WAVERTON

MARKET PERSPECTIVES

by **Algernon Percy** – July 2024

LAST QUARTER RECAP

2.9%
Stock markets make further progress – up 2.9%.

6.5%
Asia ex-Japan leads the field – up 6.5% in US dollar terms.

6%
Japan lags as the yen falls over 6% versus the US dollar.

5.6%
Gold appreciates 5.6%.

$3trn
NVIDIA attains a $3trn market cap (the entire FTSE100 index being only $2.5trn); it rose $218bn in a single day.

5 years
The European Central Bank cuts interest rates for the first time in five years.

2006
French borrowing costs exceed Portugal's for the first time since 2006.

2008
The National Bank of Greece is allowed to pay its first dividend since 2008.

There is no act of treachery or meanness of which a political party is not capable.”
Benjamin Disraeli *Vivian Grey* (1826).

The outlook for interest rates

Bond yields have been in a trading range.

Looking at bond returns over the quarter, one might think that yields were fairly static during this period, but in fact the 10 year US treasury yield moved between a low of 4.2% and a high of 4.7%, before settling at 4.4% at the end of June. This reflected the ebb and flow of sentiment regarding US economic growth and inflation – with the most recent data indicating a gradually slowing US economy that is broadly helpful to a benign inflation outlook, notwithstanding somewhat sticky services inflation and wage growth. In the UK, the economy was rather surprisingly described as 'going gangbusters' by the Office of National Statistics after some slightly better than expected figures; this, together with a decline in CPI inflation back to the official target of 2%, was welcomed with alacrity by Rishi Sunak, but wasn't enough to prevent him from being ejected from office. Gilt yields have hardly moved in response to the general election campaign and its outcome – the consensus being that five years of majority Labour government heralds a more stable outlook, with the likelihood that Sir Keir Starmer, in the early years at least, will not want to jeopardise a long term in office by pursuing an excessively radical economic policy.

The general election in France caused a degree of uncertainty in the Eurozone.

There has, however, been more election-related volatility in France, which could potentially affect the whole of Europe. A resurgent far-right in France is unnerving for the European bond markets because National Rally's stated economic policy (in contrast to its foreign policy and attitude to migration) is actually very left-wing in the sense that it advocates loose fiscal policy and eschews essential labour market reforms such as increasing the retirement age. A government led by Marine Le Pen threatened a row with the European Commission over budgets. Accordingly, OAT (French government bond) spreads over Germany increased markedly during the general election, and France's perceived credit risk has been of late worse than Portugal's – though still better than Italy's. As yet, bond pricing in Continental Europe is nowhere near as stressed as it was during the Eurozone crisis of 2012 – but the long term concern is that, if France did ever have a major break with Brussels, that would present a much greater existential threat to the euro than Greece did twelve years ago; conversely, if France somehow continues to muddle along with 6% deficits and 112% debt to GDP, that will increase tensions in Germany, which ultimately underpins the Eurozone's bond market and indeed the single currency.

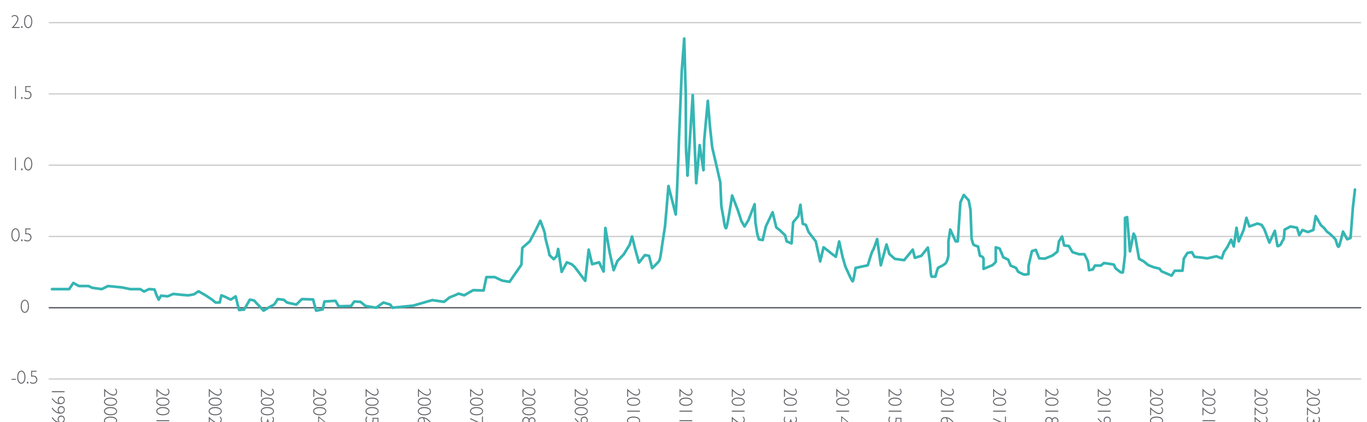
The US bond market is unlikely to be immune from continually rising debt levels.

In America also, for all the short term noise of fluctuating economic statistics and political shenanigans, we cannot ignore the fact that the level of public debt in the US is very high, and growing. Even after an extended period of economic expansion the budget deficit is still 6% of GDP, and interest costs alone are expected to be $892bn in 2024, before rising to over $1trn in 2025: the threat of another government shutdown is seldom far from the horizon. It is against this backdrop that gold has been increasing in value despite the relatively high interest rates available on cash (which ordinarily would make gold look less attractive in comparison). It appears that central banks, especially the People's Bank of China, have been buying gold in order to diversify away from their US dollar holdings.

Emerging markets can provide some useful diversification.

One obvious way of diversifying away from problematic Western bond markets is to invest in emerging market bonds. Waverton do have some modest exposure to Asian and Latin American bonds, mostly via US dollar denominated paper issued by resilient internationally-exposed businesses (e.g. a Brazilian port) – but our bond funds do also have small amounts of some emerging market currencies (e.g. the Indian rupee and the Mexican peso). Argentina is famously a no-go area for bond investors given the number of defaults that country has experienced in the last 100 years, and Waverton remain unexposed to that jurisdiction. However, it is ironic that Peronist Argentina seems now to be the model for budgetary discipline in the US and Europe, and populist politicians look like they are determined to double down on this if they get the chance. In the long run the credit risk of governments is going to become every bit as pertinent as the risk of corporate defaults.

France less Germany 10 year Government Bond Yield (%)



Source: Bloomberg.

The outlook for equities

Political risk is increasingly pertinent in the US…

Equity markets have been fairly sanguine about the potential political upheavals in the pipeline. A lack of fiscal restraint is likely to keep economic growth rates elevated – viz. the huge spending boost (especially on green energy and infrastructure) provided by President Biden's Infrastructure Investment and Jobs Act of 2021, and the Inflation Reduction Act of 2022, both of which have had a huge impact on US GDP growth. Populism doesn't sit well with fiscal austerity and a future Trump second term would likely entail more tax cuts and deregulation, both of which would be broadly beneficial for the stock market. However, one would have to be selective: energy, financial and domestic manufacturing stocks might do well, but companies reliant on global free trade would be hurt by tariffs and interest rate sensitive stocks would be impacted by the likely higher bonds yields that would accompany a Trump stimulus. International investors in the US would benefit from any US dollar appreciation that accompanied rising interest rates. One major risk would be if bond yields rose so much that asset prices had to fall across the board (rather like they did in 2022); another might be if Trump won both houses of congress as well as the presidency – such that there were no constraints to his eccentricities.

…as well as in Continental Europe and the UK.

Similar dynamics will come in to play in continental Europe and the UK, depending on the nature of political change which materialises over the next few months. The incoming Labour government claims to have economic growth at the heart of its agenda and professes to be business-friendly – but measures such as a higher minimum wage, workers' 'right to switch off', the abolition of zero-hours contracts, four-day weeks etc. would surely do nothing to resolve the country's already poor productivity record. However, if Labour were able to resolve the doctors' strikes and reform the NHS, that would be beneficial to the economy as one serious constraint on the labour market is the inability of the sick to get better quickly.

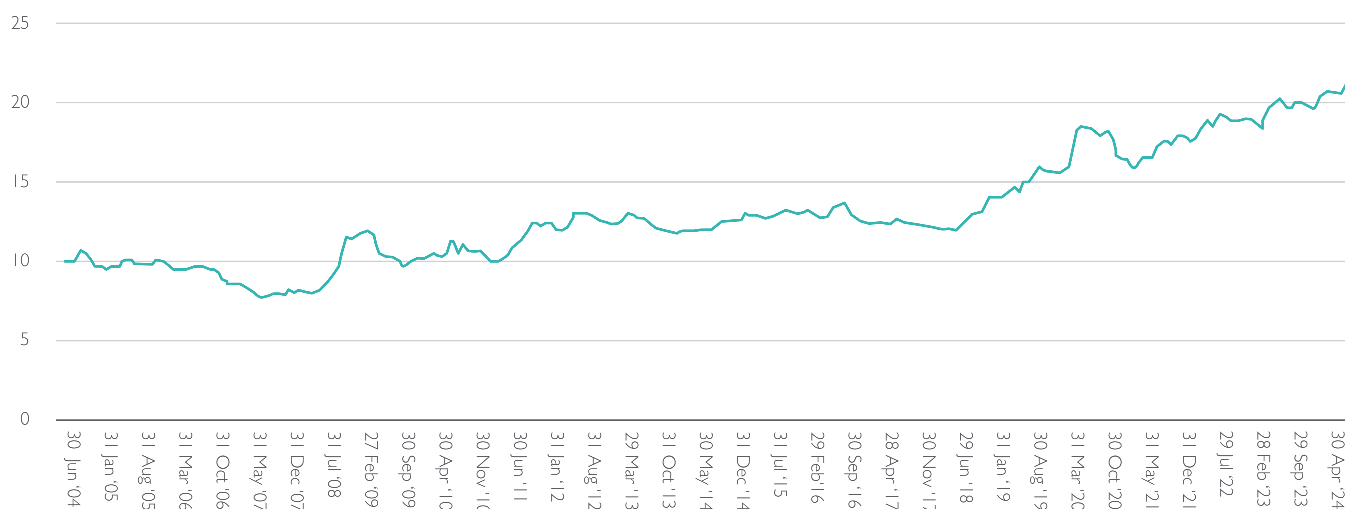
There are, however, interesting equity opportunities in Europe…

Political risk has always been something fund managers have had to contend with and, whilst it is undoubtedly elevated at present, it should not distract from our primary focus on analysing individual companies and each one's ability to grow cashflow in a way that we can evaluate and be confident of. In this vein, we have talked mostly about the US in recent issues of *Market Perspectives* as the S&P500 index has been the primary driver of equity market appreciation – hardly surprising given that so often the best global companies are listed in America. However, we should not forget Europe as a fruitful hunting ground for stock picking: our two European funds, despite having minimal exposure to technology, have both had a good quarter (and indeed year to date) thanks to their strong focus on the value within the businesses they invest in.

…often away from the big names.

Just as in America, where technology (and artificial intelligence in particular) have been dominating the equity indices, in Europe the *topic du jour* has been the 'GRANOLAS' – a phrase coined by Goldman Sachs to describe Europe's stock market champions, i.e. GSK, Roche, ASML, Nestlé, Novartis, Novo Nordisk, L'Oréal, LVMH, AstraZeneca, SAP and Sanofi. Whilst we hold some of these names, we cannot see merit in our funds being exposed to the c. 20% index-weighting in these companies when we see so much value away from these large caps. For example, two of our favoured names this side of the Atlantic are Spanish companies – Inditex and Amadeus IT, both of which are gaining market share in their respective sectors (fashion wear and travel software solutions) thanks to strong management and a favourable competitive environment. Investing in indices can be a tempting shortcut, but in the long run we believe it is only by meeting the companies and doing the work that the best way to play certain themes can be identified.

Total Weight of 'GRANOLAS' in MSCI Europe Index (%)



Source: Waverton/Factset/MSCI.

STERLING ADJUSTED	3 MONTHS (%)	6 MONTHS (%)	9 MONTHS (%)	1 YEAR (%)
ICE BofA UK Gilt Index	-1.1	-2.9	5.5	4.6
ICE BofA Global Broad Market Index (Hedged)	-0.2	-0.5	5.5	3.0
MSCI United Kingdom All Cap Index	3.4	7.3	10.7	13.2
MSCI United Kingdom Index	3.6	7.8	10.3	13.1
MSCI AC World Index	2.9	12.2	19.3	20.1
MSCI AC World (ex UK) Index	2.8	12.4	19.7	20.3
MSCI AC World (ex US) Index	1.0	6.6	12.0	12.3
S&P Composite Index	4.2	16.3	24.3	25.3
MSCI Europe (ex UK) Index	-0.4	6.4	14.4	12.1
MSCI Japan	-3.9	7.2	11.0	13.8
MSCI AC Asia Pacific ex Japan Index	6.5	9.4	13.0	13.7
MSCI Emerging Markets	5.2	8.4	11.9	13.2
Growth Index	2.0	9.0	16.1	16.7
Balanced Index	1.6	7.2	14.1	14.6
Cautious Index	1.1	5.3	12.2	12.6
Defensive Index	0.7	3.7	10.7	11.1
Return on Cash £ (1 month deposit rate)	1.3	2.6	3.9	5.2
Inflation - UK CPI	1.2	1.7	2.0	1.8
Gold Price (£1851.12)	5.5	14.4	20.4	22.9
£ vs US$	0.1	-0.8	3.6	-0.6
£ vs Euro	0.8	2.2	2.3	1.2
£ vs Yen	6.4	13.1	11.6	10.7

US DOLLAR ADJUSTED	3 MONTHS (%)	6 MONTHS (%)	9 MONTHS (%)	1 YEAR (%)
ICE BofA US Treasury Index	0.1	-0.8	4.8	1.3
ICE BofA Global Broad Market Index (Hedged)	-0.1	-0.4	5.9	3.5
MSCI United Kingdom All Cap Index	3.5	6.4	14.7	12.6
MSCI United Kingdom Index	3.7	6.9	14.2	12.5
MSCI AC World Index	2.9	11.3	23.6	19.4
MSCI AC World (ex UK) Index	2.9	11.5	23.9	19.6
MSCI AC World (ex US) Index	1.1	5.7	16.0	11.6
S&P Composite Index	4.3	15.3	28.8	24.6
MSCI Europe (ex UK) Index	-0.4	5.5	18.5	11.5
MSCI Japan	-3.8	6.3	15.0	13.1
MSCI AC Asia Pacific ex Japan Index	6.5	8.5	17.0	13.0
MSCI Emerging Markets	5.3	7.5	15.9	12.5
Growth Index	2.2	8.5	19.1	15.4
Balanced Index	1.8	6.9	16.4	13.2
Cautious Index	1.4	5.2	13.9	10.9
Defensive Index	1.1	3.9	11.8	9.1
Return on Cash $ (1 month deposit rate)	1.3	2.7	4.0	5.4
Inflation - US CPI	0.3	1.5	1.9	3.0
Gold Price ($2340)	5.6	13.5	24.7	22.2
US$ vs £	-0.1	0.8	-3.4	0.6
US$ vs Euro	0.8	3.1	-1.2	1.8
US$ vs Yen	6.3	14.1	7.8	11.3

* All MSCI benchmarks are net of tax.
Source: Factset, RIMES

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