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Market Overview

January extended the strong momentum from 2024, despite ongoing macroeconomic uncertainty. Key developments included tariff debates, the DeepSeek revelation, debt ceiling discussions, an inauguration, a Fed meeting, and key inflation reports. While emotional volatility was present, the S&P 500 advanced nearly 3%, small caps performed well, and international equities outpaced domestic markets. Market resilience persisted even as stock-bond correlations remained high.

Tariffs: Emotional Volatility vs. Market Reality

Tariff-related discussions spurred emotional reactions but had minimal immediate impact on markets, as reflected in only a modest decline on February 3rd. Investment decisions should be based on market signals, not political narratives. Historical data shows that economic fundamentals and earnings drive market outcomes, as demonstrated by sector performance under previous administrations. A 5% universal tariff increase could reduce corporate EPS by 1-2%, though potential deregulation may offset some negative effects. The takeaway is clear: markets respond to data, not emotions. Investors should prioritize underlying fundamentals over political sentiment.

Inflation & Fed Policy: Rate Cuts on the Horizon?

While inflation has moderated, it remains elevated relative to historical norms. Key indicators, including core CPI (excluding food & energy), are trending downward toward the Fed's target. Shelter inflation, comprising 34% of CPI, is expected to decline further, supporting broader disinflation. Year-over-year comparisons suggest lower inflation prints in the coming months. The Fed held rates steady in January but remains data-dependent. Two to three rate cuts in 2025 appear probable, contingent on continued inflation improvements. Fiscal policy adjustments, including potential spending rollbacks, could also influence the rate-cut trajectory. Lower rates would likely support equity markets, particularly rate-sensitive sectors.

DeepSeek & AI Market Rotation

The DeepSeek announcement sparked an AI-led sell-off, particularly among high-growth names. Hedge fund deleveraging led to forced selling, causing outsized moves, with NVIDIA and Broadcom both declining 17%. The AI-driven narrative is evolving from prioritizing raw performance to optimization, potentially benefiting smaller firms. Market breadth is improving, which may broaden S&P 500 participation and bolster small-cap stocks. Despite this volatility, the S&P 500 delivered a solid performance in January.

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Policy Uncertainty vs. Market Resilience

Historically, markets have rallied despite policy uncertainty, emphasizing the value of long-term patience over short-term reactions. Aptus' strategy balances participation with risk management to navigate uncertainty effectively. Over the past century, markets have compounded at high single-digit or double-digit rates despite persistent policy concerns, reinforcing the importance of staying invested for long-term wealth accumulation.

Looking Ahead

Earnings season continues, shaping near-term sentiment. Key themes to monitor include tariff developments and market reaction, Fed commentary and rate cut expectations, AI sector evolution and broader market participation, and fiscal policy changes and their impact on inflation and bonds. Historical context suggests market resilience despite short-term volatility.

Final Thoughts

January reinforced the importance of tuning out noise and focusing on fundamentals. Despite political, economic, and AI-driven uncertainties, markets continue to demonstrate resilience. A disciplined, long-term investment approach remains optimal. Aptus remains committed to balancing risk and opportunity, ensuring clients are positioned for long-term compounding.

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