesy: Bloomberg LP

Gold and Silver

Our view on Gold and Silver is not only intact, these metals may be ready to accelerate again, to the upside. Our friend, Mr. Addison's call is if there is a monthly close above \$2,800, then \$3,200 to \$3,400 comes into view. I agree with the direction but I also think the pressure is going to be piled on Powell to lower short rates. If he complies, I think Gold goes even higher.

Spot Gold



Source: The Institutional View

Source: The Institutional View, January 24, 2025

From Trump's Press Conference

The new America first policy will be multilateral, mercantilist and perhaps venture into new forms of currency - i.e. tariff policy, a hyper-competitive US economy, cryptos, A.I., and using Bitcoin / Gold as a settlement asset. The old system is out and something new is being born. The message to the world is get on board with the US while the teams are being lined up.

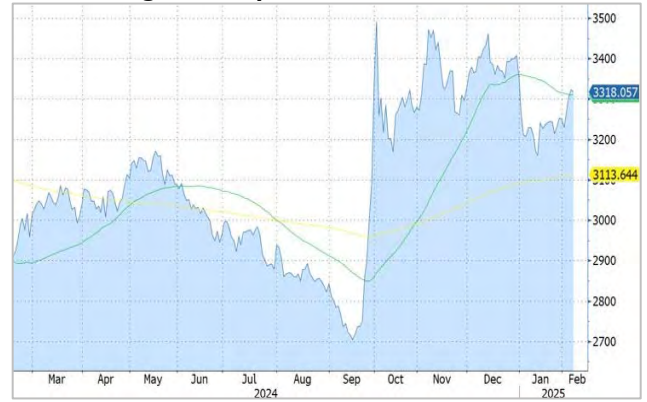
Source: Bloomberg News, NI NATO, NI TRUMP

Nikkei Index—When Will the Yen Bottom?



Courtesy of Bloomberg LP

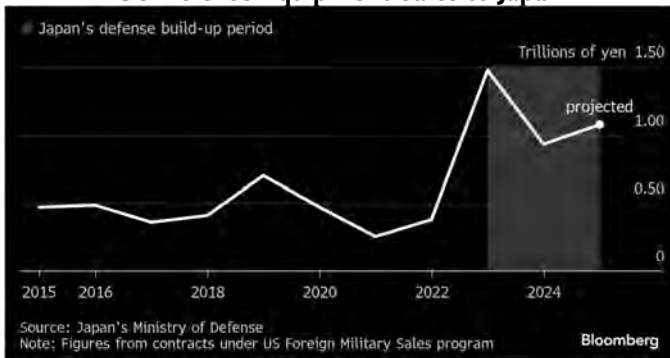
Shanghai Composite Index—Sell Rallies?



Courtesy of Bloomberg LP

Back on the Radar

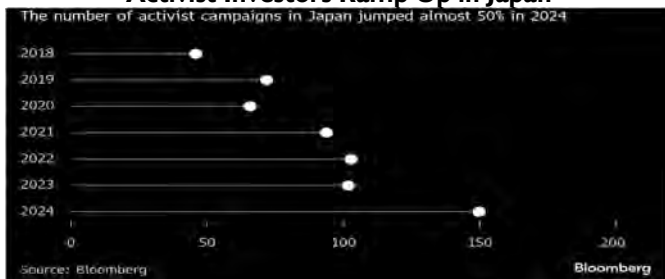
US Defense Equipment Sales to Japan



Source: Bloomberg LP

The BoJ is contemplating raising their inflation outlook, which has been influenced by the Yen's price action and the rising cost of rice. Japanese household consumption has only risen for two months out of the last year and even though workers base salaries have just grown by the most in thirty-two years, real wages have now declined for the last four months. While US defense firms are being criticized for prioritizing shareholders, the MIR has written about the dramatic shift to a more corporate minded Japan. Japanese M&A recorded the fastest growth since 2018 as activism observed a 50% increase last year versus 2023. Record cash levels are sitting with Japanese corporates currently, which could well be re-deployed both home and abroad in a dip situation. This is a contributing factor as to why analysts foresee about an 8% gain for the main Japanese indexes this year.

Activist Investors Ramp Up in Japan



Source: Bloomberg LP

Japan is a key partner for Washington across Asia-Pacific and as they embark on monetary policy and corporate normalization, their importance in the region has presented hope that they come away better off than others as Trump begins his second term, particularly if they keep promising to increase defense spending. A changing business environment and an evolving macro landscape could prove favorable for Japanese equities even with growth predicted somewhere between 1-1.5% for this year. Household consumption needs to increase to raise the growth profile, so wage negotiations in the Spring will be important but so will political and economic stability. If Trump's ability to push through his agenda proves more formidable this time around, Japan seems ideally positioned to benefit and should be watched closely as Trump begins his second term.

USDJPY vs. US - Japan Yield Differential



Source: Bloomberg LP

Sources:
Bloomberg Data
Bloomberg News

Chinese Tech

Nvidia's single day loss of market cap after its earnings report was nearly equal to the total capitalization of the Mexican stock market and about twice the prior record decline for a single stock that was set by Nvidia back in September. Nvidia now holds the dubious

honour of recording eight of the top ten largest single-day market cap losses in history.

Most people are learning about DeepSeek in real time, having largely been an unknown. Watching Nasdaq futures overnight meant investors were forced to sell down hard and ask questions later. The positive response into the close provides optimism for A.I moving forward as well as the likelihood that purse strings might be pulled a touch tighter now when it comes to AI related capex. Retail investors are about to receive their end of month statements for their investment funds so how they respond will need to be monitored especially if tech / AI holds significant losses into February.

Whether DeepSeek managed to circumvent US export controls on chips is up for debate, but Musk was quick to opine that the Chinese might be understating their usage of Nvidia chips by a factor of five. DeepSeek's founder launched a quant hedge fund back in 2015 before pursuing AI. I wouldn't be surprised if their hedge fund just had a great start to the year too.

If DeepSeek is dependent on US hardware (at least for now), is Trump going to dial up the rhetoric in the same way we just watched the interaction with Colombia? Trump specifically referred to the Colombian President as socialist, which is one of the our questions since the election; how will Trump's administration collaborate with traditional allies, many of whom have moved far to the left? Even with the CCP being somewhat of a known quantity, the threat of tariffs has so far not been activated, with the focus aimed more at regional disagreements with Canada and Mexico.



Source: Bloomberg LP

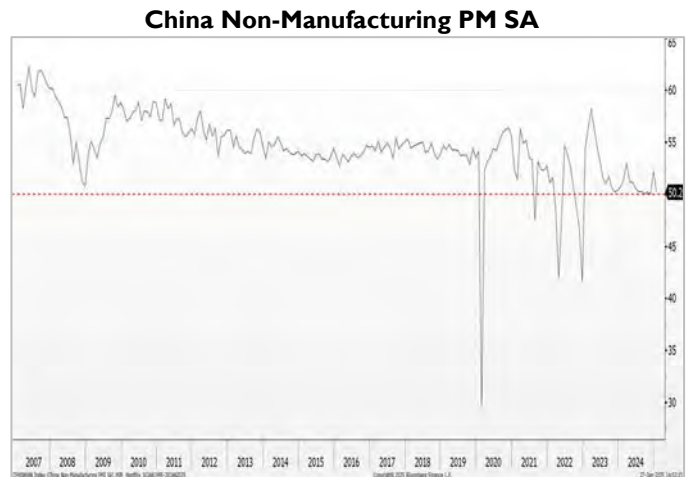
According to media in Asia, during Secretary of State Marco Rubio's conversation with Chinese Foreign Minister Wang Yi, he apparently expressed that the US is not supportive of Taiwan independence. Rubio was concerned about China's actions towards Taiwan though. During the election campaign, Trump insisted

that China should have to recompense the US for covid related damages. The Missouri Attorney General recently stated that if the Chinese fail to pay up, the US might begin seizing Chinese owned US assets, with farmland named as the specific example. It seems like some serious deal making is playing out behind the scenes between Beijing and Washington. Perhaps it involves the Chinese buying US debt again, helping Trump achieve lower rates. The stock sell-off sent the US 10-year yield lower to just above its 50-MA at 4.47%.

From a Chinese perspective the recent news flow alongside DeepSeek cannot be overlooked:

- India and China have agreed to resume direct flights after having been cancelled at the start of the pandemic.
- JD.com just agreed to take delivery company Dada Nexus private.
- On Mao's birthday (December 26th) a new sixth-generation stealth fighter jet, the J-36, was unveiled.
- China's artificial sun, the Experimental Advanced Superconducting Tokamak (EAST), sustained 100m Celsius for 18 minutes, three times longer than the 2023 record.
- Chang Guang Satellite Technology Co. may be outpacing Starlink, having transmitted at a speed of 100Gbps, ten times the speed it achieved last year.

It's not all good news though. Chinese industrial firms have now had three consecutive years of declining profits, and the chart below is teetering on contraction once more.



Source: Bloomberg LP

Prior to Christmas, we wrote the following:

“On the face of it, the idea that Japanification may be facing President Xi has merit, and yet even with tariffs dangling (which has pushed inflation to the backburner for some clients until there is full clarification), President Trump then invited Xi to his inauguration. In short, what if we have a European scenario on our hands, where the news flow just needs to be “less bad?” Investors are either conditioned to avoid China whether that be due to ESG, fears about return of capital or have been burned one too many times. Perhaps Trump wants to make a deal or the tariff package on balance isn’t quite as draconian as initially feared. In which case, no-one would be positioned for a sustained move higher and as our clients are hopefully aware we are always watching when a market is overloaded on one side of the boat.” (MIR 12/16/2024 - Considerations for the New Year)

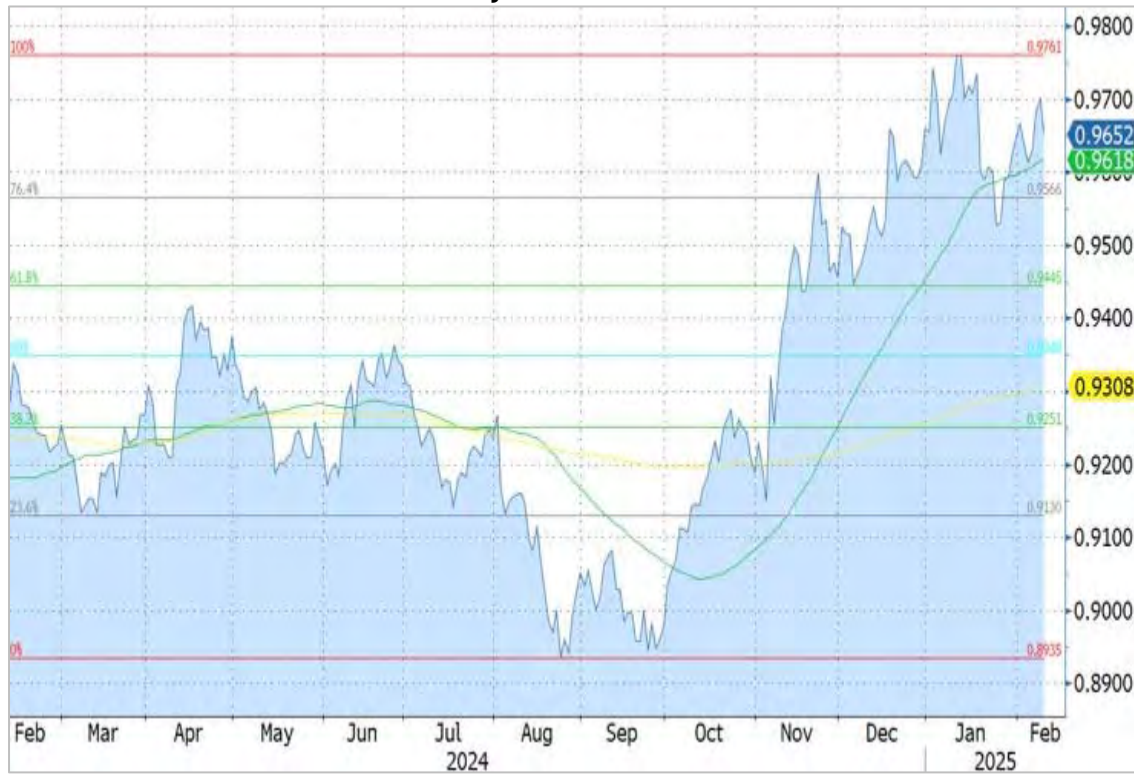
First and foremost, the price action on the back of the DeepSeek news is impressing upon me that alongside Trump tweets, we will likely experience choppy market action throughout most of the year. Ongoing restrictions on Chinese tech, either at the corporate or Federal level will ensure the US tech titans can still remain dominant onshore. An open-source approach though (Meta?) will allow new entrants following the DeepSeek approach to drive major advancements. Think back to the dot.com boom when firms like eXcite, Askjeeves and Alta Vista couldn’t maintain their edge. Lower cost structures can keep the tech train running and the prospect of higher productivity in a transformational age is exciting to say the least. How the Trump administration tries to interact with China is a big piece of the puzzle which can make markets nervous as they respond to headlines, but emerging Chinese technology plays might be becoming too significant to ignore.

Sources:

Bloomberg Data

Bloomberg News

DJ Euro Stoxx 50



Courtesy: Bloomberg LP

Economic Force

The UK is prominent throughout the global news but for all the wrong reasons. From a financial perspective, the UK is showing a similar pattern to what we saw with the German PMI, namely stagflation, with Reeves and Starmer doing little to assuage investor concerns that the debt pile is becoming unmanageable while their promise of the fastest growth in the G7 looks problematic. That said, the FTSE is outperforming all three main US indexes so far this year. The more domestically orientated FTSE 250 provides a better picture though, and is -3.25% YTD, tracking the currency lower, where GBP is the worst performing major currency YTD.

FTSE 250 - Monthly



Source: Bloomberg LP

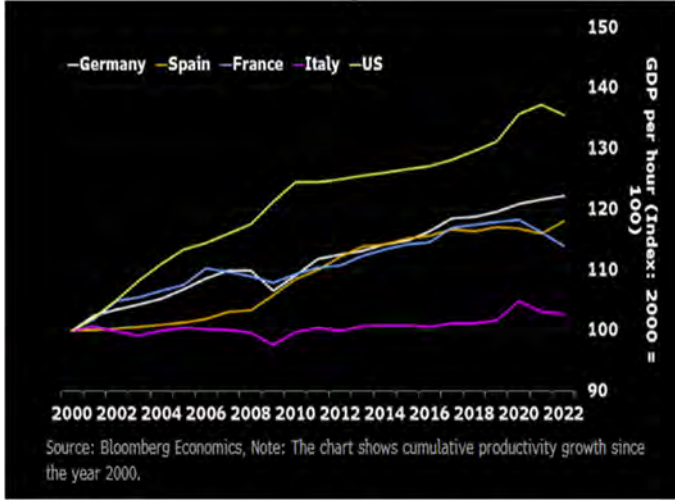
France and Germany continue to struggle. ECB governing member and Bank of France Governor Villeroy is pushing for big budget cuts as the cost of financing the debt is now above the budget for education. “The gravity of our budgetary situation at least has one virtue: our country no longer has to choose between repairing finances and economic growth. Reducing budgetary and tax uncertainty, which is weighing on businesses and households, has now become a condition for confidence and therefore growth.” Ahead of impending German elections, factory orders were -5.4% for November, significantly lower than the -0.2% expected consensus.

Victor Davis Hanson penned an interesting piece to begin the year that discussed the Morgenthau plan for post-WW2 Germany, one which Herbert Hoover disapproved of, believing it to be inhumane (1). Hanson explains the irony, which we also hear from our clients in the region, in the sense that the Morgenthau plan to deindustrialize Germany was rejected at the time for being too severe, yet has now been willfully enacted by German politicians, leaving the country in a very precarious position as Morgenthau had envisioned back in 1944.

Bloomberg has highlighted the ongoing productivity issue within Europe and as the chart below clearly shows, Italy has been the laggard within core-Europe. Italy is of

interest of late though given Meloni’s strong relationship with Musk. Last summer, her government agreed to allow foreign space related firms to operate in Italy. Meloni’s government is now in apparent negotiations to use the Starlink satellite network for encrypted communications which has raised concerns about their commitment to the EU’s competing network (IRIS²) set to launch in 2029. An Italian journalist held in an Iranian prison was released recently with Musk and Trump apparently instrumental in securing her release. Italy is currently leading the European markets at +2.7% YTD.

US Has Outperformed



Source: Bloomberg LP

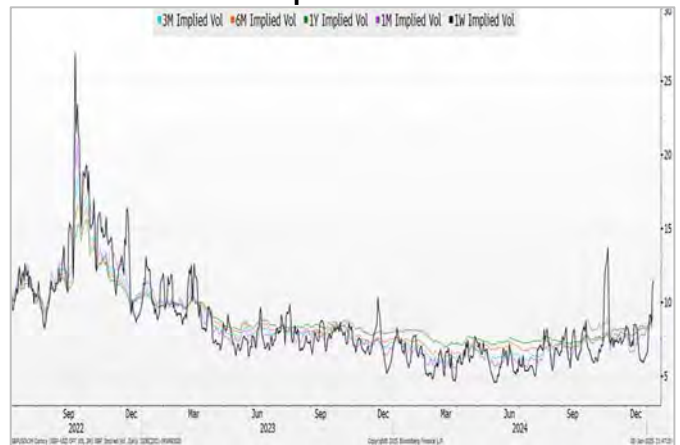
Compare this to Musk’s barrage of tweets aimed at Scholz and Starmer specifically. Bloomberg wrote, “It’s far from clear what his motivations may be in trashing relations with core US allies in fellow Group of Seven nations where he has significant business interests, still less his ability to effect the change he demands.” This is very one dimensional in its thinking and has very little to do with how many Tesla’s he sells in the UK or how many people sign up to X in Germany. These traditional allies have moved far enough to the left that the gap to the incoming US administration is borderline unworkable. The MIR wrote at the time that when staff from the UK Labour government went to work for the Harris campaign in the run-up to the US election, which Musk and Trump branded election interference, it would not be forgotten. Trump seems happy to let Musk spearhead some of the political assaults and if the departure of Trudeau is any indication, when Trump and Musk combine their significant resources and media reach to target an opponent, the clock is already ticking for that particular individual.

Trump’s earlier speech stipulated that NATO nations should now spend 5%, rather than the previous target of 2%, of their respective GDP on defense. So far NATO seems to be prepared to go to 3% as an updated goal. In response to Trump’s comments on Greenland,

Scholz remarked that, “The security situation in Europe will be very tense for the foreseeable future,...We need to wake up, strengthen ourselves in a world overtaken by might-makes-right in terms of military, competitiveness.” Anduril just secured another contract with the Pentagon, just shy of \$15m, for solid rocket motor production. Small as it may be, the more interesting news broke just before Christmas when Anduril announced a planned consortium with the likes of OpenAI, Palantir and yes, you guessed it, SpaceX, to directly compete against the traditional defense titans for US government contracts. Anduril’s Palmer Luckey has been vocal about his aim to arm allies with the best possible technology to act as a deterrent against any would-be aggressor. The question the market needs to figure out is who those allies are moving forward. Interesting side note – Luckey’s sister is married to Matt Gaetz.

BBC Newsnight has questioned whether the UK’s special relationship with the US can continue given the rhetoric that is being driven by Musk. If the current leadership continues then probably not, but that would affect the UK more than the US. Bond yields were the undoing for both Truss and Kwarteng in 2022 which should put Starmer and Reeves in a precarious position. The UK Treasury verbally intervened to suggest that Reeves’s fiscal headroom was alive and well, which is never a good sign. The Institute for Fiscal Studies, as well as a number of buy-side and sell-side firms rapidly disagreed, insisting that spending cuts, increased debt issuance and potentially higher taxes will be needed. Trump already discussed the use of economic force to achieve his aims with Canada and Denmark / Greenland. Fellow members of the G7 are finding themselves facing the very same threat.

GBP Implied Volatilities



Source: Bloomberg LP

Sources:

- (1) Hanson, Victor Davis 2025. “Germany’s New Morgenthau Plan.” January 2nd, 2025. <https://victorhanson.com/germanys-new-morgenthau-plan/>
- Bloomberg Data
- Bloomberg News

Surprise

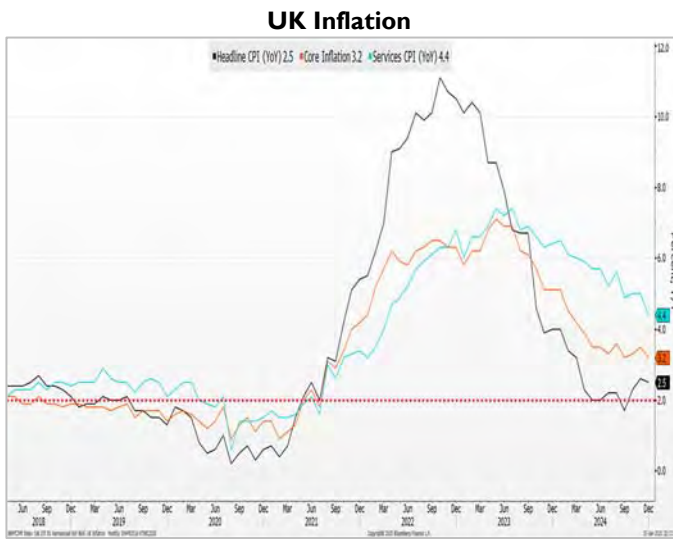
In almost every commentary I read following the UK CPI release, there was a recognition that the miss came as a surprise. Bloomberg wrote that “UK inflation unexpectedly cooled for the first time in three months in December.” Out of twenty-three analysts surveyed, only three came in at the actual figure of 0.3% m/m or below. Gilt yields declined the most since March 2023 which has apparently provided the under fire UK Chancellor some level of reprieve.

Clients are well aware of the MIR’s skepticism surrounding certain data releases particularly of the inflation variety. It can certainly be argued that this inflation miss came at the perfect time with the UK firmly in the crosshairs of investors.

According to the Office for National Statistics (ONS), “On a monthly basis, producer input prices and output (factory gate) prices both rose by 0.1% in December 2024...refined petroleum products provided the largest upward contributions to change in the annual inflation rates for input and output prices (1). And the following tweet shed some light on the issue of timing.

“Ignore downside UK inflation surprise; it’s a temporary reprieve. Inflation fell because of an early ONS price collection date—Dec. 10. ONS measured airfares left well before school holidays, returning on Xmas and NY Eve. That cut 14bp from headline inflation and will rebound (2).”

The trend though has been clear since late 2023. It’s just what is the velocity for inflation from here?



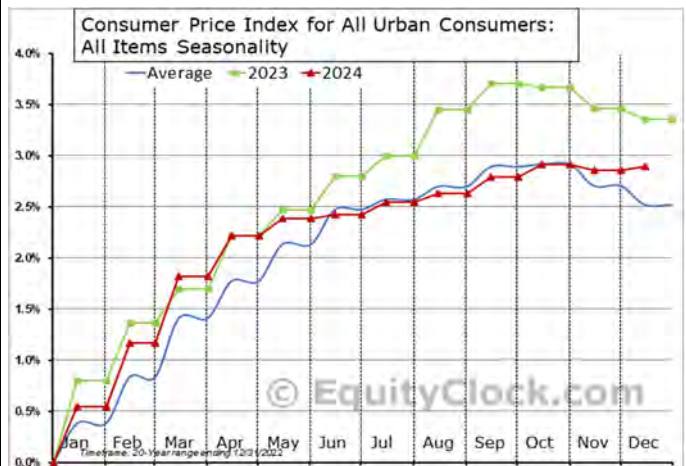
Source: Bloomberg LP

A day prior, the UK had to pay the highest real yield since at least 2006 on its 30-year inflation linked bond auction. Note that UK 10-year breakevens at 3.63% are

an interesting comparison to their US counterpart at 2.43%. The UK then auctioned on the same day as the CPI release, £4bn of 10-year gilts, with the weakest bid to cover ratio since 2023. The MIR has been writing about the risks of a sovereign bond debacle and one of the first signs to watch for is an inching towards failed auctions which signifies a significant lack of confidence with the issuers financial stability, in this case, the government.

UK electrical goods retailer, Currys, has announced that as a result of the rising national insurance cost to employers, they would be reducing hiring while introducing increased automation. This not only highlights the long-held concern related to A.I sending unemployment higher, but also the prospect for deflationary forces to resume in due course. The Royal Institution of Chartered Surveyors (RICS) has laid the blame for the weakest buyer interest in five months and the lowest number of market appraisals in a year squarely at the feet of elevated bond yields. Even though UK home prices just increased at their fastest annual rate in close to two years, banks are trying to avoid hiking mortgage rates as “banks were prepared to swallow lower asset margins and wider liability margins on lending to keep activity levels high (3).”

From a US inflation perspective, even though inflation is not where the Fed wants it, Williams, Goolsbee and Barkin were all in agreement that inflation continues to trend in the right direction. China’s money supply is rising once more and what effect the California wildfires will have on inflation may become visible rather quickly. From a seasonality perspective, the first and second quarter are where the bulk of the action has typically resided and where this year, the markets expect to receive more clarity about incoming tariffs.



Source: <https://charts.equityclock.com/u-s-consumer-price-index-cpi-producer-price-index-ppi>

Whether the market is correct to push inflation to the backburner with energy prices rising into a Middle East

ceasefire and Trump on deck remains to be seen. The focus has shifted to slowing economies where the US Dollar's strength can be a hinderance at the global level. US 30-year yields had been testing a 5% yield for the first time since November 2023. Several recent large options trades in both the US and UK have positioned for lower rates and while that may play out as the MIR had written, one takeaway would be that this might prove to be a tricky year for investors but a standout year for traders.

Sources:

(1) Producer price inflation, UK: December 2024 including services, October to December 2024. January 15th, 2025. <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/producerpriceinflation/december2024including-servicesoctobertodecember2024>

(2) <https://x.com/Robwoodecon/status/1879442443579588860>

(3) Cruise, Sinead and White, Lawrence 2025. "UK banks resist mortgage rate hikes amid money market turmoil." January 15th, 2025. <https://www.reuters.com/business/finance/uk-banks-resist-mortgage-rate-hikes-amid-money-market-turmoil-2025-01-15/>

Bloomberg Data

Bloomberg News



The Deep(Seek) Selloff

*The below article was produced by my longtime friend **Nathan Weiss** at Weiss Harrington, with his permission. Nathan speaks to the Institutional World as we do and this topic, DeepSeek and what it is/ means is a high priority. Feedback is welcome.*

We believe selloffs are the result of conditions (such as a dry forest) rather than catalysts (careless campers and lightning strikes), so we attribute much of today's tech selloff to equities being extended. With that in mind, let's discuss today's catalyst: DeepSeek.

A Brief Overview of DeepSeek

DeepSeek is a generative AI research lab established by Liang Wenfeng, the Principal of Ningbo High-Flyer Quantitative Investment Management Partnership, a prominent Chinese quant fund he founded in 2015. Liang, who holds a master's degree in information science, successfully expanded his fund to over 100 billion RMB (\$15 billion) by 2019, making it the largest quant fund in China at the time. Subsequently, Liang invested substantially in GPUs and established an internal deep learning group called Fire-Flyer. About two years ago, amidst a decline in the fund's AUM, Liang spent more time developing generative AI software.

DeepSeek initially rolled out an underwhelming language model on Christmas – DeepSeek-V3 – but on January 20th, an updated reasoning version of the model, named DeepSeek-R1, was introduced. The R-1 model is the model grabbing headlines today.

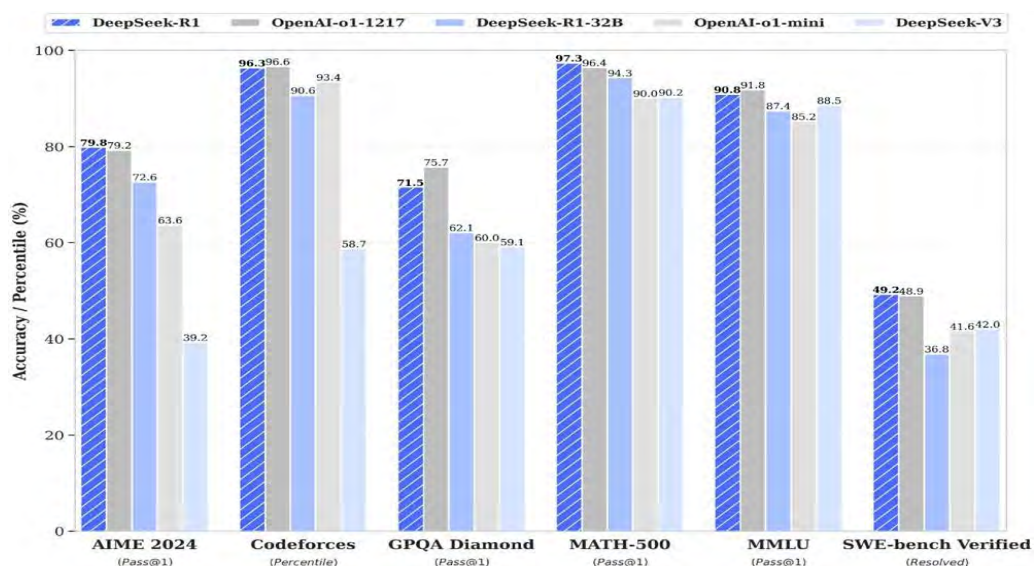
DeepSeek's Training Efficiency

According to DeepSeek, they trained their V3 model using 2,048 NVIDIA H800s, which are effectively H100s with 50% lower chip-to-chip transfer speeds, allowing them to be exported to China (prior to updated export restrictions in October 2023). The Technical Report for DeepSeek-V3 ([link](#)) states they trained the model in 2.788 mln NVIDIA H800 GPU hours – approximately 56.7 days assuming no major downtime. Meta's quite successful open-source model, Llama 3 70B, was trained over 17 days using 16,000 NVIDIA H100 GPUs – or 6.528 million H100 GPU hours. This suggests DeepSeek is twice as efficient as Meta at training.

Before we move on, we should point out that **DeepSeek reportedly has access to 50,000 NVIDIA H100 GPUs ([link](#)), a curious amount of computing power for a company claiming to have trained DeepSeek V3 using 2,048 NVIDIA H800s**, and reports from over a year ago suggest DeepSeek owned 10,000 H100 GPUs. Moving on...

DeepSeek's technical report ([link](#)) discusses how they improved the performance of their H800s by utilizing a 'DualPipe' parallel communication algorithm, low-precision communications and parallel processes to minimize the need for communications - but we do not know if they matched (or exceeded) the performance of the H100. It is also noteworthy DeepSeek did not employ a typical labeled data reinforcement learning framework (such as PPO-RL), they utilized a group policy framework (GRPO) which effectively examines the coherence of output instead of labeling data – improving efficiency. The GRPO framework has never been successfully deployed, as far as we know. That said, this discussion is beyond the scope of today's e-mail, so we will save the topic for a future update – assuming it is relevant.

Meta's Llama 3 70B and DeepSeek's V3/R1 were both trained on approximately 15 billion tokens (14.8 billion for DeepSeek V3, 15.0 for Llama 70b), so the (reported) training efficiency of DeepSeek V3 cannot be attributed to running less training data. That said, DeepSeek could have utilized more significant pre-training than they disclosed and/or baseline model weights from a competitor. Our suspicions were increased by the following performance graph published by DeepSeek:



Note how the scores of DeepSeek-R1 are very, very close to OpenAI-01-1217 – within 1.00% for every single test except the GPQA Diamond benchmark. Having spent a considerable amount of time examining benchmarks over the past year, we can say this is very unusual: Each model typically has strengths and weaknesses causing relative performance to vary significantly from benchmark to benchmark. **Assuming DeepSeek didn’t make up their benchmark performances, the very close relationship between the scores of DeepSeek-R1 and OpenAI-01-1217 suggest the models are related – meaning DeepSeek may have utilized model weights from OpenAI and/or inferred weights/outputs by utilizing o1 model for reinforcement learning or fine tuning.**

The other curious feature of DeepSeek’s V3/R1 models are the number of total parameters – or weights and biases. Higher parameter counts greatly increase the complexity – and processing resources – needed to train and run a model, with some of the increased complexity offset by the fact that higher parameter counts can encode more complex functions and patterns. DeepSeek has 671 billion parameters, making it a quite large model. For comparison, Llama 3 70B has... You guess it. 70 billion parameters. ChatGPT-4 has 1.76 billion parameters.

But...

Models such as GPT-4 use a Mixture of Experts (MOE) approach, meaning they are collections of smaller, specialized (“expert”) models that together account for the total advertised parameter count. Specifically, ChatGPT-4 is made up of 8 smaller models, each with 220 billion parameters. DeepSeek’s previous model, DeepSeek-V2, has 236 billion parameters dividend into a stunning 160 experts, suggesting the average model size was just 1.48 billion parameters. DeepSeek-V3? Surprisingly, the technical paper did not discuss their expert policies, perhaps because they do not want to draw attention to them.

Based on DeepSeek’s disclosure that V3 activates 37 billion parameters per request, the model utilizes at least 18 experts. On the upper end, we know that V2 activated 6 experts per request, resulting in 112 experts for V3 assuming DeepSeek utilized the same framework. So why are we nerding out over MOE models?

The following table shows the price to train various models on the Cerberus Model Studio:

Model	Parameters	Tokens to Train to Chinchilla Point (B)	Cerebras Model Studio CS-2 Day to Train	Cerebras Model Studio Price to Train
GPT3-XL	1.3	26	0.4	\$2,500
GPT-J	6	120	8	\$45,000
GPT-3 6.7B	6.7	134	11	\$40,000
T-5 11B	11	34*	9	\$60,000
GPT-3 13B	13	260	39	\$150,000
GPT NeoX	20	400	47	\$525,000
GPT 70B	70	1,400	85	\$2,500,000
GPT 175B	175	3,500	Contact For Quote	Contact For Quote

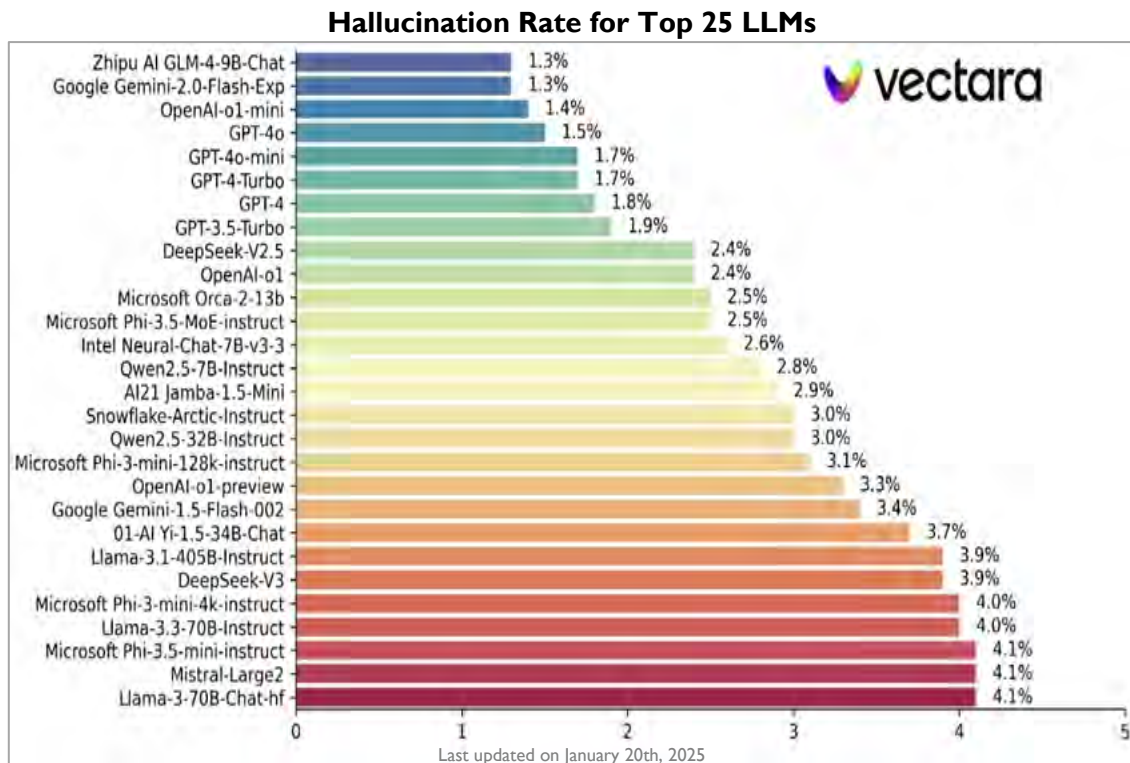
Training a 70 billion parameter model, the size of Llama 3-70B, costs \$2,500,000. Training an 11 billion parameter model? \$60,000. You probably get where this is going. If one were to build a 700 billion parameter model utilizing 10 experts, based on the above table, the total cost would be \$25,000,000. Training a 700 billion parameter model utilizing 64, 11 billion parameter experts? \$3,840,000.

The utilization of a high number of experts is not an innovation or development unique to DeepSeek. Surely, they have done proprietary research to develop their own ‘Gating Network’ – the system which decides which models to call upon for each request (most expert systems call on multiple models at a time), but this approach is not revolutionary.

Why don’t other firms use a higher number of experts to reduce costs and increase inference performance?

Hallucinations

Smaller models simply ‘know’ less – there is less information, less context, and fewer/less refined relationships between tokens than in larger models. As a result, small models suffer from hallucinations – especially with multi-domain questions (such as asking which car to buy based on payment calculations AND reliability data AND your personal preferences). Fortunately, we have some early hallucination rate data for DeepSeek-V3 from Vectara:



As displayed on the above table, **GPT-4o has a 1.5% hallucination rate while o1 has a 1.4% hallucination rate. Even DeepSeek 2.5V has a still-respectable 2.4% hallucination rate. DeepSeek-3V? 3.9% - among the worst of all models tested.**

When solving complex problems or executing multiple step queries as a reasoning model tends to do, the hallucination rate effectively multiplies: If a model has a 1.4% chance of getting each of 5 steps wrong, the probability of a correct answer at the end is 93.2%. A 3.9% hallucination rate lowers the 5-step problem success rate to just 81.9%. Presumably DeepSeek can improve the performance of V-3 over time, but the deployment of small experts has consequences.

Benchmarks

So far, we know that DeepSeek is a top-performing model because... DeepSeek told us it is a top performing model. There are multiple ways a developer can exaggerate a model’s performance:

- **Training Models on Benchmark Questions:** This is surprisingly common problem, sometimes occurring intentionally and sometimes unintentionally (training data contains benchmark test data). Several

studies have shown simply changing the names of people in mathematical reasoning question lowers the performance on many language models, suggesting they were trained on the benchmark questions. In the coming days, researchers will evaluate DeepSeek-R1 using modified benchmark questions, assuming they aren't already.

- **Applying Excessive Inference Time Compute:** Developers can allocate additional compute time to taking a benchmark test, inflating scores. In the case of OpenAI, their o3 model scored 76% on the ARC-AGI benchmark at a cost of \$17 to \$20 per question. OpenAI then tested o3 in a 'High Compute/Tuned' configuration, spending more than a million dollars to answer the 400-question exam. The score?? 88%. In this instance, OpenAI was not trying to cheat – they wanted to demonstrate the capabilities of an unconstrained reasoning model. In doing so, they arguably took the title of the first model to achieve AGI, quite possibly as a negotiating tactic with Microsoft.
- **Lying:** Developers, and nation-states, have a massive incentive to make their models appear to be leading-edge. As we pointed out earlier, the fact that DeepSeek V3 scored so similarly to GPT-o1 on multiple tests is highly unusual. It is also noteworthy that other developers need months of tuning for their models to score well on benchmark tests, but apparently this was not the case for DeepSeek (insert sarcasm).

While we wait for independent testing of DeepSeek R-1, we do have early data from the Chatbot Arena. As we wrote in our September 5th AI Insights, the Chatbot Arena is an open, web-based platform designed for evaluating and ranking LLMs utilizing crowdsourced prompts and feedback. To utilize Chatbot Arena, users submit text or image-based prompts via a browser-based interface, after which they are presented with responses from two models, labeled 'Model A' and 'Model B,' in a side-by-side comparison. The user continues entering prompts until their preferred model becomes apparent, at which point they 'vote' by choosing 'A is better,' 'B is better,' 'Tie,' or 'Both are bad.' The platform then records the ranking and reveals the identities of each model.

So far, DeepSeek-R1 ranks fourth behind Gemini 2.0 Flash, Gemini 1206 and ChatGPT 4o on the Chatbot Arena:

Rank* (UB)	Rank (StyleCtrl)	Model	Arena Score	95% CI	Votes	Organization	License
1	1	Gemini-2.0-Flash-Thinking-Exp-01-21	1382	+8/-6	6437	Google	Proprietary
1	1	Gemini-Exp-1206	1374	+5/-4	22116	Google	Proprietary
3	1	ChatGPT-4o-Latest-(2024-11-20)	1365	+4/-4	35328	OpenAI	Proprietary
3	1	DeepSeek-R1	1357	+12/-13	1883	DeepSeek	MIT
4	1	Gemini-2.0-Flash-Exp	1356	+4/-4	28939	Google	Proprietary
4	1	o1-2024-12-17	1352	+6/-6	9238	OpenAI	Proprietary
7	1	o1-preview	1335	+3/-3	33186	OpenAI	Proprietary
8	1	DeepSeek-V3	1317	+6/-5	13648	DeepSeek	DeepSeek
8	11	Sten-2-106-Exp	1305	+9/-7	4533	StopFun	Proprietary
9	11	o1-mini	1305	+2/-3	49952	OpenAI	Proprietary
9	9	Gemini-1.5-Pro-002	1302	+3/-4	46621	Google	Proprietary
12	11	Grok-2-88-13	1288	+3/-3	67158	xAI	Proprietary

The Rise of Small Language Models (SLMs)

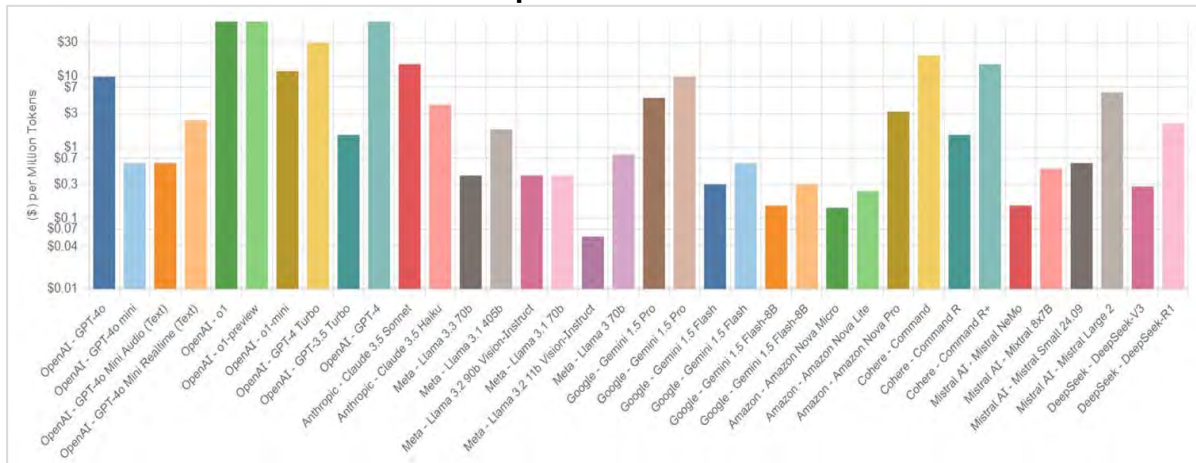
Smaller models are faster, lower cost and can sometimes run locally on a desktop or laptop. One of the scariest metrics circulating today is that DeepSeek-R1 costs \$2.19 per million output tokens versus \$60.00 per million for GPT-o1.

But..

Looking at the above Chatbot Arena leaderboard, Gemini 2.0 flash is basically tied with DeepSeek-R1. Google hasn't disclosed Gemini 2.0 flash pricing yet, however Gemini 1.5 flash costs \$.30 per million output tokens. **I'll wager a dinner that Gemini 2.0 flash output tokens are priced near (or below) DeepSeek-R1.**

Other notable small models, such as GPT-4o-mini, cost just \$.60 per million output tokens, as the following graphic from DocsBot.AI displays:

Output Token Costs



Microsoft says Small Language Models (SLMs) can Rival or even Surpass OpenAI o1 (link)

As we wrote in our January 14th AI Insights, Microsoft recently developed a new reasoning technique called rStar-Math, which utilizes Monte Carlo Tree Search (MCTS) to allow Small Language Models (SLMs) to efficiently determine the best answer for complex problems. Using rStar, the math benchmark score of the 7 billion parameter Qwen2.5-Math-7B model increased from 58.8% to 90.0% while the score of Microsoft’s 2.8 billion parameter Phi3-mini-3.8B increased from 41.4% to 86.4%. Both scores surpassed OpenAI’s GPT-o1 benchmark score of 86.1%.

Notably, the o1 model uses an estimated 300 bln parameters but lots of inference time compute. As a result, OpenAI charges \$63.00 per million tokens of output. Models with less than 10 bln parameters typically cost around \$0.10 per million tokens of output. We believe rStar-Math is a more significant development than DeepSeek’s R-1.

Over time, humanity will become a more efficient consumer of generative AI – a natural evolution which will drive demand. Rather than deploying frontier models ranking in the top 1% of physicists and mathematicians to calculate a restaurant tip, perhaps a small model would suffice...

Conclusions

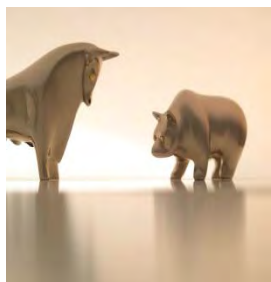
We believe today’s selloff was largely the result of the condition of tech stocks – overbought – rather than the catalyst of DeepSeek. That said, **a competitive race between the U.S. and China is in everyone’s interest** – it boosts morale in China, underscores the importance of U.S. investments in AI, justifies the policies of President Trump and makes for engaging news coverage – evidenced by the endless string of TV guests today discussing the situation. For these reasons, the debate (‘is DeepSeek real’) will likely continue.

While advancements in Small Language Models (SMLs) are detrimental to hardware companies and energy producers in the short run, we were surprised to see software companies sell off in tandem. Microsoft (MSFT), for example, is a huge beneficiary of smaller, faster models as they will greatly enhance their Copilot services. Palantir (PLTR) would also benefit as generative AI moves closer to the user (or the drone). Salesforce (CRM) would be another software beneficiary as the cost of running intelligent agents declines while their utility improves.

In addition, not all hardware companies would be losers: AMD should be a net beneficiary of SMLs, having competitive inferencing GPUs and absolutely dominating AI PCs – which today remain uninteresting due to a lack of local (on-PC) AI software. Google (GOOG) and Apple (AAPL) also benefit as local AI on devices improves.

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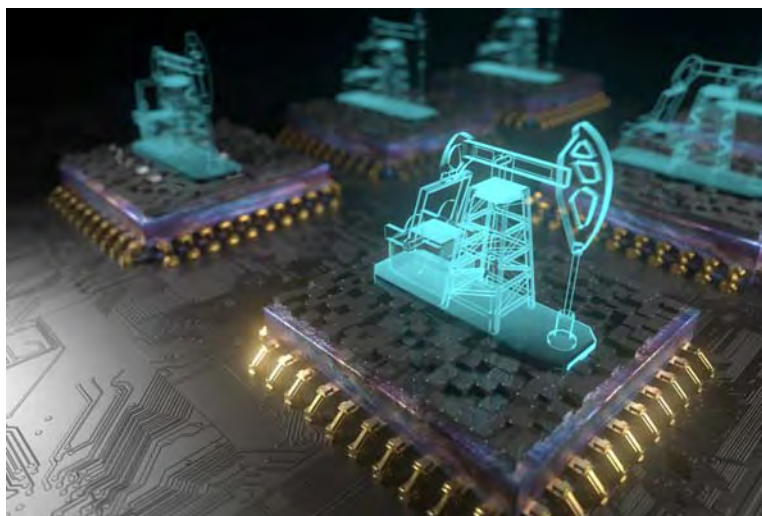
The DeepSeek Drama: Market Manipulation or AI Breakthrough?

The below article comes to us courtesy of our friends at Guild Investment Management in Los Angeles. They have hit the key part of the AI story we are looking at- which companies are applying AI to the benefit of operational returns. Are productivity and earnings rising as a result of AI usage and in what sectors/ companies is that occurring? Thanks to our long time friends at Guild for allowing us to re-print this piece.

Chinese AI firm DeepSeek claims to have trained a 671-billion-parameter model for just \$5.6 million using 2,048 Nvidia H800 GPUs -- a cost efficiency that, if true, would be a breakthrough in AI development. The announcement triggered a 17% drop in Nvidia's stock before it rebounded, as investors questioned whether AI hardware demand could decline faster than expected. However, OpenAI alleges DeepSeek used "distillation" to train its model -- a practice that would violate OpenAI's terms of service -- raising concerns about intellectual property theft (as well as putting the lie to DeepSeek's claims about its development costs). The timing is also notable, coming just before new U.S. export controls on AI chips to China.

While the details remain contested, the broader trend is clear: AI capabilities are becoming increasingly commoditized. As training costs decline and efficiency improves, the competitive landscape will shift, much as it did with cloud computing and semiconductors. **Whether DeepSeek's claim is genuine or a well-timed market play, the trajectory toward lower-cost AI models is inevitable.**

The Energy Sector Looks Poised to Turn AI Investments Into Financial Rewards...Without Higher Prices



While headlines focus on chatbots and content generation, AI is quietly revolutionizing traditional industries. The energy sector provides a compelling example of how AI is creating tangible economic value through operational improvements. From predictive maintenance to real-time drilling optimization, AI is proving its ability to enhance efficiency, reduce costs, and improve safety in energy production.

Schlumberger's AI Implementation: A Closer Look

Schlumberger (SLB), the global oil service giant, is emerging as a leader in AI-driven energy solutions. The company has developed an AI platform focused on practical applications in exploration and production. Key capabilities include:

1. Subsurface Simulation & Reservoir Analysis

Traditionally, geologists and engineers rely on multiple software tools to model underground reservoirs. Schlumberger's AI platform streamlines this process by allowing users to run complex simulations using natural language commands. This reduces analysis time and ensures higher accuracy in modeling oil and gas reserves.

2. Retrieval-Augmented Generation (RAG) for Energy Data

AI is only as good as the data it learns from. Schlumberger has implemented “retrieval-augmented generation” (RAG), a system that integrates AI with the company’s vast technical knowledge base. This ensures that AI-driven recommendations align with established engineering best practices rather than relying solely on generic pattern recognition.

3. Vector Similarity Search Across Distributed Nodes

A major challenge in energy operations is sifting through massive datasets -- spanning geological surveys, historical drilling results, and equipment telemetry. Schlumberger’s system employs vector similarity searches, enabling real-time access to relevant insights from billions of data points stored across distributed servers.

4. Reliability, Transparency, and AI Explainability

Unlike consumer AI models that operate as black boxes, Schlumberger has prioritized system transparency. This includes audit trails to track AI-driven recommendations; continuous monitoring to detect potential errors before they escalate; and explainable AI features to ensure engineers understand why the system makes certain predictions.

While it is still early to measure the full impact, initial case studies suggest that these innovations could drive substantial efficiency gains. The key question is whether these improvements will consistently translate into higher profitability and lower operational risk over time.

Predictive Maintenance: AI’s Cost-Saving Power

One of the most immediate AI applications in the energy sector is predictive maintenance. For example:

- British Petroleum (BP)’s APEX system has demonstrated the ability to predict equipment failures two to three weeks in advance, significantly reducing repair costs and unplanned downtime. Given that offshore drilling downtime can cost up to \$1 million per day, early detection of potential failures translates into substantial financial savings.
- ExxonMobil (XOM) has implemented AI-driven predictive maintenance in its refining operations, reportedly reducing downtime by 25% and increasing asset lifespan.
- General Electric (GE) Oil & Gas has developed AI solutions that use digital twins — virtual models of physical assets — to monitor and optimize equipment performance in real time.

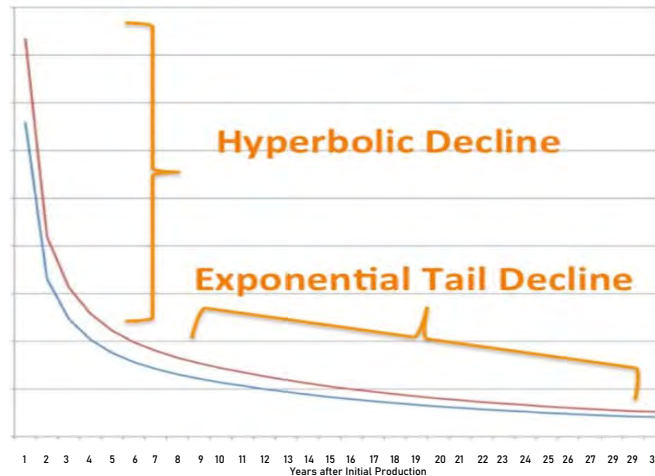
Real-Time Drilling Optimization

- Shell has reported meaningful reductions in drilling time through AI implementation, with some wells showing up to 40% improvement in drilling efficiency. AI-driven optimization adjusts drilling parameters dynamically, allowing for smoother and faster operations.
- Halliburton’s AI solutions analyze real-time sensor data to automate drilling adjustments, reducing human error and increasing precision.

AI in Well Planning and Reservoir Management

- AI-driven geospatial analysis is improving the success rate of well placement, reducing costly miscalculations. Companies report that AI-assisted planning can improve resource recovery rates by 10–15%.
- Chevron’s reservoir management system uses AI to continuously optimize production, helping to maximize oil recovery while minimizing environmental impact.

Oil and gas economics are at the mercy of the production decline curve. Can AI change its slope and shape?



Investment Implications: AI-Driven Efficiency Reshaping Energy Sector Economics

AI's impact on the energy industry could lead to structural changes in markets, affecting valuations and investment strategies. Key considerations include:

1. **Operational efficiency driving profitability:** Companies that leverage AI effectively may enjoy higher profit margins due to reduced costs and improved resource recovery.
2. **Shift in competitive dynamics:** As in all sectors, energy firms investing in AI-driven operational improvements effectively will gain an edge over competitors that lag in adoption.
3. **Impact on geopolitics and energy prices:** Increased efficiency in oil and gas extraction could extend the lifespan of fossil fuel reserves, potentially moderating price volatility. At the same time, AI's role in renewable energy optimization could accelerate the transition toward cleaner sources, while simultaneously decreasing costs and thus increasing energy supply -- which historically leads to lower prices for consumers.

Looking Ahead: Distinguishing AI Hype from Reality

The transformation of the energy sector through AI represents a crucial case study in how this technology **is reshaping almost all traditional industries**. However, as with any major innovation, it's important to separate real-world impact from speculative claims.

Key questions for investors to consider:

- While markets may initially “cheer” companies who commit large capex to AI, are the ROI gains visible, or merely hoped-for?
- Are companies reporting measurable improvements in efficiency, cost reduction, and asset longevity?
- Are AI-driven enhancements leading to sustained improvements in profit margins, or are they one-time gains?
- How much of the reported improvements are due to AI specifically, versus broader technological advancements (such as better sensors or improved materials)?

While consumer-facing AI applications grab headlines, the most significant economic impact may come from industrial applications that quietly transform efficiency and profitability behind the scenes. For investors, the key is to focus on companies who are proving their success in AI integration and seeing improvement in clear performance metrics, rather than those simply making ambitious claims about AI's potential.

Thanks for listening; we welcome your calls and questions, and please feel free to share this newsletter with any friends and family you think would find it useful.

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China Update

The following article is written by Simon Hunt, who writes for TIS Group's Frontline China Report. If you are interested in articles similar to today's piece, please contact Larry Jeddlob at tis@tisgroup.net

Introduction

This is a short report to focus on a few essential factors, such as economic growth, risk of tariffs, US relations, deflation and currencies.

Negativity about China and its economy has been compounded by President Trump's statements on raising tariffs on their exports to America. The fear has been compounded by Marco Rubio, the new Secretary of State with President Trump's support inflicting damaging tariffs and other containing policies on China so much so that their economy will be damaged towards recession.

US-China Relations and Tariffs

In our report China: A Paradigm Shift of 15th November we quoted from an extensive report that Rubio's office had prepared on China which illustrated China's strengths and how China could respond to tough measures if America introduced them.

Subsequently, the two Presidents have spoken by phone; and China's Vice-President was invited to the Inauguration where he spoke with members of the cabinet and businesspeople.

As John Browning wrote in today's Letter, 'It was the lack of specific detail on tariff issues that was perhaps the most salient feature of Trump's inauguration speech. That he intends to create an External Revenue Service to collect tariffs, adding 'it will be massive amounts of money pouring into our Treasury coming from foreign sources.'

What seems to have been a policy changer was the conversation between Xi and Trump on Friday. It seems to have been a constructive meeting with both presidents wishing to resolve outstanding issues.

This constructive relationship was confirmed by reports from Xinhua of Vice President Han Zheng's meeting with VP JD Vance. 'The two sides are currently working hard to achieve their respective developments goals and dreams. As long as the two sides uphold the principals of mutual respect and peaceful coexistence and win-win cooperation, they will contribute to each other's progress...Economic and trade relations are important are important issues of common interest to both sides.

If discussions between the two countries continue in this vein, the outcome would be that America will impose enough tariffs on China to satisfy the hawks on the Hill but not enough to risk China's economic growth.

Deflation

China's deflation is being portrayed as Japan's deflation of the 1990s but this is hardly a correct interpretation.

Japan's deflation was the result of a negative demand shock – the popping of the bubble economy. The mid-1990s were the years when Japan was the most expensive economy in the world which caused lower aggregate demand and lower prices.

China's deflation is the result of a positive supply shock as credit has been redirected from property into advanced manufacturing. Prices in China are amongst the cheapest in the world because of the country's highly efficient supply chains and automated factories. Aggregate supply has risen but prices have fallen.

For instance, BYD's entry level Qin Plug-in Hybrid Electric Vehicle over 18 years BYD has halved the price but has quadrupled the range and power of the vehicle.

In fact, consumer products in China are experiencing a revolution in 'hedonic' improvements from electronics to smartphones to appliances to restaurant services to boutique hotels and so on. Chinese households are getting more for the renminbi they spend across wide swathes of the economy.

Average per capita disposable income was RMB 41,314 which increased by 5.3% in 2024 according to NBS. Had the forecast CPI of 3% for that year materialized the average disposable income would only have purchased RMB 40,000 of goods and services. But reality was the opposite. CPI was only 0.2% so the average person's real spending power was RMB 41,231 last year.

In short, China's deflation has been a bonus for consumers; their average disposable income has gone further by RMB 1231.

Bibliography

Simon Hunt

** The author(s) of the above article have gathered information from confidential sources deemed to be reliable, but no assurance can be made as to the accuracy of the information given.

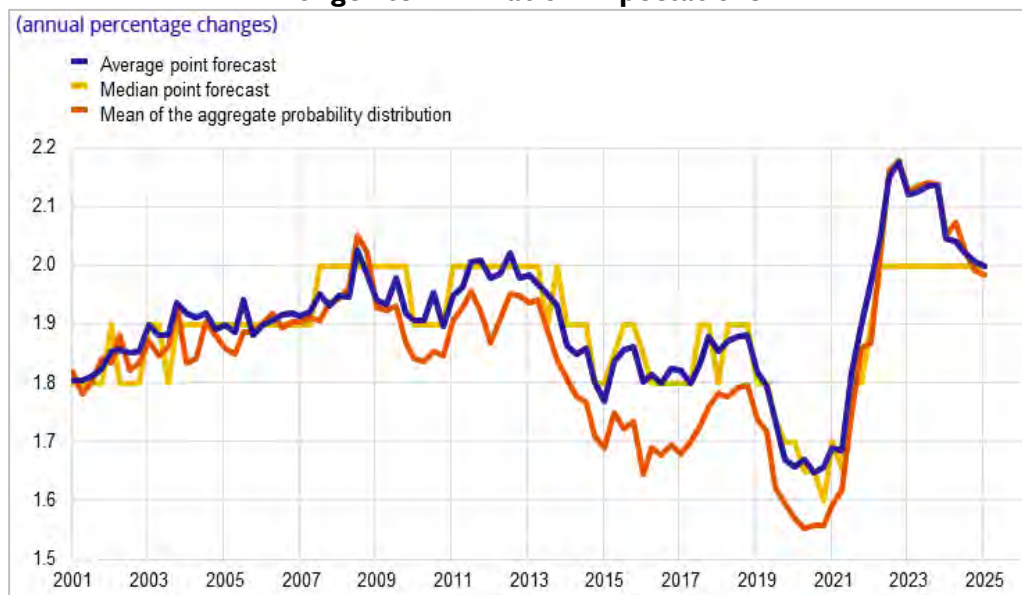


European Outlook — February 2025

The ECB

Having just lowered rates as expected at the end of January, the message from the ECB remains the same; inflation is headed back to 2% this year and while growth is still a significant concern, rising real wages should increase demand moving forward.

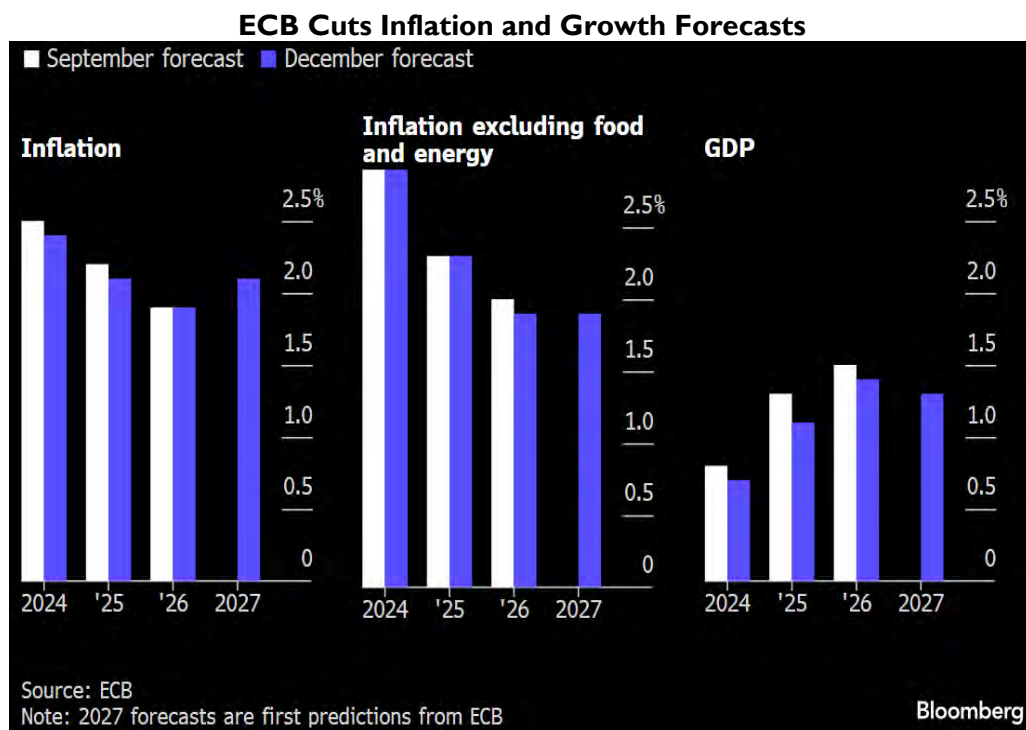
Longer-term Inflation Expectations



Source: https://www.ecb.europa.eu/stats/ecb_surveys/survey_of_professional_forecasters/html/ecb.spf2025q1~12ccd2307f.en.html#toc2

ECB's Nagel estimates that the neutral rate is in the range of 1.8% - 2.5%, and so another cut at the March meeting would hit the upper boundary meaning that additional rate cuts will receive less encouragement especially with the Fed priced for about one more cut for the remainder of the year. ECB's Elderson is in favor of placing more weight on the incoming data rather than utilizing a theoretical level for rate decisions. Elderson also noted that, "Over the medium term, a tighter US monetary policy tends to be disinflationary also for the euro area."

Lagarde seems confident now that inflation this year will return to the 2% target that was established by the ECB. However, the prospect of reciprocal tariffs is something that Lagarde is keenly aware of. "The disinflation process in the euro area is well on track. Greater friction in global trade would make the euro area inflation outlook more uncertain." ECB's Guindos is concerned that tariffs not only lower global growth but create a supply shock in the process. According to ECB's Vujcic, it's tariffs that are now creating the majority of uncertainty for the European central bank.

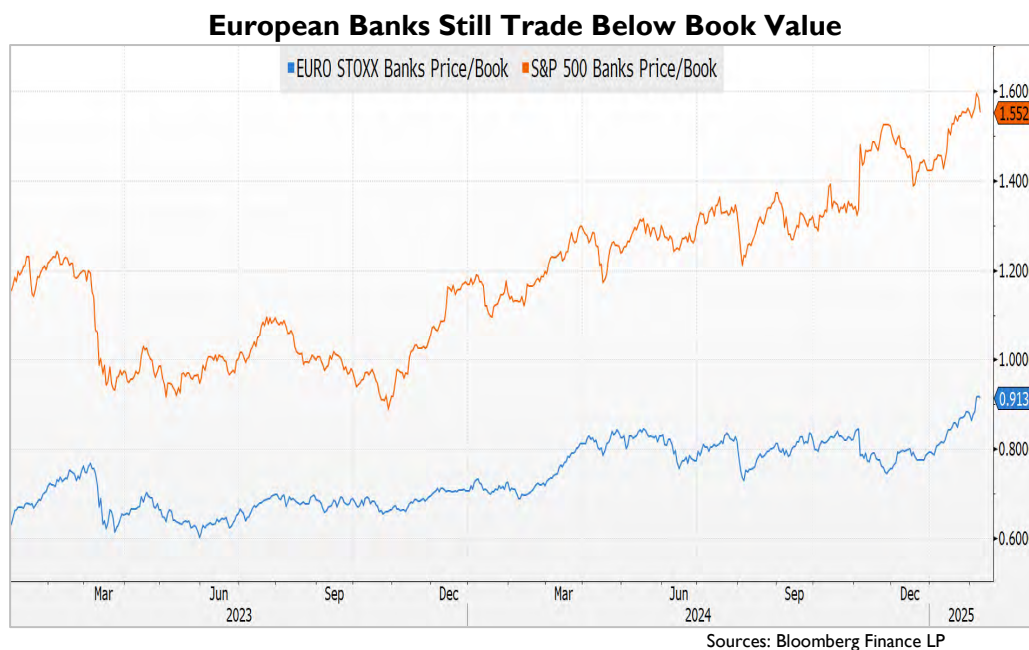


ECB’s Schnabel had an interesting take on the situation in Europe, one that we agree with, and which may limit the upside on European outperformance unless some political hard decisions are finally delivered. “Interest-rate cuts can mitigate the economic weakness. But they can’t solve the structural crisis. The export-led growth model needs to be reconsidered in the face of this increasing geopolitical fragmentation.”

Europe

In last month’s European outlook, the following was written:

“A growth turnaround for Europe would be the shock for the year, especially with so much negativity surrounding the EU economy and earnings growth expected to be flat. As the chart for the banking index shows, even with geopolitical and interest rate risk flying high, the potential upside could become a major consideration if some of the pieces begin to fall into place.”



Banks may have provided the clue that a change in sentiment was coming, but with the US patriotism trade slowing following the post-election boost, markets as always are pricing forward and see a more positive outlook coming for Europe. To be clear, Europe is by no means out of the woods, and effective changes have not been enacted to meaningfully alter the growth trajectory. Europe is performing well due to valuation metrics, but there are a couple more areas to consider that could provide meaningful upside.

Europe's P/E in Line with EM



Source: Bloomberg Finance LP

Firstly, a more cohesive European Union that moves towards joint issuance or exempting specific spending (e.g., defense) from fiscal targets would unleash aggressive spending into the Eurozone. The head of the Bundestag Defense Committee recently stated that he views 3% of GDP as "the new floor" for defense spending by NATO members, as Trump tries to push them towards 5%. Ursula von der Leyen is apparently contemplating the use of emergency powers to permit increased defense spending throughout the EU. The beneficiaries may not all be EU-companies, but that may help lessen the blow from prospective tariffs, which is a critical topic in itself. Secondly, a topic which the MIR has touched on in our writing and recently during in-person meetings in Europe, is the potential for what is occurring with DOGE to become more of a movement by finding support in other countries. Consider the blowback to some of the egregious spending that DOGE has already documented related to USAID. That one agency was responsible for only about 1% of the Federal budget. As this unravels, how many more countries are going to demand increased transparency from their governments to better understand where their taxes are being spent?

The EU is now reviewing their own foreign aid allocations "to more closely align the bloc's funding allocation with its foreign policy interests." In Poland, PM Donald Tusk is driving a new initiative for greater deregulation to spur entrepreneurship. This is also curious timing with a criminal probe having been launched against Tusk's allies for alleged criminal activities. Whether this is successful or not, the conservative movement throughout Europe has been emboldened by Trump with Vox (Spain) now the preferred choice by those under thirty-five and Reform in the UK now performing best in recent UK polls. German elections will be held on February 23rd and another uneasy coalition may be brewing, but the possibility that the debt brake could be removed could unleash more spending that in this environment might be targeted more towards (digital) infrastructure. In France, Macron just announced €109bn of A.I related projects, to be spent within five years.

The American Chamber of Commerce is pushing for changes to be made to ESG regulations in the EU. The focus on the green agenda has meant the desire for capital markets integration has taken a back seat, however, several major firms have sounded off about listing in the US to be treated more favorably from a regulatory standpoint as well as reviving their valuations. Activist investor Elliott Investment Management has built a stake in BP, increasing the possibility of a New York listing. Again, it's not to say this will happen but perhaps the EU has seen enough to finally take some hard decisions, especially now that the

green agenda doesn't resonate as much with voters. European upside should be viewed as a trade for now until some of the political pieces begin falling into place. Clearly something has shifted though, Sentix investor confidence delivered on the high end of forecasts, and the expectations index (economic sentiment six months from now), just turned positive for the first time since last July.

BP vs. Shell



Source: Bloomberg Finance LP

Eurozone Sentiment vs. EuroStoxx



Source: Bloomberg Finance LP

The UK

Citi Economic Surprise – United Kingdom



Source: Bloomberg Finance LP

The chart above shows an improvement in the poor UK data which has dominated since the second half of last year. Growth is still very much a concern though for the UK, even though a recession at the end of last year was narrowly avoided. Construction is still dragging on GDP as is private demand, yet government spending is still acting as a backstop to the economy. Confidence from both businesses and consumers has not really recovered since the budget announcement which has seen the government make more noise about juicing growth and lowering regulations specific to the financial sector, without much follow through. The risk of higher taxes and increased unemployment as employers are forced to reduce headcount to pay corporate tax bills still makes the outlook cloudier than Reeves and Starmer would prefer. Even with BoE's Mann pivoting to a dovish stance, support from monetary policy is not assured with the BoE's chief economist remarking that, "We are able to remove some of the restriction we imposed because of the successful - but not yet complete - process of disinflation. I would expect we're going to cut Bank Rate further. But the pace at which you can do it is less." This is yet another central bank having to operate in a wait and see mode for how US tariff policy affects the global economy.

While the UK economy remains on a weak footing, the markets are acting as a port in a storm as Trump has not mentioned the UK yet, relevant to tariffs. That's not to say they aren't coming, especially after Starmer's Labour government interfered with the US election according to Trump and Musk. Yields have backed off their high, helped by a dovish BoE tone, but still remain in a danger zone. GBP has also bounced off the January low of 1.21 which may affect the FTSE's performance if the Dollar weakens further. For now though the defensive nature of the FTSE and its foreign exposure are being viewed favorably especially as we receive more questions about moving back towards value and away from growth names. Much like the European market's strong start to the year, cheap valuation has been a major factor for investors. And similar to their neighbours on the continent, political volatility and a weak underlying economy are structural issues that will need to be addressed sooner rather than later.

UK 10-Year Gilts



Source: Bloomberg Finance LP

FTSE 100



Source: Bloomberg Finance LP

Bibliography

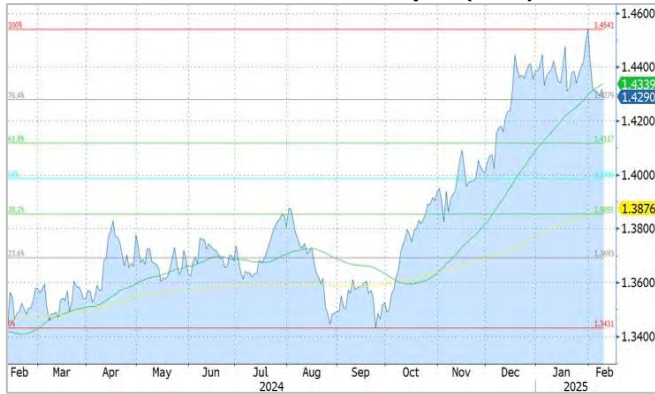
Bloomberg Data

Bloomberg News

ECB

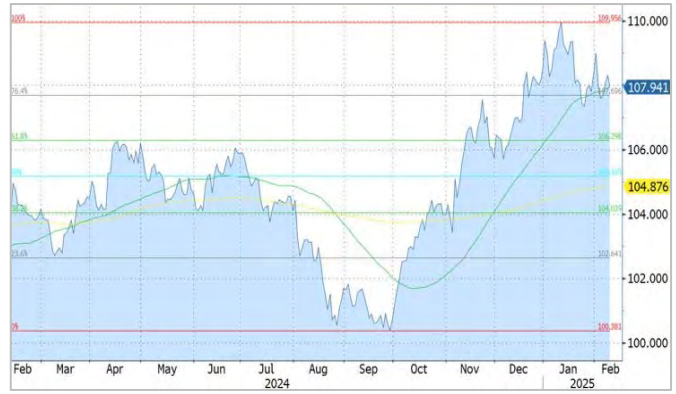
https://www.ecb.europa.eu/stats/ecb_surveys/survey_of_professional_forecasters/html/ecb.spf2025q1~12ccd2307f.en.html#toc2

USD/Canadian Dollar Spot (GPF)



Courtesy of Bloomberg LP

DXY



Courtesy of Bloomberg LP

THE CAD CORRELATES TO COMMODITIES —COMMODITIES ARE VERY CHEAP RELATIVE TO GROWTH STOCKS/CHANGE OF GOVERNMENT COMING?

CANADA DATA

	Rate of Change	as of
REAL GDP YoY	0.00%	11/30/2024
PPI YoY	7.61%	12/31/2022
CPI YoY / Inflation	1.80%	12/31/2024
Unemployment	6.60%	1/31/2025
MI YoY	6.74%	11/30/2024
M3 YoY	5.40%	11/30/2024
Overnight Lending Rate	3.00%	2/11/2025

Comparative Data to Other Major Currencies

Country	10 yr		Real Short Rates	Real Long Rates
	3 Mo Int Rates	Int Rates	(Using 3-yr Govt Bonds less CPI)	(Using 10-yr Govt Bonds less CPI)
Australia	4.28%	4.43%	1.88%	2.03%
Canada	2.85%	3.10%	1.05%	1.30%
Euro	2.45%	2.43%	-0.05%	-0.07%
Japan	0.30%	1.32%	-3.30%	-2.28%
Switzerland	-0.75%	0.415%	-1.35%	-0.19%
US	4.32%	4.54%	1.42%	1.64%
UK	4.40%	4.51%	1.90%	2.01%

Country	GDP	CPI	PPI	Unemployment
Australia	2.30%	7.00%	5.20%	3.57%
Canada	0.00%	1.80%	7.61%	6.60%
Euro	0.90%	2.50%	0.40%	6.30%
France	0.00%	1.40%	-3.80%	7.10%
Germany	-0.20%	2.30%	0.80%	6.20%
Japan	0.50%	3.60%	3.80%	2.40%
Switzerland	1.70%	0.60%	-0.10%	2.70%
US	2.30%	2.90%	2.80%	4.00%
UK	0.90%	2.50%	0.00%	4.40%

MONETARY/ECONOMIC FACTORS

- Canada’s money supply is +5.4% (broad money) on a y-o-y basis.
- The currency markets are weighing factors beyond yield differentials. Creditor vs. debtor countries, commodity markets exposure (positive if a commodity producer), fiscal

management, trade relationships and asset diversification are additional determining factors. Sovereign credit ratings also play a role. The CAD could trade much stronger than expected if the global economy is stronger than expected in the coming years (no US recession?) and commodity prices rise. The number of central banks cutting rates is growing to more than 50 at last count. The Fed has further to go which will affect the CAD. Commodities may be at the beginning of a secular bull market. Supply interruptions due to emerging conflicts in the Mideast and Russia started the trend toward re-shoring. Re-shoring also drives a shift in supply lines with the IRA. The next phase of re-shoring is likely to be due to trade / tariffs related. Negotiation on tariff policy, globally, may become the most important FX story of 2025.

- The future of the energy sector represents a key national asset in Western Canada and increasingly in Eastern Canada (the Maritime Provinces). A re-balancing of global supply / demand due to long term cap-ex shortages and sanctions against Russia, should continue to strengthen the C-Dollar over time. But will Canada’s energy policy change? The Canadian government is pushing for banks to reduce their funding of the fossil fuel industry. Will that policy change if the government changes in the next election? Oil / gas prices must rise and remain at a relatively high level to fund cap-ex necessary to keep oil supplies from falling and to make the renewables sector economically viable. Natural gas could be headed for years of additional demand as the arbitrage between North American and European gas closes and China purchases three decades of LNG supply. Texas is awash in natural gas for now – when that inventory dissipates, the C-Dollar and other natural gas producers should get additional support. The current pause is over. The new administration will end it. Near term, Canada continues to supply five million bpd of oil to the US. Could those exports grow per demand from data centers and technology users? How does “drill, baby, drill” fit in? Ontario is

openly running ads on US television about the US-Ontario relations. Whatever the Federal government is thinking, Ontario wants to trade.

- The US is Canada’s major trading partner. Economic recovery in the US and China are key to Canada’s economy. A new government in Canada, which seems likely, may be a different kind of economic partner to the US. Likewise, the new US President is changing US economic / trade policy. Tariff wars have erupted between the US-Canada. Started with the US 25% tariff on everything except oil. Canadians responded very quickly.

POLITICS

US economic policy may shift to a more pro-growth / energy friendly stance. Canada occasionally has Conservative governments. Is that the next political change in Canada, a more Conservative government, particularly one that is more fossil fuels energy friendly? Or will tariff wars giving the Liberals a new lease on life?

Development of BRICs as a trading block is important for the C-Dollar. Many BRICs and new entrants to BRICs are commodity producers. Combine that factor with development of a new BRIC currency as well as a trading platform and things could become interesting for Canadian exports and the C-Dollar. This assumes BRICs hangs together – Italy has given notice it is leaving, while Mexico and Turkey may want to join. Or will Trump 2.0 force Mexico out of the BRICs? Thailand has applied to join. The US is demanding BRICs not threaten the Dollar usage or they will be hit with 100% tariffs. Thirty-eight small countries walked out of the last BRIC’s meeting, saying they no longer wished to be governed by large countries.

WHAT THE CENTRAL BANK/ GOVERNMENT WANT

Depends on the next government.

TARGETS

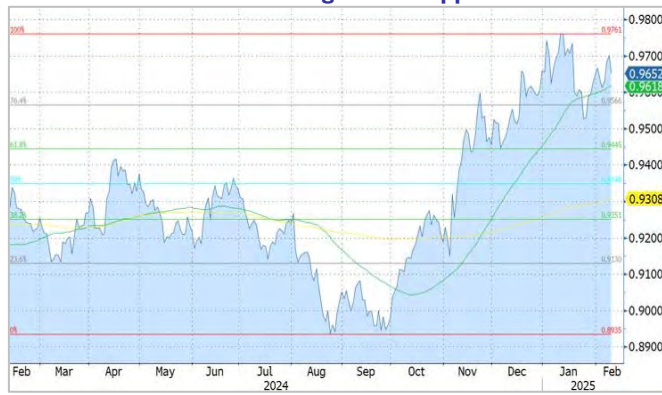
China / US demand for Canadian exports and the price of gold / commodities, were the principal factors affecting the C-Dollar. Now it may be tariffs. Gold is a long term bull market. Gold correlates well to a stronger CAD over the long term.

CANADIAN DOLLAR/CURRENCY

The CAD is very sensitive to the global economy, commodity prices, and especially the US economy, which is being set up for long term growth with new policies. The Canadian Dollar should strengthen over time, as commodity prices firm due to years of cap-ex which were too low, and higher global growth. Global mining cap-ex is down over 60% from the peak – suggesting ramping up capacity will take time and put a floor under commodity prices – which are crucial for the C-Dollar. Particularly in the US, the demand for power due to AI, is rising rapidly, which means new demand for electrical power and the fuel to power electricity, will grow rapidly. Canada has many of those power sources. The C-Dollar is undervalued on a long term basis. Is it in Canada's interest to devalue or appreciate the C-Dollar?

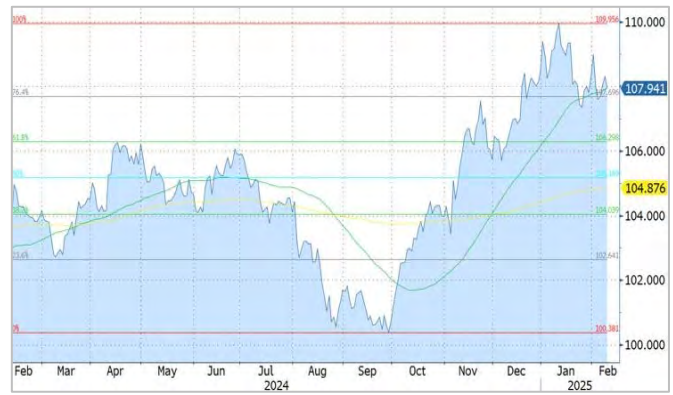
Sources: Bank of Canada & Bloomberg

Euro vs. Dollar—Long Term Support is 0.82



Courtesy of Bloomberg LP

DX-Y



Courtesy of Bloomberg LP

EURO: DOLLAR — WHITHER THE EURO IF THE UKRAINE WAR ENDS? LOWER?

EURO DATA

	Rate of Change	as of
REAL GDP YoY	0.90%	12/31/2024
PPI YoY (changed to OECD)	0.40%	12/31/2024
CPI YoY / Inflation	2.50%	1/31/2025
Unemployment	6.30%	12/31/2024
MI YoY	1.60%	12/31/2024
M3 YoY	3.50%	12/31/2024
Overnight Lending Rate	2.90%	1/30/2025

Comparative Data to Other Major Currencies

Country	3 Mo Int Rates		Real Short Rates (Using 3-mo rates less CPI)		Real Long Rates (Using 10-Yr Govt Bonds less CPI)	
	3 Mo Int Rates	10 yr Int Rates	Real Short Rates (Using 3-mo rates less CPI)	Real Long Rates (Using 10-Yr Govt Bonds less CPI)		
Australia	4.28%	4.43%	1.88%	2.03%		
Canada	2.85%	3.10%	1.05%	1.30%		
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UK	4.40%	4.51%	-0.20%	2.01%		

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Australia	2.30%	7.00%	5.20%	3.57%
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Euro	0.90%	2.50%	0.40%	6.30%
France	0.00%	1.40%	-3.80%	7.10%
Germany	-0.20%	2.30%	0.80%	6.20%
Japan	0.50%	3.60%	3.80%	2.40%
Switzerland	1.70%	0.60%	-0.10%	2.70%
US	2.30%	2.90%	2.80%	4.00%
UK	0.90%	2.50%	0.00%	4.40%

MONETARY/ECONOMIC FACTORS

A “low” Euro and cheap Russian gas have been instrumental for German exports and the EU economy, especially autos and chemicals. It is the Euro / RMB cross rate which is crucial to Germany now along with the price and availability of natural gas. There are signs of German companies moving operations to China or closer to natural gas supply. The “off-shoring” of German industry and technology is recessionary and well underway. Germany’s peak industrial production occurred in 2017! Germany has industrialized. Germany’s economy is unlikely to recover in the near term due to a dependence on higher priced LNG from overseas and a slowing of Chinese demand. A new Chinese spending package could alter the German economic picture, at least for the near term.

Will the build-up in LNG port capacity (solidified by 20-year delivery contracts) with US companies solve the supply problem, though at a higher price? US / European companies are moving production to Mexico / Algeria or other countries where natural gas is price competitive, available and exportable to Europe. The US is also gearing up with a 3x increase in LNG trains coming online. US natural gas is plentiful, for now. 2025 could see American natural gas prices much higher.

2024-2025 will be a very interesting period for Europe’s economy, monetary policy and for the Euro, as the EU and the ECB are at a crossroads on multiple issues. China is looking to increase trade ties across Eurasia, which may turn out to be Europe’s economic salvation from a demand standpoint if politics and the EU’s relationship with the US do not short circuit the process. In one early signpost, Italy has notified China it may leave the Belt / Road platform. Meanwhile, Thailand and Mexico have decided to join.

Europe’s energy dependence on external sources is a major ongoing risk. The EU will soon import LNG from Qatar, Mozambique and the US – at much higher cost than Russian gas, making it imperative for German industry to restructure. But how best can the Euro help? Our hunch is a stronger Euro policy will eventually emerge as Germany needs to re-industrialize and the EU / NATO need to present a more

effective front vs. Russia – including on the economy. With China buying a 30-year supply of LNG and increasing energy consumption pretty much across the board, will the rest of the world (EU), be able to import what they need? With oil / gas from the Mideast now sailing around Africa, the supply line is lengthening by about 50% and becoming more expensive. The Red Sea oil route is also a risk to Europe’s energy supply as it has nearly been cut-off by the Houthis. A Mideast war between Israel and Iran is possibly a huge energy problem for Europe. Can the Trump administration / Israel and Iran resolve their differences this year?

WHAT THE GOVERNMENTS / CENTRAL BANKS WANT

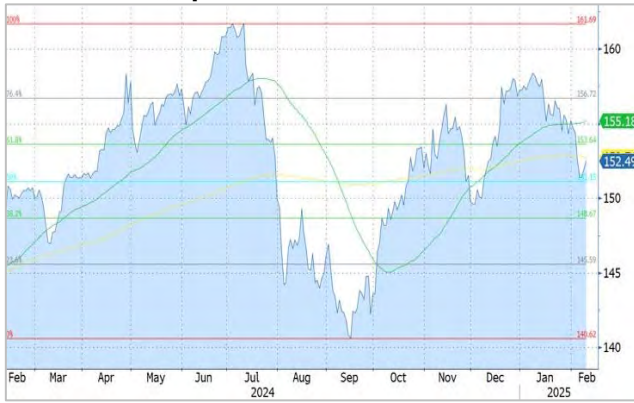
The EU and Germany in particular, have been happy with a structurally weak Euro, perhaps until now. Is what Europe really needs is a higher Euro to depress inflation and attract badly needed capital for building new manufacturing infrastructure? Or will it be a lower Euro to counter a deflationary outcome? With the German economy moving into a mild recession, this may not be the time for a higher Euro.

TARGETS

An end to the war in Ukraine would be very positive for Europe’s economy – and possibly the Euro. Structurally, a stronger Euro is probably in Europe’s longer term interest as the EU needs to rebuild its energy supply lines and re-industrialize. For a number of reasons, Euro / Dollar could be lower by 2026-2027.

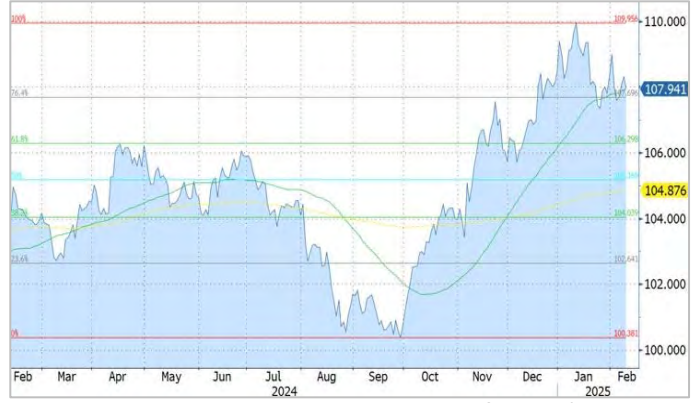
Sources:
Bloomberg Data
Bloomberg News

Japanese Yen vs. Dollar



Courtesy of Bloomberg LP

DXJ



Courtesy of Bloomberg LP

THE YEN IS STRENGTHENING SHARPLY VS USD

JAPAN DATA		
	Rate of Change	as of
REAL GDP YoY	0.50%	9/30/2024
PPI YoY	3.80%	12/31/2024
CPI YoY / inflation	3.60%	12/31/2024
Unemployment	2.40%	12/31/2024
M1 YoY	1.30%	12/31/2024
M3 YoY	0.80%	12/31/2024
Overnight Lending Rate	0.48%	2/7/2025
Japan Merchandise Trade Exports	2.80%	12/31/2024
Japan Indices of Industrial	-1.10%	12/31/2024
Jap Tankan Bus ond Large Ent	14.00%	12/31/2024

Comparative Data to Other Major Currencies					
Country	3 Mo Int Rates		10 yr Int Rates (Using 3-yr Govt less CPI)		Real Long Short Rates (Using 10-yr Bonds less CPI)
	Australia	4.28%	4.43%	1.88%	2.03%
Canada	2.85%	3.10%	1.05%	1.30%	
Euro	2.45%	2.43%	-0.05%	-0.07%	
Japan	0.30%	1.32%	-3.30%	-2.28%	
Switzerland	-0.75%	0.415%	-1.35%	-0.19%	
US	4.32%	4.54%	1.42%	1.64%	
UK	4.40%	4.51%	1.90%	2.01%	

Country	Unemployment			
	GDP	CPI	PPI	ment
Australia	2.30%	7.00%	5.20%	3.57%
Canada	0.00%	1.80%	7.61%	6.60%
Euro	0.90%	2.50%	0.40%	6.30%
France	0.00%	1.40%	-3.80%	7.10%
Germany	-0.20%	2.30%	0.80%	6.20%
Japan	0.50%	3.60%	3.80%	2.40%
Switzerland	1.70%	0.60%	-0.10%	2.70%
US	2.30%	2.90%	2.80%	4.00%
UK	0.90%	2.50%	0.00%	4.40%

MONETARY FACTORS

- The BOJ is the only major central bank which has been pumping liquidity at or near peak levels over the past 18 months. It is the only major CB to raise rates.
- Japan owns a lot of risk assets in the US, i.e., CLOs, Treasuries, high yield bonds and US stocks. Large-scale repatriation, i.e. NASDAQ Stocks, would cause a Yen spike (it probably did) and potentially an interest rate problem, as well as potentially a major break in the carry trade.
- Japan is in the early stages of fundamentally shifting its national security strategy to aligning with the US and South Korea / Philippines

vs. China and North Korea. The polls find the Japanese public now supports putting nuclear weapons in the country. Defense spending will double in the next budget, but the bigger picture is Japan is starting the largest defense build-up since before WW2. The US and Japan have made new defense agreements which will cost significant amounts of money and bring US defense business to Japan. With the Trump administration some of those contracts may revert to the US. US-Japan ties are deepening the defense and economic fronts.

- Asset allocation shifts by corporate / government pension funds (especially GPIF) will move additional funds toward J-equities. More Japanese pension funds, public and private, are joining the move toward larger equity allocations, as the government pushes to improve returns, governance and transparency. The Japan Prime Index, which highlights Japanese companies which are improving returns and transparency / governance will attract foreign capital. A massive increase in NISA's savings plans for individuals are on the way. These two factors are bringing significant amounts of capital into Japan's equity market. The second derivative of higher J-stocks prices will be foreign investors have to start buying Yen as they return to the TSE.
- The rate of growth in the broad money supply is +0.7% on a Y-o-Y basis, a fraction. Narrow money supply is +1.3% Y-o-Y.
- The issue of shifting global capital flows is a growing concern as currency barriers go up. Sanctions and tariffs are a new feature of the global currency platform. Japan has the largest major rate "peg" still in place among major markets. But how much longer will that "peg" endure?
- The BOJ has committed to print money to buy all available 10-year JGBs and they have had to do so, boosting their holdings in parts of the yield curve to a majority position. And how will Japan's trade be affected by a lower CNY – driven by US tariffs?

WHAT THE CENTRAL BANK / GOVERNMENT WANT

- A major policy change on interest rates with respect to Japan's monetary policy is unfolding – but slowly and quickly halted.

- Japan's markets are essentially being nationalized? JGBs and Nikkei ETFs are not far behind as the BOJ increased holdings. Will new forms of Japanese QE be needed to pay for "buying them all," whether it's stocks or bonds? The JGB market has been transferred on to the BOJ balance sheet, as is a portion of Japan's equity market – which is in the early stages.

TARGETS

The USD / Yuan / Yen triangle is crucial for Asian trade and global growth.

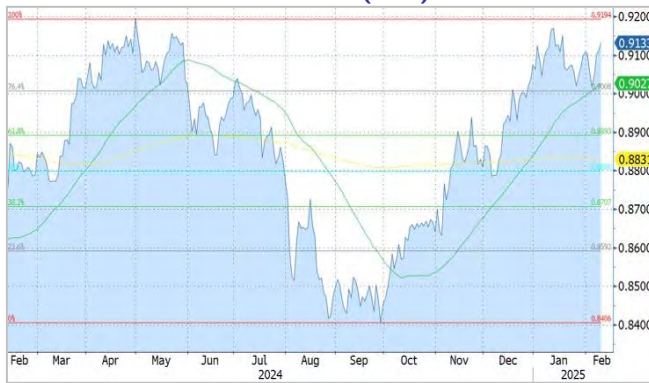
Japan was the first major country to go into deflation years ago. Japan now has a new burst of inflation, +2.3%. As a result, will Japanese interest rates go up? This will be important for global capital flows and for the Yen. Japanese investors are receiving -100+ bps in 10 years.

Taiwan's relationship with the USA is becoming a larger and larger issue for Japan. Japan has aligned itself with US defense policy, the Indo-Pacific Trade Agreement and the Quad. Japan's government is in the early stages of designing a more offensive military policy which will be expensive. Foreign FX reserves and other foreign assets may need to be brought home to help fund the defense buildup. In the technology sphere, Japanese companies benefitted from the IRA and the CHIPS Act in the US. But will the Trump administration slow the CHIPS Act spending, forcing Japan to expand in that area?

How events play out in Europe, and a potential conflict in Taiwan are also key issues for the Japanese economy. Finally, the US elections matter to Japan and all of Asia, especially for the long-term security outlook. The Trump administration is putting additional trade pressure on China – possibly resulting in a CNY devaluation, which could push Japan to devalue the Yen. Instead, the Yen is rising. How relations develop with the US / China will play the major role, in BOJ policy and the Yen – which is still cheap, but can it become a lot cheaper? Dollar / Yen has been very volatile recently. A wide trading range between 125-162 is quite possible.

Sources:
Bank of Japan. (<http://www.boj.or.jp/en/>)
Bloomberg Data
Department of the Treasury/Federal Reserve Board

Swiss Franc (GPF)

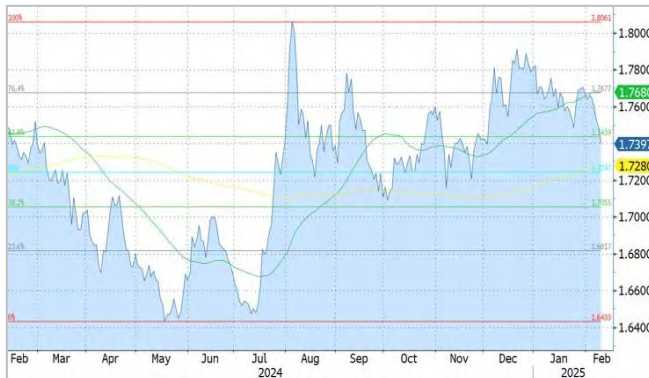


DXY



Courtesy of Bloomberg LP

SF/Aussie Dollar



Above two charts courtesy of Bloomberg LP

SWITZERLAND DATA		
	Rate of Change	as of
REAL GDP YoY	1.70%	9/30/2024
PPI YoY	-0.10%	12/31/2024
CPI YoY / Inflation	0.60%	12/31/2024
UNEMPLOYMENT	2.70%	1/31/2025
M1 YoY	2.28%	12/31/2024
M3 YoY	1.89%	12/31/2024
Central Bank Rate	-0.75%	12/31/2021

SWISS FRANC—LT TARGETS—SF WEAKENED TO 0.91. LT THE TARGET REMAINS 0.75

SWITZERLAND DATA		
	Rate of Change	as of
REAL GDP YoY	1.70%	9/30/2024
PPI YoY	-0.10%	12/31/2024
CPI YoY / Inflation	0.60%	12/31/2024
UNEMPLOYMENT	2.70%	1/31/2025
M1 YoY	2.28%	12/31/2024
M3 YoY	1.89%	12/31/2024
Central Bank Rate	-0.75%	12/31/2021

Comparative Data to Other Major Currencies				
Country	3 Mo Int Rates	10 yr Int Rates (Using 3-yr less CPI)	Real Short Rates	Real Long Rates (Using 10-yr Govt Bonds less CPI)
			Int Rates	Int Rates
Australia	4.28%	4.43%	1.88%	2.03%
Canada	2.85%	3.10%	1.05%	1.30%
Euro	2.45%	2.43%	-0.05%	-0.07%
Japan	0.30%	1.32%	-3.30%	-2.28%
Switzerland	-0.75%	0.415%	-1.35%	-0.19%
US	4.32%	4.54%	1.42%	1.64%
UK	4.40%	4.51%	1.90%	2.01%

Country	GDP	CPI	PPI	Unemployment
				ment
Australia	2.30%	7.00%	5.20%	3.57%
Canada	0.00%	1.80%	7.61%	6.60%
Euro	0.90%	2.50%	0.40%	6.30%
France	0.00%	1.40%	-3.80%	7.10%
Germany	-0.20%	2.30%	0.80%	6.20%
Japan	0.50%	3.60%	3.80%	2.40%
Switzerland	1.70%	0.60%	-0.10%	2.70%
US	2.30%	2.90%	2.80%	4.00%
UK	0.90%	2.50%	0.00%	4.40%

POLITICAL FACTORS

Upside pressure on the SF could develop further if the Ukraine War accelerates or US involvement in the Middle East grows. Or will the new Trump administration end the Ukraine War / realign the Mideast, leading to a weaker SF? The initial weeks of the Trump administration suggest a weaker SF may be coming.

MONETARY/ECONOMY

- The SNB's goal of managing the currency against the Euro to assist the country's export-oriented firms, seems to have shifted to focus more on inflation. The economy has picked up to a +1.7% nominal growth rate.
- Long term, positive yields may have unintended consequences on capital allocations, asset prices and eventually on the economy, after years of negative yields. The SNB already seems to have shifted gears and is happy with a higher SF to combat inflation.
- Switzerland was the first major FX country to have achieved below 2% inflation. If the currency market's perception of Swiss banking safety improves further, the SF could trade even higher.

WHAT THE SNB/GOVERNMENT WANT

The SNB seems to have changed to a policy of SF appreciation in order to fight inflation. Broad money measures are flat, but M1 is falling at -1.9%.

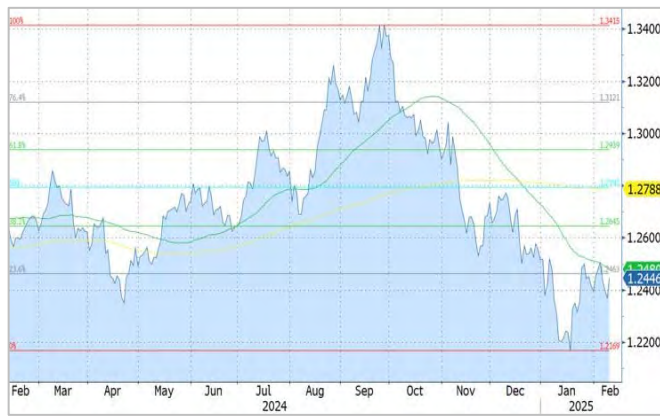
TARGETS

The Swiss Franc remains a currency that will be bought in an economic / financial crisis. There is relatively little inflation in Switzerland, so

reflation tools are available to the SNB, if the need arises. In a risk-off world, the Swiss Franc will likely be a go-to asset, again. On the charts, the SF looks like, long term, it can strengthen further vs the Dollar in the long term. Over the next few years, the Dollar / SF could trade to 0.76. An end to the Ukraine War may well weaken the SF. Increasingly, the European geopolitical situation looks like it could deteriorate, the SF should appreciate.

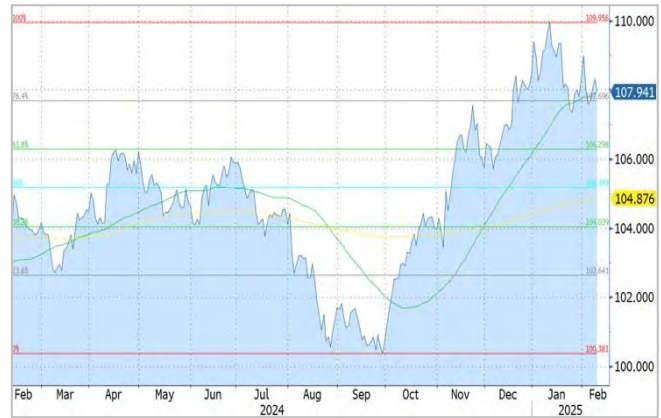
Sources: Bloomberg Swiss National Bank <http://www.snb.ch/e/search/index.html>

British Pound to US Dollar



Courtesy of Bloomberg LP

DXY



Courtesy of Bloomberg LP

UK POUND/US DOLLAR — STERLING IS CHEAP – AND SUDDENLY CUTTING INTEREST RATES!

UNITED KINGDOM DATA

	Rate of Change	as of
REAL GDP YoY	0.90%	9/30/2024
CPI YoY / Inflation	2.50%	12/31/2024
Unemployment	4.40%	11/30/2024
M4 YoY	2.50%	12/31/2024
Notes & Coins	2.90%	1/31/2025
Central Bank Rate	4.50%	2/11/2025
RPI	3.50%	12/31/2024

Comparative Data to Other Major Currencies

Country	3 Mo Int Rates		Short Rates (Using 3- mo rates less	Real Long Rates (Using 10- Yr Govt Bonds less CPI)
	3 Mo Int Rates	10 yr Int Rates		
Australia	4.28%	4.43%	1.88%	2.03%
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	GDP	CPI	PPI	ment
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France	0.00%	1.40%	-3.80%	7.10%
Germany	-0.20%	2.30%	0.80%	6.20%
Japan	0.50%	3.60%	3.80%	2.40%
Switzerland	1.70%	0.60%	-0.10%	2.70%
US	2.30%	2.90%	2.80%	4.00%
UK	0.90%	2.50%	0.00%	4.40%

POLITICS

- A burst of new fiscal spending is expected which could push the economy higher and Sterling lower. Instead, interest rate were cut February 6th.
- Sterling is cheap. The new government is moving to balance the budget – which the US is also doing. Tighter fiscal policy could put additional upside pressure on Sterling. Or will new spending programs and capital outflows and make funding the deficit more difficult?

MONETARY/ECONOMIC FACTORS

- Housing is a key UK asset price to watch. If mortgage rates begin to decline, the economy could surprise on the upside. If rates do not come down, Covid era mortgage rates are re-setting much higher with an effect on the economy. Non-dom rules were changed, then those changes were being modified.
- Flow-of-Funds – The UK is a much more service-oriented economy than it is export-driven. For years, foreign capital poured into the London real estate market and the buy-to-let schemes which pushed even more capital into prime property. That scheme peaked as stamp duties were piled on and buy-to-let schemes ended. Affordable housing remains a problem in London.
- The UK's trade deficit:GDP ratio is about 5.9%, a level which suggests an undervalued Sterling is needed to finance it. Sterling has sold off by almost 50% since the pre-Brexit period, so historically, it is not expensive. It should be cheap enough even after the recent rally, to attract long term-oriented buyers of UK assets – or will changes in government policy reduce the appetite for UK assets?

WHAT THE BOE/GOVERNMENT WANT

The new government is moving toward better relations with the EU. Specifically trade relations need to be improved. Low Sterling / Euro probably suits what the economy needs, but it won't help the inflation picture. Cheap Sterling, probably does not bother the government too much, unless it leads to a permanent surge in inflation which becomes a problem. The UK remains vulnerable to import prices changing on short notice – as they did in 2022. Supply chains are

important to the UK. Another surge in oil and natural gas prices could be devastating for the UK economy as utility costs and inflation would rise again. There are some articles appearing in the media that suggest power rationing lies ahead.

TARGETS

Sterling is cheap relative to the USD.

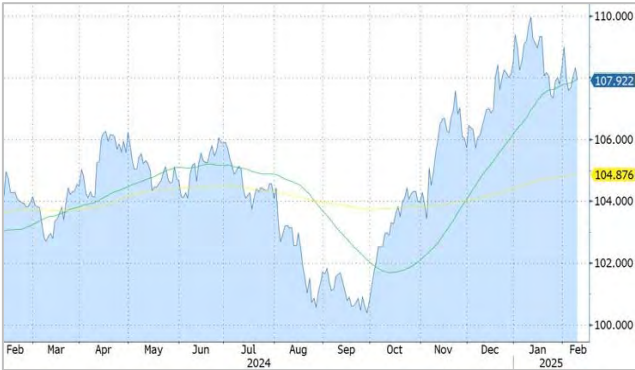
The government is run by Labour and new fiscal plans are being introduced. Will further regulation / fiscal spending put downside pressure on Sterling? Longer term, two years plus, who might the Labour leader be?

In the event the Ukraine War ends, Sterling / Dollar should strengthen. So far, New Labour has been slightly negative for Sterling / Dollar and for the gilt market where yields were spiking.

Sources:

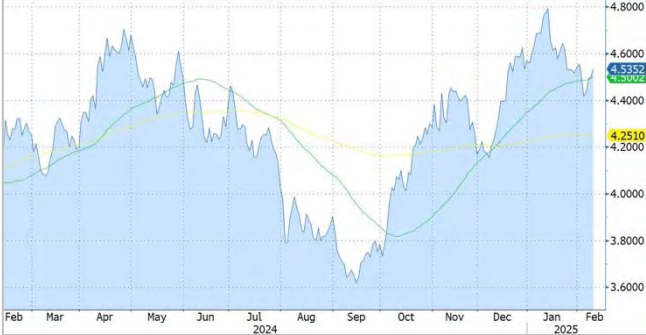
Bank of England. (<http://www.bankofengland.co.uk/>) and Bloomberg LP

US Dollar Index



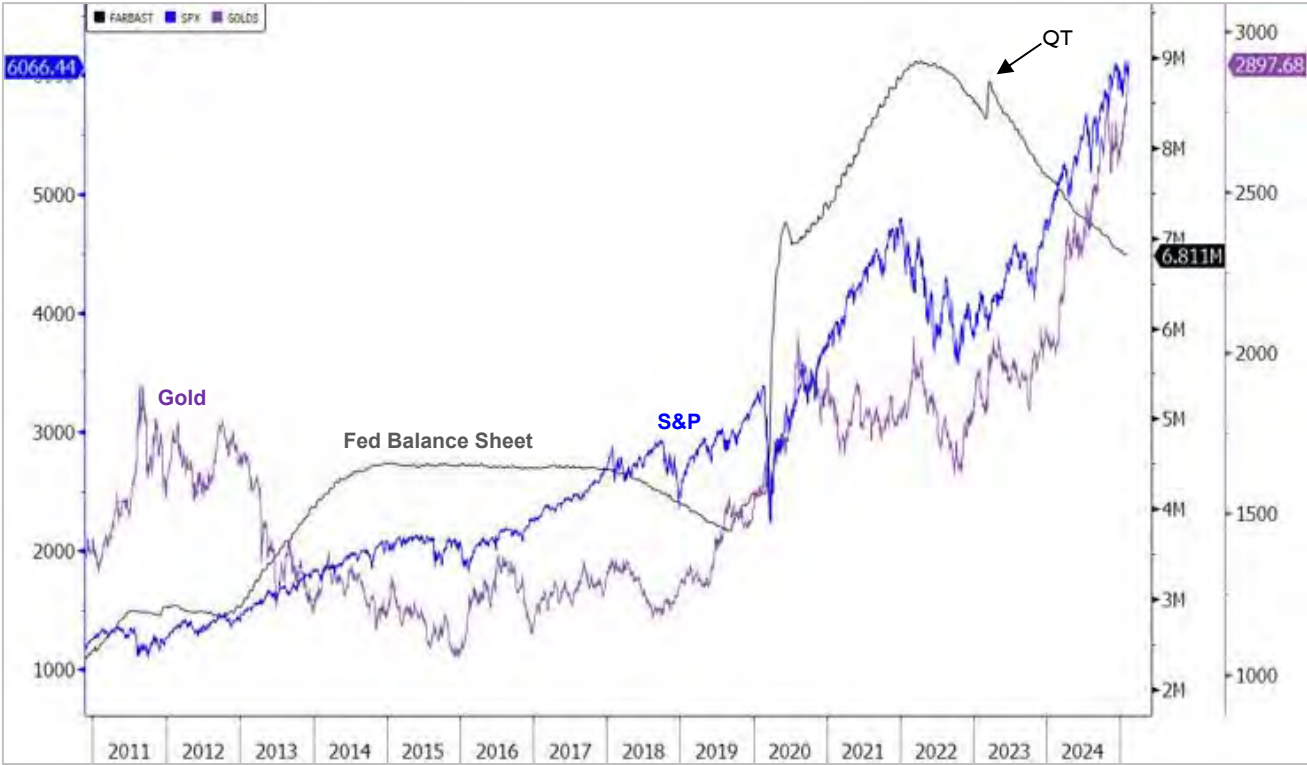
Courtesy of Bloomberg LP

10-Year Gov't Yields
Are Generational Yield Lows in Place?



Courtesy of Bloomberg LP

**Fed Drives Liquidity / Liquidity Drives Markets
Fed Balance Sheet to Grow to 40% of GDP**



Courtesy of Bloomberg LP

US DOLLAR—IS A HIGHER DOLLAR WHAT THE FED / TREASURY WANT? TRUMP / VANCE WANT? WILL A LOWER DOLLAR EVENTUALLY BE NEEDED TO INFLATE THE DEBT AWAY?

POLITICS

Is it in the US' interest to eventually devalue the Dollar? T-debt is 120% of GDP and growing at a rapid rate. Surprisingly, a rapid deterioration in the fiscal situation has not pressured the Dollar. Steps must be taken to either cut fiscal spending, inflate debt away, raise taxes, or grow the economy at a faster rate. Multiple policy steps are being taken by the new administration.

The issue now for the Dollar is how the US government funds itself over the next few years. Another energy crisis / second wave of inflation / a large war could be crippling. Many of the policy actions Trump is taking, will impact the Dollar. DOGE may be able to cut Federal spendings by \$1 trillion or more. That could have a significant effect on the Dollar.

MONETARY/ECONOMIC FACTORS

- There may well be a limit as to how high interest rates can go. Around 3%-3.2% is the average yield at all Treasury maturities. Less than three year maturities rolling over are yielding 2.3% but are rolling into 4%-5% T-bills. Are the Fed / Treasury essentially implementing YCC? 22% of all new debt is being issued in T-bills, well above levels of two years ago.
- Is the Fed being pushed into interest rate cuts from a problem in the economy or political pressure? Or are cuts done to contain interest expense in 2025 and in years ahead?
- The Fed needs to be extra careful now about interest rate levels and the guidance they give, given the amount of debt the Treasury needs to sell and the cost of capital.

WHAT THE FED / GOVERNMENT WANT

A lower Dollar and a long period of stable rates is needed for the economy to grow at a pace which has the potential to outrun the nation's debt service and eases pressure for funding the budget deficit. That is the definition of yield curve control. Inflating the debt away which has accumulated in the last two-three years, which could become a priority. A Treasury issuance problem is emerging. "Wars", whether trade wars or military wars, which are multiplying tend to be inflationary. Judging from this recent language, the Fed is moving toward managing rates. A move away from QT and toward QE, then YCC seems the likely outcome for monetary policy. A proposal by ISDA to lower the margin in Treasury's will help the bond market by adding liquidity.

UNITED STATES/DOLLAR

TARGETS

The major macro event of 2024 in the US was the national election. The major event in 2025 may be how the debt and deficit are handled as well as wholesale changes in tax policy, trade policy, de-regulation, fiscal policy, immigration – and more. The Dollar may be over-owned and on a PPP basis, overvalued. But relative to other world currencies, it backs the strongest profitable economy. Capital is flowing to the US.

An outside the box risk (a Dollar spike) is a liquidity / economic / financial problem coming from Europe, or a recession.

Has the Dollar fully priced Trump 2.0 and the numerous policy changes which are coming? Doubtful. The wild card may be wholesale changes in how the US government funds itself via tariffs and far fewer personal / corporate tax receipts.

UNITED STATES DATA

	Rate of Change	as of
US GDP Nominal Dollars YoY SA	2.50%	12/31/2024
PPI YoY	2.80%	12/31/2024
CPI YoY / inflation	2.90%	12/31/2024
U-3 Unemployment	4.00%	1/31/2025
U-6 Unemployment	7.50%	1/31/2025
M1 YoY	2.70%	12/31/2024
M2 YoY	3.90%	12/31/2024
Federal Funds Target Rate	4.50%	2/11/2025
ISM Non-Manufacturing NMI NSA	52.80%	1/31/2025
US Industrial Product MoM 2	0.92%	12/31/2024

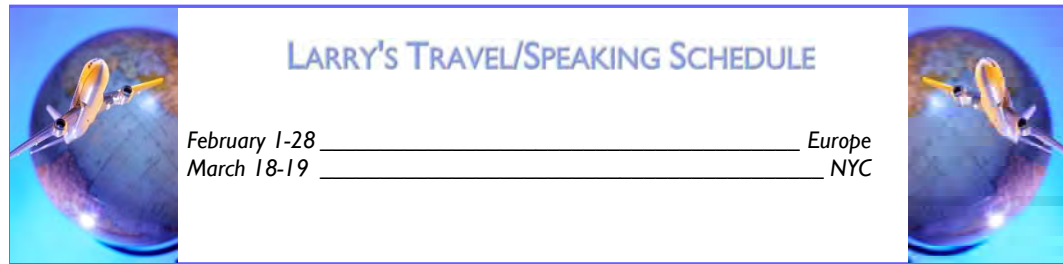
Comparative Data to Other Major Currencies

Country	3 Mo Int Rates	Int Rates	Real Rates (Using 10-yr Govt Bonds less CPI)	
			10 yr less CPI	Real Long Short Rates
Australia	4.28%	4.43%	1.88%	2.03%
Canada	2.85%	3.10%	1.05%	1.30%
Euro	2.45%	2.43%	-0.05%	-0.07%
Japan	0.30%	1.32%	-3.30%	-2.28%
Switzerland	-0.75%	0.415%	-1.35%	-0.19%
US	4.32%	4.54%	1.42%	1.64%
UK	4.40%	4.51%	1.90%	2.01%

Country	GDP	CPI	PPI	Unemployment
Australia	2.30%	7.00%	5.20%	3.57%
Canada	0.00%	1.80%	7.61%	6.60%
Euro	0.90%	2.50%	0.40%	6.30%
France	0.00%	1.40%	-3.80%	7.10%
Germany	-0.20%	2.30%	0.80%	6.20%
Japan	0.50%	3.60%	3.80%	2.40%
Switzerland	1.70%	0.60%	-0.10%	2.70%
US	2.30%	2.90%	2.80%	4.00%
UK	0.90%	2.50%	0.00%	4.40%

as of 2/11/2025

Sources:
Bloomberg Data
Bloomberg News



A Long Love Story

A Brazilian couple whose wedding was in 1940 officially took the Guinness World Record for the longest marriage for a living couple.

Manoel Angelim Dino, 105, and Maria de Sousa Dino, 101, were awarded the title when Guinness World Records and LongeviQuest, a website that tracks data about centenarians and super-centenarians, verified they had been married for 84 years and 77 days as of Valentine's Day.

The duo met in 1936 and were married at the chapel of Boa Ventura in Ceará, Brazil, in 1940.



The couple raised 13 children, and now have 55 grandchildren, 54 great-grandchildren and 12 great-great-grandchildren.

Too Much Chocolate

An opossum was treated at a Nebraska animal hospital after wandering into a family's back yard and gorging itself on an entire chocolate mousse cake from Costco.

Kim Doggett said the cake had been placed on a table in her Gretna back yard because she ran out of room in the fridge.

"I always have a house full and we cook a lot and when you run out of room in the fridge you just sit it on the table outside in the winter," Doggett told Forbes.

She said her son took some fresh-made peanut butter balls outside to cool and discovered an opossum was curled up on the outdoor sectional, which was covered in chocolate paw prints.

"The cake had been knocked off the table and was sitting on the floor in front of where she was," Doggett told the Omaha World-Herald. "The cover was off, and it was almost gone."

The opossum was not moving, and appeared to be panting.



"The opossum looked a little distressed," she said. "We thought we better call the Humane Society and get this guy checked out."

Doggett said she couldn't find any information online on whether chocolate is dangerous to opossums, but she knew the treat was toxic to dogs, so she figured it was better to be safe than sorry.

Veterinarians treated the opossum with activated charcoal to neutralize any potential toxicity from the chocolate. She was also found to have a high level of lead, likely from eating local insects.

The opossum is now being treated for the lead in her system and will be released in a few weeks, rehab officials said.

"With some time in rehab (and a diet reset), this choco-holic should be stabilized enough to return to the wild but until then, she is definitely a little cranky about our strict 'zero chocolate' policy," the rehab said on social media.

Unusual Delay

On February 11, A Ryanair flight bound for Germany was grounded for two days in Rome after a stowaway cat was found to have climbed into the plane's electrical bay.

The Boeing 737 had been scheduled to take passengers to Germany, but the flight was delayed when crew members heard meowing coming from the plane's inner workings.

Engineers discovered the cat was in the vehicle's electrical bay, and their attempts to reach the feline only caused it to flee further into the mechanism.

The plane was grounded, with engineers raising fears that the cat could cause potentially catastrophic damage while in the air.

A door was left open and the cat finally exited the plane on its own after about two

days on the tarmac allowing the plane to finally depart for Germany.

Fish Bounty

On February 11, 2024, A seafood company that lost about 27,000 salmon from a fish farm off the coast of Norway is offering a bounty of about \$45 per fugitive fish caught.

Mowi, the world's largest producer of farmed salmon, said about a quarter of its 105,000 salmon escaped Sunday night from a fish farm in Troms and entered the waters of northwest Norway.

The company said the fence separating the farm from open waters was damaged by stormy weather in the area.

The company called on registered fishing professionals in the country to bring any of the fugitive salmon caught to designated "reception centers," where they will be paid about \$45 per fish.



A 'Sticky' Situation

California Highway Patrol officers were left playing "a giant game of pick-up sticks" when a truck spilled its load of chopsticks onto the highway.

The CHP's Hayward station that officers responded to a report of a traffic hazard on Interstate 580, near the Redwood Road exit, and arrived to find the "sticky situation."

"Turns out, someone turned the freeway into a giant game of pick-up sticks," the post said. "Unfortunately, this means a local restaurant might be short on utensils tonight."

The CHP said the spill should serve as a reminder to all highway travelers to make sure their loads are properly secured.

Mozart
da Vinci
Shakespeare
Beethoven
Picasso
Einstein
Isaac Newton
FOR GENIUSES ONLY

Think you're a genius? Take the below quiz. Passing requires 4 correct answers.

1. How long did the Hundred Years War last?
2. Which country makes Panama hats?
3. From which animal do we get cat-gut?
4. In which month do Russians celebrate the October Revolution?
5. What is a camel's hair brush made of?
6. The Canary Islands in the Pacific are named after what animal?
7. What was King George VI's first name?
8. What color is a purple finch?
9. Where are Chinese gooseberries from?

All done, genius? Check your answers below.

1. How long did the Hundred Years War last? 116 years
2. Which country makes Panama hats? Ecuador
3. From which animal do we get cat gut? Sheep and Horses
4. In which month do Russians celebrate the October revolution? November
5. What is a camel's hair brush made of? Squirrel fur
6. The Canary Islands in the Pacific are named after what animal? Dogs
7. What was King George VI's first name? Albert.
8. What color is a purple finch? Crimson.
9. Where are Chinese gooseberries from? New Zealand.

A Big Surprise

Authorities are investigating the origins of a mysterious huge chunk of ice, six feet tall by more than three feet wide, that fell out of the sky and punched a large hole in the metal roof of a Florida home. Residents said it sounded like an explosion.

The Palm Coast Fire Department said that crews responded when a caller "reported multiple pieces of ice scattered across the roadway, with one striking a neighbor's home."

The Palm Coast Building Department inspected the damage and determined the house was safe to occupy.

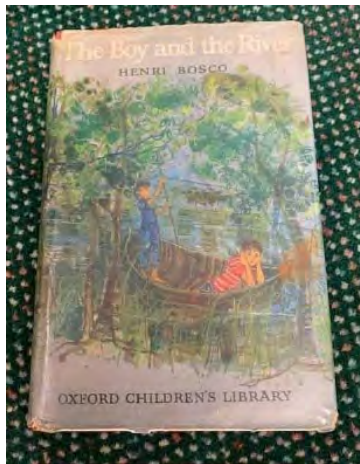
The fire department said the Federal Aviation Administration was notified of the incident.

Little Over Due

A book found in a hallway outside of a British library was due back at the facility 49 years and six months earlier.

The Torrington Library in Devon, England, that a copy of *The Boy and the River* by Henri Bosco was found by a volunteer in a hallway just outside of the library.

"Thank you to whoever left this slightly overdue library book outside the library recently," the post said. "It was due back 23rd June 1975 and is older than some of our staff! I wonder where it has been for the last 49 years?"



Library supervisor Kate Cooper theorized the book may have been left in the hallway by a former patron who was worried about overdue fees.

"We don't fine for children's books anymore, but it would be about £3,600 [about \$4,482]," she told the BBC. "We are obviously not expecting anyone to pay us that sort of money."

But Can You Taste It?

A Chinese chef took his noodle-making skills to the set of an Italian TV series and hand-rolled a noodle measuring only .18 millimeters -- about .007 inches thick.



Li Enhai attempted to break the Guinness World Record for the thinnest handmade noodle on the set of *Lo Show Dei Record* in Milan.

Enhai had held the record previously, but the title was taken by another chef who hand-rolled a .14-millimeter noodle.



Enhai successfully took the record with a noodle measuring just .18 millimeters thick.

Riddles

1. What do you get when you cross a rabbit with a spider? (A hare net.)
2. Why should you never tell a pig a secret? (Because he's a squealer.)
3. Did you hear about the exhausted kangaroo? (He was out of bounds.)
4. What do you get when you cross an alarm clock with a German Shepherd? (A watch dog.)
5. What happens when a frog is parked illegally? (It's toad away.)
6. How do you tune a fish? (You have to know the scale.)
7. What animal eats with its tail? (They all do. The can't take them off.)
8. What do a dog and the forest have in common? (There's a lot of bark in both.)
9. Is a dog better dressed in the summer or in the winter? (He's better dressed in the summer because in the winter he has a coat, but in the summer he has a coat and pants.)
10. What driver never gets arrested for speeding? (A screwdriver.)
11. What is the world's largest punctuation mark? (It's the hundred yard dash.)
12. What begins and ends with "e" but has only one letter? (An envelope.)

Sources: upi.com; Wit and Witticism

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ABOUT THE EDITOR-IN CHIEF, LARRY JEDDELOH

EDITOR-IN-CHIEF:

..... LARRY E. JEDDELOH

RESEARCH/PORTFOLIO MANAGEMENT:

..... Larry Jeddelloh

..... Andy O'Kelly

AIDES-DE-CAMP:

..... Dan Lehn

..... Randa Helmberger

..... Sara Jeddelloh

Larry is the Editor of *The Institutional Strategist*, and Founder of TIS Group of Minneapolis. He is an experienced investment management professional with over 40 years in the business. Mr. Jeddelloh founded TIS Group in 1995. Previously, Mr. Jeddelloh held the position of Chief Investment Officer of Resource Capital Advisers, with responsibilities for \$1 billion in assets. Prior to joining Resource, he was with the Union Bank of Switzerland in Zürich, where he was a Vice Director and the Chief Investment Strategist in the Institutional Global Asset Management Group. In the 1980s, he was Director of Equity Research at the Leuthold Group, a well-known institutional research firm in Minneapolis, Minnesota, for seven years. He was also a partner of Leuthold and Anderson Investment Management Counseling and Weeden & Company, an institutional brokerage firm. Mr. Jeddelloh earned his Bachelor of Science in Finance and a Masters of Business Administration degree from University of St. Thomas in St. Paul, Minnesota. He has taught courses in investments and corporate finance at the University of Minnesota, the University of Northwestern St. Paul (formerly Northwestern College, MN), and Augsburg University (formerly Augsburg College, MN). Mr. Jeddelloh is a member of Chatham House, home of the Royal Institute of International Affairs. His work has been noted and used in various publications such as *The Wall Street Journal*, *Newsweek*, *Forbes*, *Money Magazine*, *Your Money*, *U.S. News & World Report*, *Barron's*, and *Global Finance*.

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SUBSCRIPTIONS & CIRCULATION

TIS Group, Inc.
100 Village Center Drive
Suite 260
North Oaks, MN 55127

Contact: Larry Jeddelloh

E-Mail: tis@tisgroup.net

Telephone: 651.379.5070

Toll free within U.S. 866.527.8698

Fax: 651.279.5080

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