



4Q24 Market Overview: Parting of the Sensory

Global equity market performance in the fourth quarter was in many ways a microcosm of the past two years.

As has been the trend, outperformance during the last stanza of 2024 could be found in the most concentrated, highest-growth segment of the world's largest stock market; that is, tech-oriented US stocks. The NYSE FANG+ Index, for example, gained more than 15% in the fourth quarter, the cherry on top of a 51% annual gain. Overlapping with nine of the 10 FANG+ components, the S&P 500 Index was able to share in some of the spoils, advancing 2.4% for the quarter and 25% for the year, while the FANG+-less MSCI EAFE Index returned -8.1% and 3.8% for the quarter and year, respectively.¹

As suggested by the recent dominance of US stock markets, risk perception in the US has been low, boosting equity multiples and pushing credit spreads to cyclical tights. In stark contrast, risk perception in China is high, as the tailwinds that benefitted the world's second largest economy in the immediate aftermath of Covid-19 have turned. The MSCI China Index was down as much as 50% from its early-2021 peak at one point, while government bond yields across the curve ended 2024 near all-time lows.² Given the massive impact the interplay of US and China has had on economies, markets and the world in general, we think their post-pandemic decoupling is worth examining.

KEY TAKEAWAYS

- With risk perception low in the US and high in China, the countries' financial markets have been on divergent paths.
- Fixed asset investment in China has shifted toward manufacturing following the collapse of its property sector bubble. The resulting excess capacity has weighed on export prices and provided China's trading partners with a strong disinflationary impulse.
- Though the US has made significant progress taming inflation, a range of possible developments could spark renewed pressures, including a rebound in Chinese growth, new tariffs on imports, ongoing tech capex and persistent labor-market strength.
- While the valuation of growth stocks relative to value stocks are at all-time highs, renewed inflation is but one of the many potential catalysts for a recalibration of risk appetites.

1. Source: FactSet; data as of December 31, 2024.

2. Source: MSCI, Bloomberg; data as of December 31, 2024.

“Chimerica” a Chimera?

For much of the past several decades, the symbiotic relationship between the US and China represented a primary driver of global macroeconomic activity and financial market performance, so much so that the term “Chimerica” was coined to describe the interconnectivity of the world’s most rapidly growing emerging market (at the time) and its dominant economic power (still).³

While signs of strain in the Chinese economy in the not-too-distant past were typically viewed as bad for global activity and risk assets broadly, the impacts of China’s current malaise have been more nuanced. For example, the collapse of China’s property market bubble—which began with the default of developer Evergrande in 2021 and has yet to find a bottom—is at least partly responsible for the cyclically moderating inflation pressures in the US and many other countries. Fixed asset investment in China has shifted away from real estate and toward manufacturing, and the resulting excess capacity has weighed on export prices and provided China’s trading partners with a strong disinflationary impulse.⁴ Meanwhile, waning confidence among Chinese businesses and households depressed imports and caused a range of economically sensitive commodities—everything from oil to copper to wheat—to derate versus gold, another exogenous source of downward pressure on global inflation.

The collapse of China’s property market is at least partly responsible for cyclically moderating inflation pressures in many developed countries.

Bloody, but Unbowed

While the US has made significant progress against inflation, the battle has reached only a fragile peace, in our view, and the country remains vulnerable to renewed pricing pressures.

Ironically, China is one potential source of such a renewal. China’s rate of deflation has moderated, as has the disinflationary impulse being exported to its trading partners. This impulse might weaken further still should policymakers make good on suggestions of large-scale stimulus; for example, a December meeting of the Central Economic Work Conference produced a statement that “lifting consumption vigorously” was among party leaders’ top goals for 2025.⁵

New tariffs on imports into the US could add further fuel to the inflation fire. While China is the main target of President-Elect Trump’s protectionist leanings—on the campaign trail, Trump vowed to impose new 60% tariffs on all Chinese imports—he also has pledged tariffs as high as 10% on global imports and an additional 25% on goods from Canada and Mexico.⁶ Beyond their impact on producer and consumer costs, these tariffs could have both direct and indirect impacts on oil prices, which are already highly susceptible to shifts in the geopolitical temperature. Meanwhile, the surge in capital expenditures among big tech companies—previously capital-light businesses like Meta, Google and Microsoft now have capital budgets that dwarf those of traditional giants like Exxon—has implications for the real economy, particularly as these investments extend into energy.⁷

3. Niall Ferguson and Moritz Schularick, “Chimerica’ and the Global Asset Market Boom,” *International Finance* (10:3, 2007).

4. Source: UBS, First Eagle Investments; data through September 30, 2024.

5. Source: Bloomberg; data as of December 12, 2024.

6. Source: Reuters; data as of January 8, 2025.

7. Source: Bloomberg, First Eagle Investments; data as of September 30, 2024.

The US labor market may be the root of our inflation concerns, however. During the Fed's tightening cycle, nonfarm payrolls continued to grow even as the unemployment rate ticked modestly higher, an unusual dynamic we think can be attributed to the massive stimulus provided during the Covid-19 era. The nominal rebasing of the economy that resulted from the government's debt spree bolstered corporate profits even as margins contracted, which supported a moderation in payrolls growth rather than an outright contraction. With financial conditions easing and economic confidence mounting, profits and profit margins have since inflected upward, and it's reasonable to think that payrolls and wage growth may follow suit.⁸ Though down from its peak of 6.7%, wage inflation of 4.3% remains inconsistent with the Fed's 2% inflation goal, and this stickiness is likely among the reasons why inflation prints have stubbornly persisted above target even as other components have retreated.⁹

Perhaps recognizing these challenges, the Fed has grown increasingly hawkish only a few months into its rate-cut cycle. While 100 basis points worth of cuts since September brought the Fed's key policy rate to 4.25–4.50% by year-end 2024, its December dot plot expects only 50 basis points more in 2025, down from 100 basis points in September.¹⁰ Should inflationary pressures reignite—notably, many measures of inflation already have bounced off the lows established earlier in the year—even this revised forecast may prove ambitious.¹¹

Valuation Has Its Own Gravity

As a result of this period of low-risk perception in US markets, the valuation of growth stocks relative to value stocks has reached all-time highs. While it's been a challenging period for value-oriented investors, we'd be wary of extrapolating recent results going forward.

The extremities we are seeing in markets today remind us of a phrase often used by our former colleague Jean-Marie Eveillard: "Valuation has its own gravity." While their timing is uncertain, any number of potential developments—renewed inflation but one of them—could trigger a swift recalibration of risk appetites and drive markets back to their long-term means.

Any number of potential developments could trigger a swift recalibration of risk appetites.

8. Source: Federal Reserve Bank of Atlanta; data as of December 31, 2024.
9. Source: Federal Reserve Bank of Atlanta; data as of December 11, 2024.
10. Source: Federal Reserve; data as of December 18, 2024.
11. Source: Bureau of Labor Statistics; data as of December 11, 2024.

The opinions expressed are not necessarily those of the firm. **These materials are provided for informational purposes only.** These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Any statistics contained herein have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed. The views expressed herein may change at any time subsequent to the date of issue hereof. The information provided is not to be construed as a recommendation to buy, hold or sell or the solicitation or an offer to buy or sell any fund or security.

Past performance is not indicative of future results.

Risk Disclosures

All investments involve the risk of loss of principal.

A principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value. "Value" investments, as a category, or entire industries or sectors associated with such investments, may lose favor with investors as compared to those that are more "growth" oriented.

There are risks associated with investing in foreign investments (including depository receipts). Foreign investments, which can be denominated in foreign currencies, are susceptible to less politically, economically and socially stable environments; fluctuations in the value of foreign currency and exchange rates; and adverse changes to government regulations.

Investment in gold and gold-related investments present certain risks, and returns on gold-related investments have traditionally been more volatile than investments in broader equity or debt markets.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Definitions

Federal funds rate is the interest rate at which depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight on an uncollateralized basis.

Indexes are unmanaged and do not incur management fees or other operating expenses. One cannot invest directly in an index.

MSCI China Index (Net) measures the performance of large and midcap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings. A net-return index tracks price changes and reinvestment of distribution income net of withholding taxes.

MSCI EAFE Index (Net) measures the performance of large and midcap equities across developed markets countries around the world excluding the US and Canada. A net-return index tracks price changes and reinvestment of distribution income net of withholding taxes.

NYSE FANG+ Index is an equal-weighted equity benchmark designed to track the performance of 10 highly traded growth stocks of technology and tech-enabled companies in the technology, media & communications and consumer discretionary sectors.

S&P 500 Index (Gross/Total) measures the performance of the large cap segment of the US equity market but is widely recognized as a proxy for the US market as a whole. It is composed of 500 constituent companies across the US economy, weighted by float-adjusted market capitalization. A total-return index tracks price changes and reinvestment of distribution income.

FEF Distributors, LLC ("FEFD") (SIPC), a limited purpose broker-dealer, distributes certain First Eagle products. FEFD does not provide services to any investor but rather provides services to its First Eagle affiliates. As such, when FEFD presents a fund, strategy or other product to a prospective investor, FEFD and its representatives do not determine whether an investment in the fund, strategy or other product is in the best interests of, or is otherwise beneficial or suitable for, the investor. No statement by FEFD should be construed as a recommendation. Investors should exercise their own judgment and/or consult with a financial professional to determine whether it is advisable for the investor to invest in any First Eagle fund, strategy or product.

First Eagle Investments is the brand name for First Eagle Investment Management, LLC and its subsidiary investment advisers.

©2025 First Eagle Investments. All rights reserved.