Citi Wealth

Investment Strategy *Bulletin*

February 1, 2025

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Disrupting the Disruptors

Key Takeaways

- News that a Chinese AI innovator was able to rival the capabilities of leading US providers with a fraction of the costly chips sent Nvidia's market cap down by $600 billion in a single day (history's largest nominal single day value decline). Shares subsequently rebounded. Investors should understand that innovations in experimental technology can be highly disruptive even when positive. There is more idiosyncratic risk in the US's mega caps than some investors seem to understand.
- The news that AI may be less micro-processor intensive also hit utility and energy infrastructure shares Monday. However, reduced barriers to entry in AI will likely speed adoption and applications. Digital assets are another source of power demand in a rising trend.
- As we suggested in our Wealth Outlook 2025, Banks, Energy and Power Infrastructure and digital assets are deregulation beneficiaries that are outperforming in the volatile new year. So is the S&P 500 equal weight index, one way of reducing concentration risk in portfolios.

Potential Portfolio Implications

- AI experiments are producing staggering results. Finding ways of reducing capital intensity may help AI grow in scope. We believe AI software developers are best placed to take advantage of reduced chip and power bottlenecks.
- Volatility can create opportunity. So, too, can changing circumstances. Opportunistic investment ideas likely to benefit from the new administration's lighter regulatory touch include banks, midstream energy and nuclear power.
- President Trump signed an Executive Order emphasizing the importance of the digital assets industry in innovation and economic development and focusing on promoting US leadership in crypto. To maintain its growth, the crypto market will need greater infrastructure from crypto mining companies, mining equipment makers, brokerages and trading firms. Equities across this space have recovered strongly from their late-2022 lows. We believe they may remain on this path in the coming year.

Innovation Key, but Isn't Enough for Portfolios

The world of international politics was abuzz with news this past week that President Trump successfully used a tariff threat to win concessions on migrants from Colombia, one of many small countries with a lot at stake in the US trade relationship (also see last week's CIO Bulletin). What moved financial markets more, however, was news that a Chinese firm replicated most of the west's AI progress on a shoe-string budget.

News that DeepSeek was able to roughly match or even eclipse the results of large language models released by US hyperscaler firms with fewer advanced chips at a fraction of the cost rocked the tech tape, pulling down the world's most valuable semiconductor designer and fabricator. While we profess no engineering insights, key to results appears sets of compromises to use fewer chips more efficiently and continuously.

What will come of this is to be seen. If and when US AI firms copy this methodology, it will either sharply reduce their investment spending or enable a much cheaper option for building ever more. It may change the competitive landscape for AI innovators, reducing barriers to entry and some of the profit opportunities.

As **FIGURE 1** shows, three cloud computing hyperscalers have accelerated their investment spending growth in excess of 35%. Shareholders have rewarded this, but the firms would eagerly cut back if they could achieve the same or better results more cheaply. This may turn out to be a negative for the key semiconductor winner of the past 18 months. It also pulled down utilities and other energy providers to the AI industry, but long-term demand for AI is even more likely to be assured if the technology can be scaled more easily. Software designers for the AI industry could be a clear winner.

So, will the latest breakthrough end the AI arms race? Hardly. But it should serve as a reminder that investing in technology breakthroughs comes with great, unanticipated risks as well as rewards (see **FIGURE 2**). There is simply more idiosyncratic single stock risk in the US equity market when three firms are worth nearly 20% of the whole.

Fortunately, other winners are emerging on the deregulation front including banks, power, and digital assets infrastructure as we highlighted in Wealth Outlook 2025 and updated below. These gains should help investors see that highly concentrated tech portfolios are not the only way to generate returns.

FIGURE 1: Big three cloud computing capex

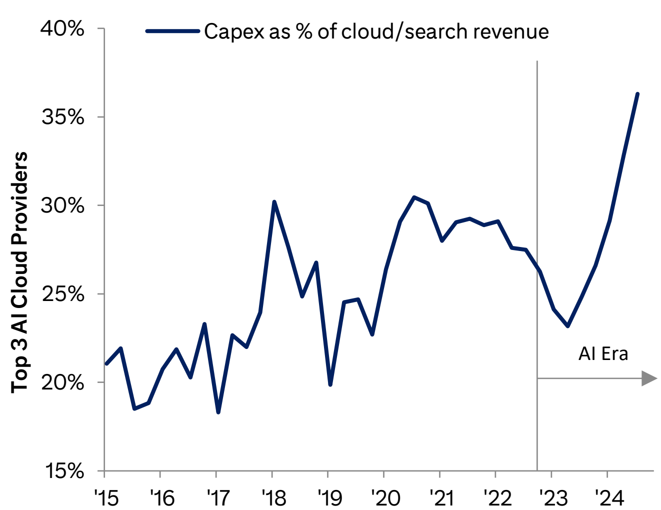
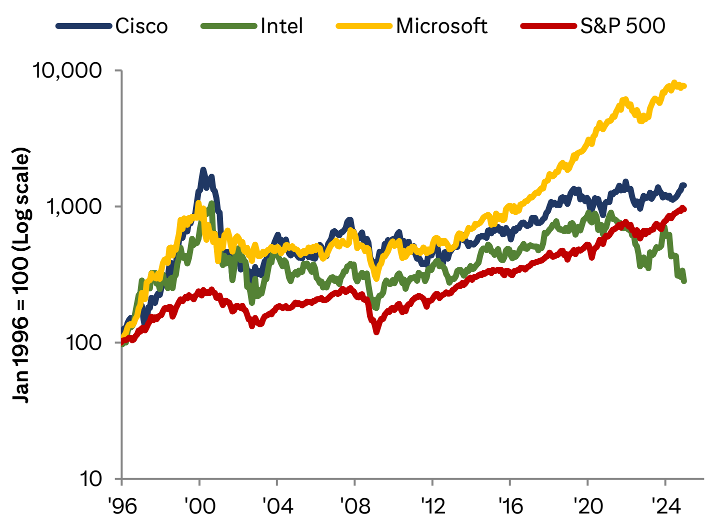


FIGURE 2: Top 3 market cap tech companies in the late 1990s to date



Source: Bloomberg as of January 27, 2025. AI era is the period of rapid progress in the field of Artificial Intelligence. Any company named herein is not a recommendation and is solely being used for illustrative purposes only. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

Deregulation Beneficiaries

In our Wealth Outlook 2025, we identified opportunistic investment ideas likely to benefit from a lighter regulatory touch, including banks, midstream energy and nuclear power.

President Trump has said he'd like to remove ten old regulations for every new one. Banks may benefit from less stringent capital requirements since the financial crisis of 2007-2009 and a rise in M&A and IPO activity (see **FIGURE 3**), while the Trump Administration's pro-energy stance could also boost the supply of oil and gas. The administration's commitment to cryptocurrencies and AI means electricity generation could rise by 30% from 2023 to 2030.

The big banks kicked off the 4Q24 earnings season with robust results, driven by strong investment banking activities and increased consumer spending. Elevated interest rates allowed banks to earn more net income from the spread between the loans they make and what they pay on deposits, while increased credit card usage drove fee-based income higher. An expanding economy led to lower loan loss provisions and some banks were also able to reduce their operating expenses. Banks generally benefit from a positively sloped and steepening yield curve where longer maturity rates exceed shorter maturity ones. This should continue in 2025 as the Fed eventually lowers rates to 3.75%, in our view.

Midstream equities present a compelling investment case for 2025 driven by resilient cash flows, attractive yields, and growth opportunities. These companies, which own and operate critical infrastructure like pipelines, storage and processing facilities, benefit from fee-based revenue models. As energy demand remains robust, particularly in LNG exports and refined products, midstream assets are positioned for steady volume growth. The Alerian Midstream Energy index recently had a dividend yield of 4.5%. In our view, with valuations far from their historical highs, midstream equities offer the potential for both income and capital appreciation (see **FIGURE 4**).

Nuclear power is gaining momentum as a critical solution for global decarbonization, offering reliable, carbon-free energy to meet growing demand. Governments worldwide are extending the lifespans of existing reactors and investments in next-generation technologies, including small modular reactors (SMRs), are on the rise. This resurgence supports uranium mining stocks, too, as uranium is an essential nuclear fuel. While risks include shifting political agendas, safety incidents, and legal challenges, the sector's long-term outlook remains influenced by technological advancements and the pursuit for both nonintermittent and sustainable energy solutions.

FIGURE 3: Banks may benefit from a rise in IPO activity

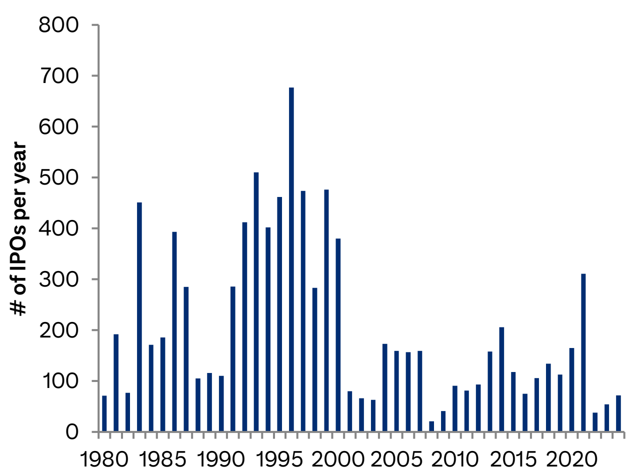
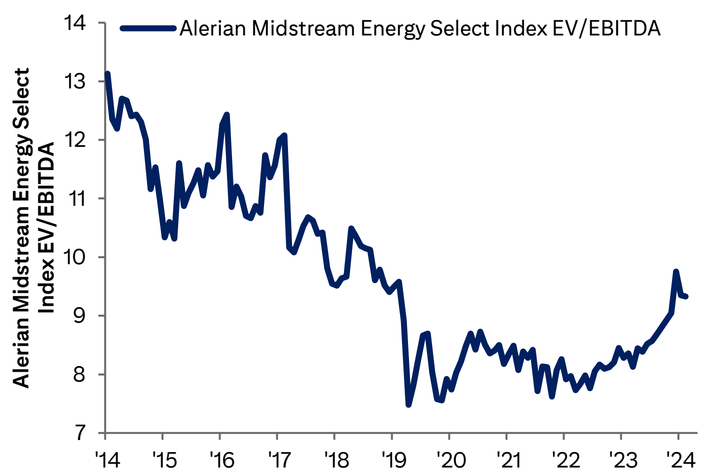


FIGURE 4: Midstream Energy EV/EBITDA ratio



Source: Bloomberg and University of Florida as of January 28, 2025. LHS: The sample is IPOs with an offer price of at least $5.00, excluding ADRs, unit offers, closed-end funds, REITs, natural resource limited partnerships, small best efforts offers, banks and S&Ls, and stocks not listed on Amex, NYSE, and NASDAQ. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

Continued Global Expansion of Digital Assets

The global market for digital assets continues to expand. In January 2025, the combined market capitalization of cryptocurrencies alone reached an estimated $3.7 trillion[1].

The new U.S. administration is crypto-friendly, with Trump most recently having signed an Executive Order emphasizing the importance of the digital assets industry in innovation and economic development and focusing on promoting US leadership in crypto. Amongst the takeaways, Trump ordered the creation of a working group in charge of promoting a constructive and accommodative regulatory environment and exploring the creation of a national cryptocurrency stockpile.

To maintain its growth, the crypto market will need greater infrastructure. Among the providers of this are crypto mining companies, mining equipment makers, brokerages and trading firms. Equities across this space – as represented by the Bitwise Crypto Innovators 30 Index – have recovered strongly from their late-2022 lows.

We believe they may remain on this path in the coming year. We also consider crypto industry equities as having the highest risk of the opportunistic positions discussed here, particularly given their rapid recent appreciation. Price volatility, technological failures, cyberbreaches and delays in regulatory developments could challenge our positive case.

FIGURE 5: Wealth Outlook 2025 opportunistic ideas

Top Potential Opportunities	YTD Performance
1) Philadelphia Stock Exchange Semiconductor Index	9.3%
2) Healthcare	
Dow Jones U.S. Select Medical Equipment Index	9.6%
S&P Biotechnology Select Industry Index	3.2%
3) S&P Aerospace & Defense Select Industry Index	9.2%
4) S&P Banks Index	9.1%
5) Energy	
Alerian Midstream Energy Index	8.0%
MVIS Global Uranium and Nuclear Energy Index	17.6%
6) CBOE VIX Index	-13.4%
7) Bitwise Crypto Innovators 30 Index	16.5%
8) MSCI Brazil USD Index	7.4%

Source: Citi Wealth Investments, Bloomberg as of January 23, 2025. See Wealth Outlook 2025 for more information. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

[1] Bloomberg as of January 2025.

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High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

1 The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2, or 3, to show relative standing within the category.
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- restrictions on transferring interests in the Fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
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