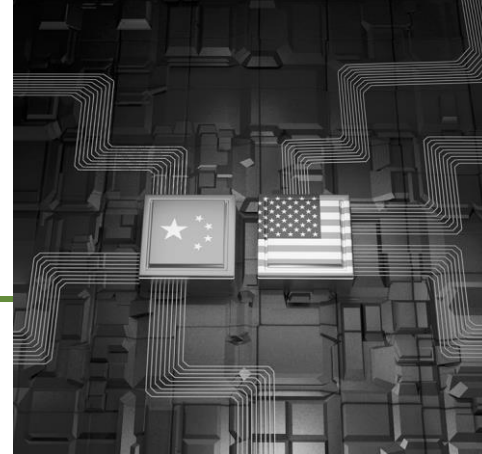


# MARKET SIGHT LINES



## DeepSeek, AI, and U.S.-China Competition

By Michael O'Keeffe, *Chief Investment Officer*



We're coming to the end of January 2025, and this is the last "spotlight" article from our Outlook 2025: *Gravitational Shifts* ([report](#), [video](#), [webinar](#)). U.S.-China competition, which is included in our update to our *Geopolitical Risk Dashboard*, made the news this month as the Chinese company High-Flyer launched the DeepSeek-R1 reasoning model. In this week's Sight|Lines, our outlook spotlight discusses the implications of this model launch with a focus on the article *Crossroads: Four Ways Forward*.

### THE TAKEAWAY: DEEPSEEK BRINGS U.S.-CHINA COMPETITION INTO FOCUS

Markets were rattled with the launch of the DeepSeek-R1 model, bringing into focus U.S.-China competition. In summary:

- The DeepSeek-R1 model was developed at a fraction of the cost of comparable models.
- The stocks of many U.S. companies leading in artificial intelligence (AI) fell this week.
- We remain positive on the transformative potential of AI over the coming decades.
- The forces of change we consider when evaluating U.S.-China competition are innovation, global trade, domestic policy, and foreign policy.
- We model four ways forward in a two-by-two grid, modeling the success of the U.S. on one dimension and China on the other.
- The first scenario, *U.S. Reenergized*, explores the potential for the U.S. leading with transformative technologies, even as China struggles.
- *Productive Competition* considers the path where both countries develop economic strength and technological advancement, ultimately leading to interdependence.
- *A Fragmented World* contemplates both the U.S. and China struggling even as other countries and regions emerge to play increasingly important roles in the global order.
- *China Takes the Lead* sees China emerging as a global power as the U.S. falters due to fiscal mismanagement and a polarizing political environment.

## IN-DEPTH: THE LAUNCH OF THE GENERATIVE AI MODEL DEEPSEEK PUTS U.S.-CHINA COMPETITION INTO FOCUS, ILLUSTRATING HOW ADVANCES LIKE AI WILL PLAY A KEY ROLE GOING FORWARD

The launch of the DeepSeek-R1 model rattled the markets and brings into focus U.S.-China competition.

*Crossroads: Four Ways Forward* helps us understand how this battle may unfold in the future. Going deeper:

- The launch of the DeepSeek-R1 model shook the confidence in U.S. AI leaders:
  - The model's development cost ~\$6 million, 15% of the cost of a comparable ChaptGPT model.
  - An index of semiconductor stocks fell 9% on Monday, while Nvidia declined 17%.
  - We remain positive on the transformative potential of AI going forward, and lower compute costs should benefit established AI companies and open up innovation to smaller companies.
- We consider these forces of change when evaluating U.S.-China competition:
  - *Innovation: The Growth Engine* – Transformative technologies can fuel economic growth.
  - *Global Trade: The Bargaining Chip* – Owners of transformative technologies have a leg up in trade.
  - *Domestic Policy: Strength Starts at Home* – The U.S. and China have domestic issues to address.
  - *Foreign Policy: The Strategic Compass* – Global alliances translate to global dominance.
- We model four ways forward, exploring both success and failure for the U.S. and China.
- *U.S. Reenergized* explores the U.S. leading through transformative technologies, as China struggles:
  - The U.S. diversifies its supply chain and trade partners to the detriment of China.
  - China struggles with domestic challenges.
- *Productive Competition* considers the path where both countries develop economic strength:
  - Both nations experience technological advancement and acknowledge mutual dependence.
  - Each exercise restraint to maintain relations, ultimately collaborating on global challenges.
- *A Fragmented World* envisions other countries and regions emerging to fracture the global order:
  - Both nations face economic and political challenges, eroding their global influence.
  - China struggles with domestic challenges such as debt, demographics, and lagging innovation.
  - The U.S. grapples with deepening political polarization, fiscal strain, and uneven growth.
  - Their weakness creates opportunities for other countries to pursue global influence.
- *China Takes the Lead* considers a faltering U.S. due to fiscal mismanagement and polarization:
  - China is successful in “the great rejuvenation of the Chinese nation.”
  - The U.S. faces economic stagnation, influenced by political polarization and mounting debt.
  - Nations around the world increasingly view China as a helpful and productive strategic partner.

### CONCLUSION

The launch of the DeepSeek-R1 reasoning model brings into focus U.S.-China competition, a risk profiled in our *Geopolitical Risk Dashboard* and our outlook article *Crossroads: Four Ways Forward*. This launch shook the markets, illustrating how this competition will shape economic and market dominance through time. To learn more, check out these articles in our Outlook 2025: *Gravitational Shifts* ([report](#), [video](#), [webinar](#)).

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. The Standard & Poor's 500 index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The DJIA was invented by Charles Dow back in 1896. The MSCI EAFE index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. VIX is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options.

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