WAVERTON

GLOBAL OUTLOOK

July 2024

This document should be used as a guide only. It is based on our current view of markets and is subject to change.

INTRODUCTION

This document shows the charts that we think are particularly useful to help us determine where we are in the economic cycle and what the outlook is for markets.

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SUMMARY OF OUR VIEWS

Macroeconomic background

The narrative in markets has shifted again in July. On a macro level, there has been a return to a more optimistic view about inflation.

The June CPI report for the US was better than expected. This has increased confidence that the Federal Reserve will cut interest rates before the end of the year. There are four policy making meetings left in 2024 and the market is fully pricing two rate cuts, with the first coming in September.

This has contributed to bond yields being at their lowest level since March and to a rotation in the stock market away from the leading technology and communication service names to a "value" tilt. In the last month, the best performing US sectors are energy and financials.

But to repeat ourselves from previous reports, in our view, it may take a significant hiccup in markets and/or in the economy to get the Fed to cut rates before the election. We say this simply because since 1992, the Fed has only cut interest rates after May in an election year on one occasion, 2008, when the world was literally falling apart.

One very much doubts that the Fed will want to make its first cut in this cycle before November unless the growth outlook deteriorates significantly.

President Biden has stood down from being the Democratic party nominee for President in November. His polling against Trump had collapsed after his faltering performance in the June 27 debate which highlighted his age and apparent infirmity. At the time of writing it seems that Vice President Kamala Harris is likely to be the nominee. There may be a bump upward in the polls for her relative to Biden in the short-term but she is also a flawed candidate.

The Democratic party base was very demotivated given Biden's obvious frailty. But there is also very little enthusiasm for Vice President Harris.

The attempted assassination of Trump on July 13 has added a wildcard into the election too. Although Trump has not had a significant bump in support in the first polls after the attempt on his life, it is a reasonable assumption that the Republican party base will be very motivated to vote.

It remains our view that either Trump or the sitting Vice President would be fine as far as markets are concerned. Even a different Democratic nominee is unlikely to be radically different from a policy perspective.

In his first term, Trump cut taxes, reduced business regulation and his tariff policies have become somewhat mainstream.

Biden/Harris (as they will now describe the Democratic ticket) kept the economy going with his fiscal stimulus measures and avoided a recession that many of us thought likely in 2023. The unemployment rate has been the lowest since 1969 and the stock market has been in a bull market.

The rotation in market leadership has also had a political angle. The Republican party platform is pro-energy drilling and pro tax cuts which could increase the budget deficit. That has contributed to the move in bond markets where at one point, 2-year note yields were below 30-year bond yields in mid-July. That has helped bank stocks.

The market is also thinking that the Republican party may now take control of the Senate and retain control of the House of Representatives. Trump would be empowered on all fronts if that happens. Initially, that feels market friendly. But tariffs increase headline inflation and tax cuts could too. We are watching market expectations for inflation closely.

Risk warning: The above should be used as a guide only. It is based on our current view of markets and is subject to change. As at 22.07.24

SUMMARY OF OUR VIEWS (continued)

Equities (overweight)

Global equities returned 2.9% in Q2 and are up 12.2% this year (in sterling terms).

Our investment criteria continue to serve us well and stock selection continues to be the key driver of our outperformance. In these markets, it is particularly important to remain both disciplined in our approach and long-term in our perspective.

We are comfortable with the more balanced positioning introduced into our equity exposure since mid-2020 and, as ever, the focus is on those companies where the Equity team has greater confidence in their ability to deliver future free cash flow (irrespective of sector, style factor or region), and where valuations are supportive of strong real returns over the cycle.

It is encouraging that there has been broader participation in the market rally this year. Although the so called "Magnificent 7" technology and communication service giants did well, every sector has risen this year (as of July 18). Communication Services and Information Technology lead the way but Energy, Financials, Industrials. Staples and Utilities have also had double digit gains.

We continue to identify opportunities in all regions, especially Japan which has long provided us with an attractive way to gain exposure to market leading industrial technologies, but with the country's renewed emphasis on corporate governance improvements and with it more efficient allocation of capital, likely to unlock considerable value across a broader range of sectors over time.

Fixed income (underweight)

The overall gilt total return index returned -1.1% in Q2 and -2.9% so far this year.

We still see value in government bonds. We also see them as an important diversifier after a strong rally in the equity market in recent months.

Short dated sterling credit is also attractive with yields of 5.5% on offer for an investment grade portfolio of bonds maturing within the next 18 months.

Alternatives (neutral)

We believe Alternatives have an important role to play in diversified portfolios.

Absolute Return strategies can give exposure to an uncorrelated stream of returns giving diversification benefits. This sector has struggled in recent years, but well-run funds have attractive volatility dampening characteristics.

Real Assets such as property (both physical and intellectual), infrastructure (including transportation), commodities (such as gold) and other investments underpinned by physical assets offer a combination of income and capital return that is attractive. Many of the assets that produce income have inflation-linked cashflows.

Cash (neutral)

Even though savings rates have risen, cash still loses purchasing power quickly in any period of high inflation.

Risk warning: The above should be used as a guide only. It is based on our current view of markets and is subject to change. Data as at 18.07.24

POLITICS, POLICY, BONDS & CURRENCIES

TRUMP NOW SEEN AS VERY LIKELY TO WIN BY BETTING MARKETS

The top chart shows the current probability of who wins the 5 November Presidential election based on betting done on www.predictit.org. As of July 22, the probability of Vice President Harris winning is 39%, of Trump winning is 60%.

Biden dropped out of the race on July 21 in the wake of his poor performance at the debate with Trump on June 27 and missteps in the weeks following. Every time he attempted to show he was really in command of his faculties he only seemed to confirm that was not the case.

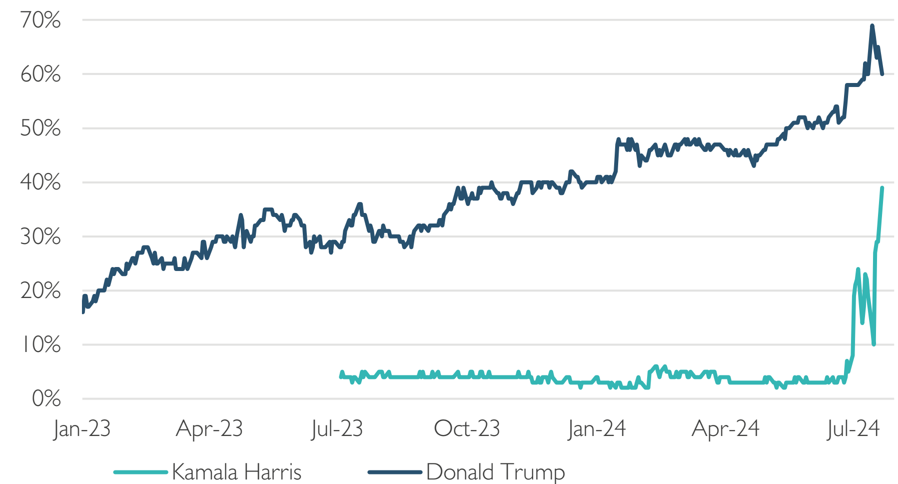
The assassination attempt on former President Trump on July 13 has not materially altered the perception of the state of the race although it is likely that it will have motivated his supporters to vote in November.

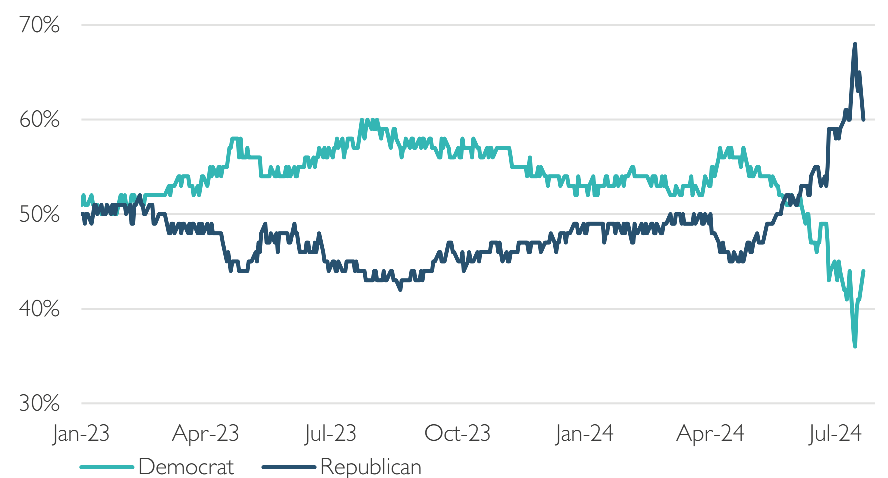
The bottom chart shows the probability of any Democrat or Republican winning. For a long time, "any Democrat" was outperforming Biden. "Any Democrat" is outperforming Harris slightly too, probably reflecting the initial market reaction that Harris is also a weak candidate and that better candidates are available (e.g. Michigan Governor Gretchen Whitmer).

But to get the Democrat nomination to anyone other than Harris will be difficult. Harris is doing her best to shore up support in the first day after Biden's withdrawal.

Financial markets are relaxed about Trump winning. Trump cut taxes and had a light touch on regulation in his term.

If the Democrats can recover, the market will not expect significant policy change, whoever is the nominee, which will also be acceptable given the Biden administration kept the economy growing and oversaw a stock market at record highs.





Source: Bloomberg, www.predictit.org, Waverton Data as at 22.07.24

BUT US PRESIDENTIAL ELECTION COULD STILL BE CLOSE

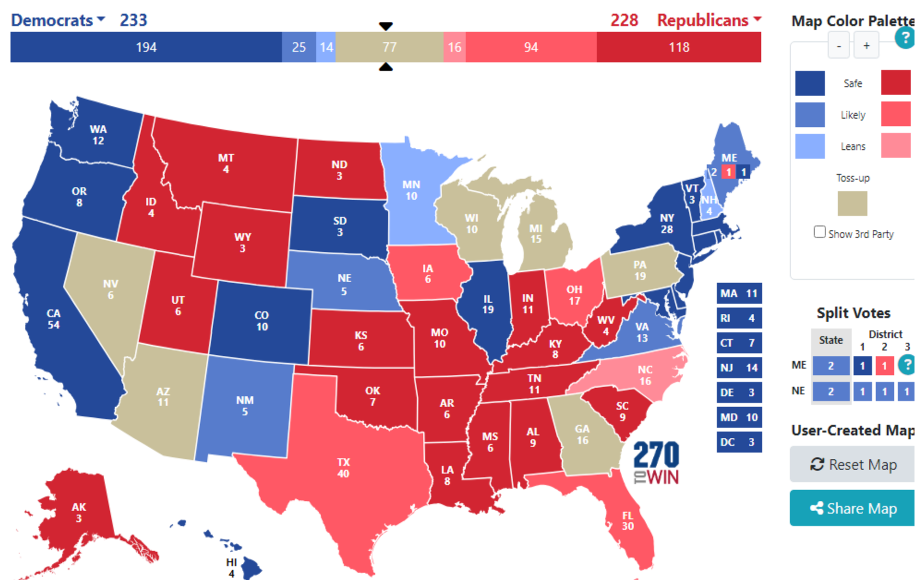
Although the betting markets are convinced that Trump is now the strong favourite in November, the first polling done after the 13 July assassination attempt has not shown a significant bounce in support for Trump.

The map below shows the states likely to vote Republican in red and likely to vote Democrat in blue. The election will be decided in the brown states which are states that have voted both Democrat and Republican in the last three elections.

The latest polling in those six states is shown in the chart on the right. Trump is in the lead in five states with Biden (there is no polling yet post Biden's withdrawal) only tied with Trump in Michigan.

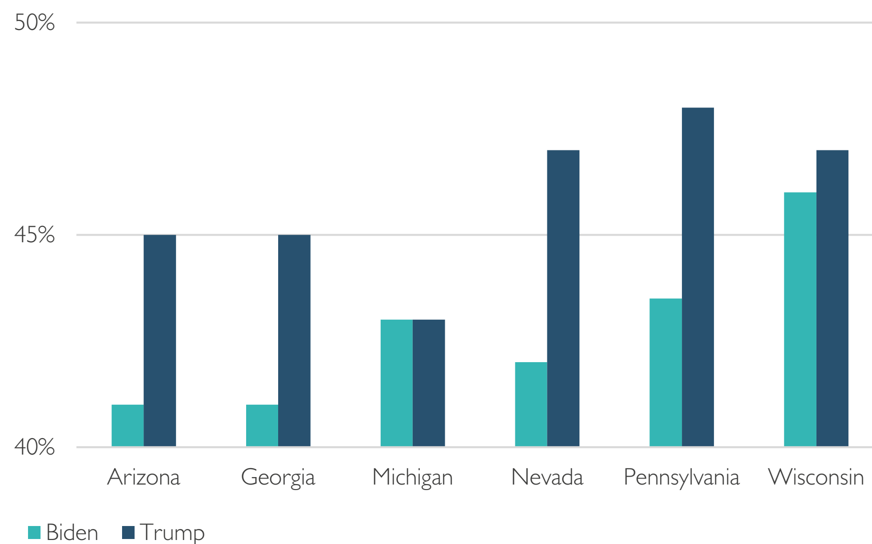
It will be interesting to see how this evolves in coming weeks. Does Trump get the bounce the betting markets expect? Or does the new Democrat candidate play catch up with Trump in these states?

US Electoral College projection after 2024 election



Source: https://www.270towin.com/ data as of 16.07.24

Latest opinion polls in six swing states %



US CONGRESSIONAL ELECTIONS LOOK CLOSE

The policy impact any President has, is in part determined on the outcome of the Congressional elections. All of the House of Representatives and one third of Senate seats are in play this year.

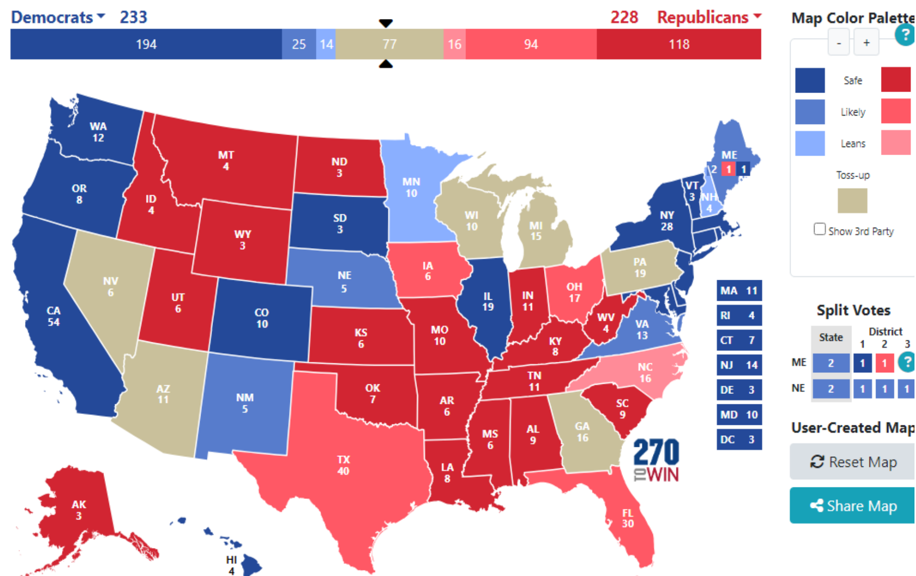
Currently the Republicans control the House 218 – 213 with four vacant seats. The current consensus is that the Republicans look like they are leading in 214 seats, the Democrats in 219. So, the majority will be determined in the other 107 seats.

A lot of Democratic voters were demoralised by Biden's travails so a critical thing to watch will be to see if the new Democratic candidate can galvanise the party's supporters to vote in November and thereby increase their chances of taking the House.

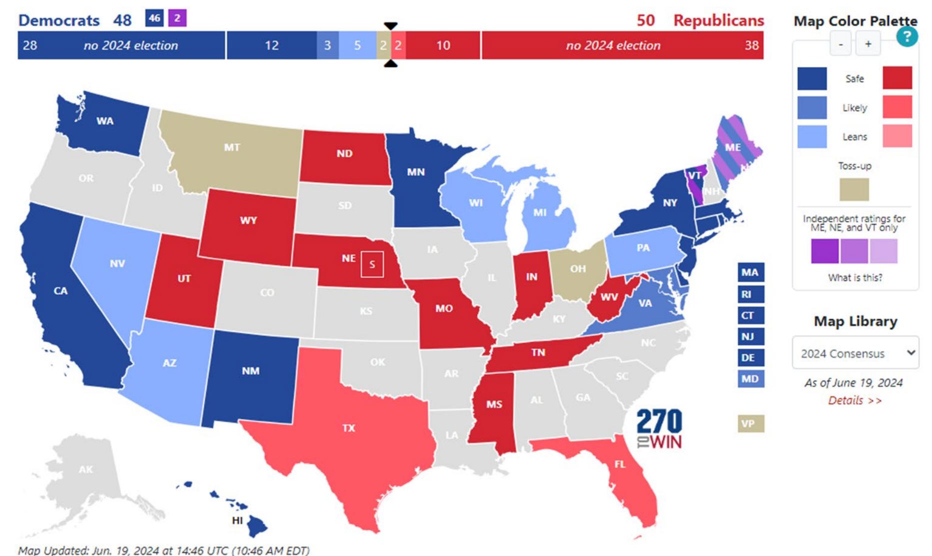
The Democrats currently control the Senate by 51 – 49. The consensus is that the Republicans are likely to take control of the Senate. The party is favoured in the majority of the 34 seats up for election. At the moment, that is seen giving the party at least 50 seats with the Democrats looking likely to have 47 seats.

A Trump Presidency with Republican control of Congress would likely be seen as business and market friendly.

US House of Representatives projection after 2024 election



US Senate projection after 2024 election



Source: https://www.270towin.com/ data as of 03.07.24

SIGNIFICANTLY FEWER RATE CUTS THAN WERE EXPECTED AT END OF 2023

The top chart shows current expectations for the US Federal Reserve policy rate over the next year and what those were at the end of last year.

The market expects the Fed is going to cut rates two times between now and January 2025 with the first cut priced in for the September 2024 policy setting meeting.

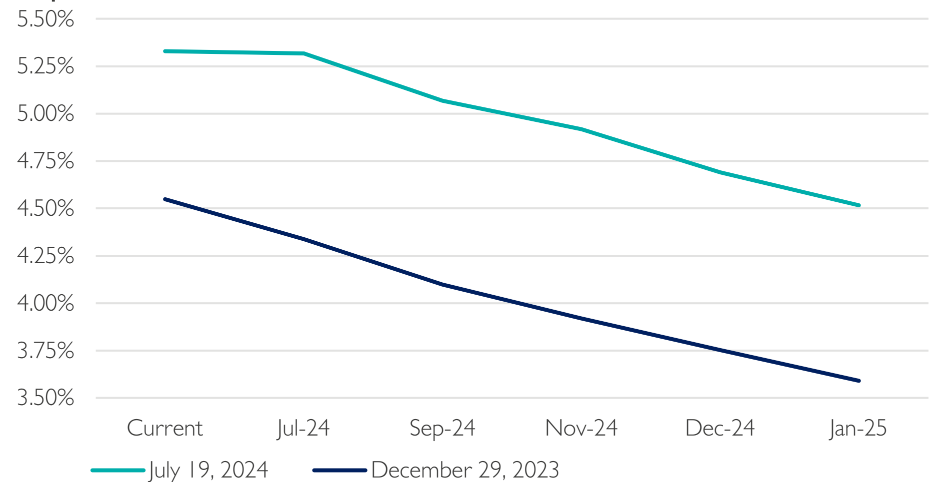
A wrinkle in the narrative though is that since 1992, only in 2008, in the midst of the financial crisis, has the Fed cut interest rates after May in a Presidential election year. We are sceptical that the Fed will actually cut in September. The Fed will not want to be seen to be doing something that could benefit the incumbent party just weeks ahead of the election.

The bottom chart shows current expectations for the Bank of England's base rate and those expectations at the end of last year. The Bank is now expected to cut rates three times by June 2025. At the turn of the year, six cuts were expected by December 2024.

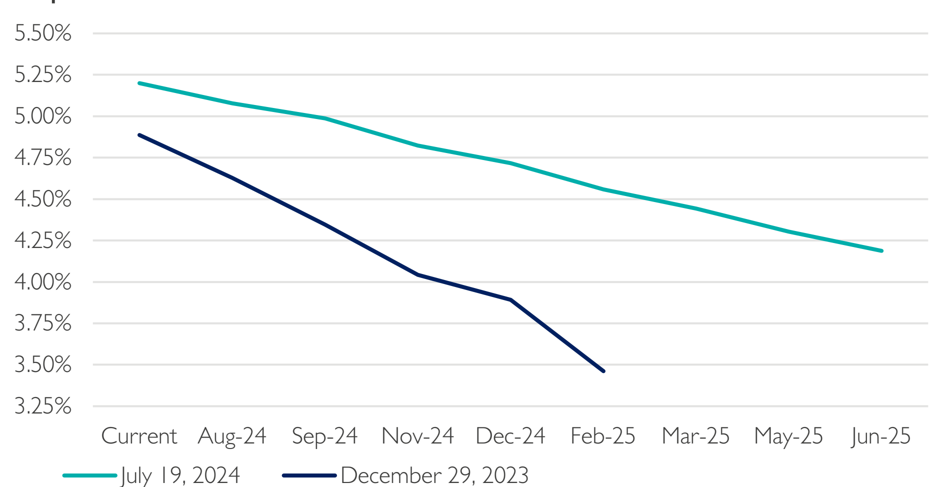
The first cut here is expected at the September Monetary Policy Committee meeting.

It seems reasonable to think the Bank will cut later this year. Inflation is back to 2.0% and a cut would help stimulate parts of the economy that have been in the doldrums such as the property market.

Implied US Fed Funds rate %



Implied UK Base Rate %



Source: Bloomberg, Waverton. Data as at 19.07.24

FISCAL POLICY WILL BE DOMINANT ISSUE IN 2025

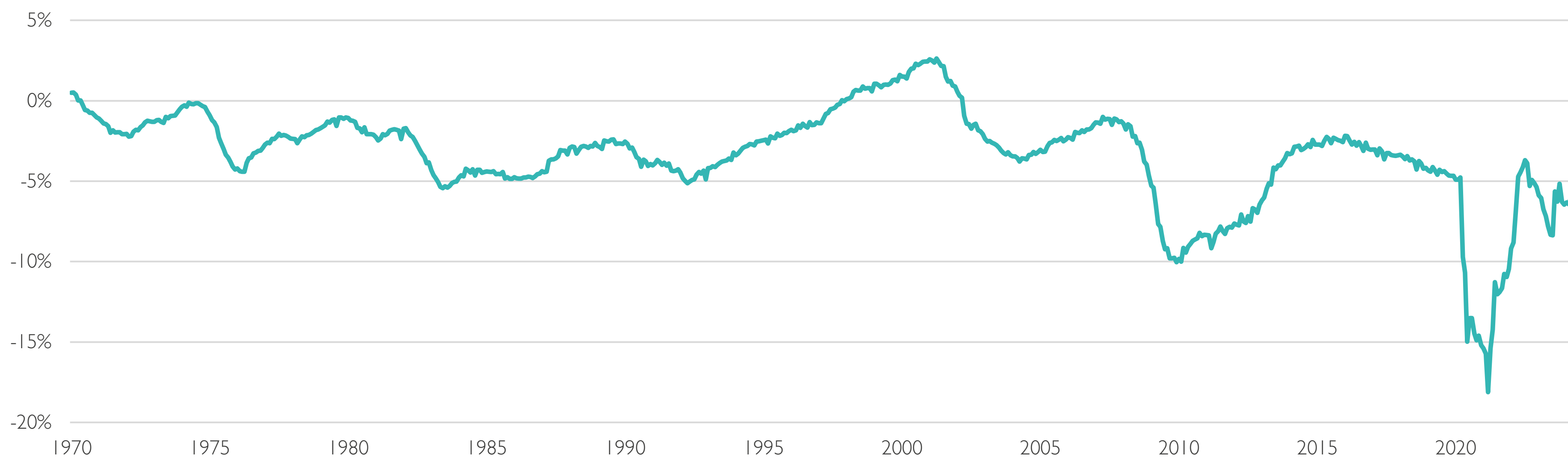
This chart shows the US budget deficit as a % of US GDP. It is currently 6.1% of GDP. So far the bond market has been relaxed about the likelihood of more supply of government bonds in the months and years ahead. But that could change in 2025 for two reasons.

Firstly, the Federal government debt limit will be reinstated on 2 January 2025 at the level that includes all borrowing since the June 2023 suspension of the debt limit by Congress. So, it is a legal requirement that at some point next year Congress will have to raise the debt limit to permit more borrowing. The US Treasury can rely on its cash holdings for a little while before the limit needs to be raised but it is likely that the new Congress will have to deal with this issue in the first weeks of 2025. If no one party controls both houses of Congress and the Presidency that could be a challenge.

Secondly, the 2027 tax cuts for individuals and small businesses roll off at the end of 2025. If new legislation is not passed to renew them, then taxes will rise by over $4 trillion. A Trump administration with Republicans in control of both houses will definitely renew them. It could be a battle to do so if that is not the situation.

Renewed tax cuts would be a positive for demand in the economy in the short term but will boost the deficit further in the medium term. Could the bond vigilantes come out of hibernation at that point?

US budget deficit as % of GDP 1970 - current



Source: Bloomberg, Waverton. Data as at 31.05.24

US PROFITS AS % OF GDP REMAIN RESILIENT

This chart shows pre-tax profits of corporate America relative to GDP through Q1 2024, the most recent data available. This profit series shows aggregate profits across the whole economy and shows them in US dollars, not as earnings per share.

Consequently, this series is not susceptible to financial engineering via such things as share buybacks to boost earnings per share. It is a proxy for profit margins.

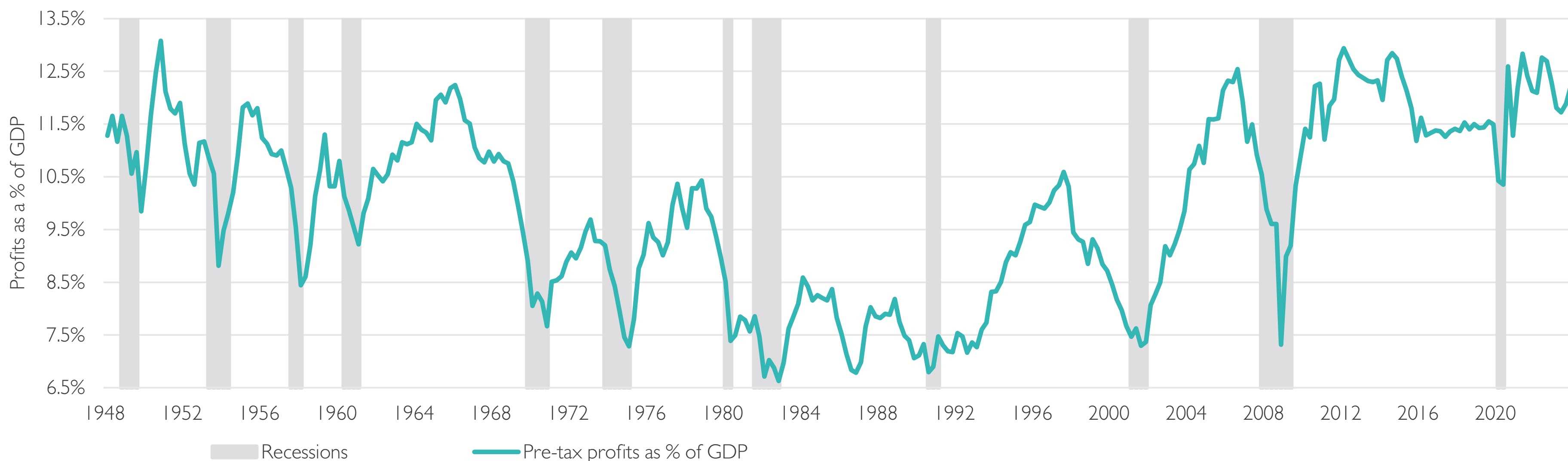
In every recession except 1982, profits were falling as a % of GDP before it.

Profits are below the cyclical peak as % of GDP which was 12.8% in Q2 2021.

But on this measure profits have been resilient in the last three quarters when they were reported as 11.9%, 12.2% and 11.9% of GDP respectively.

This is now another indicator suggesting a recession in the near term is unlikely.

US profit cycles and recessions (%)



Source: MSCI, FactSet, Waverton. Data as at 31.03.24

GOVERNMENT BONDS REMAIN INTERESTING AT THESE LEVELS

The top chart shows how the yield on 10-year gilts and 10-year US Treasuries has evolved over the last two years.

Yields have backed up by 0.5% here and by 0.3% in the US since the turn of the year but are still below where they were in October 2023.

The bottom chart shows those same yields after deducting the current 10-year inflation swap rate in each market. The swap rate is one indication of market expectations for inflation over the life of the bond.

Inflation swaps are priced on RPI in the UK so we have deducted 1.2% from the swap rate to get an implied indication of expectations of CPI inflation (1.2% is about the long-term "wedge" between RPI and CPI inflation).

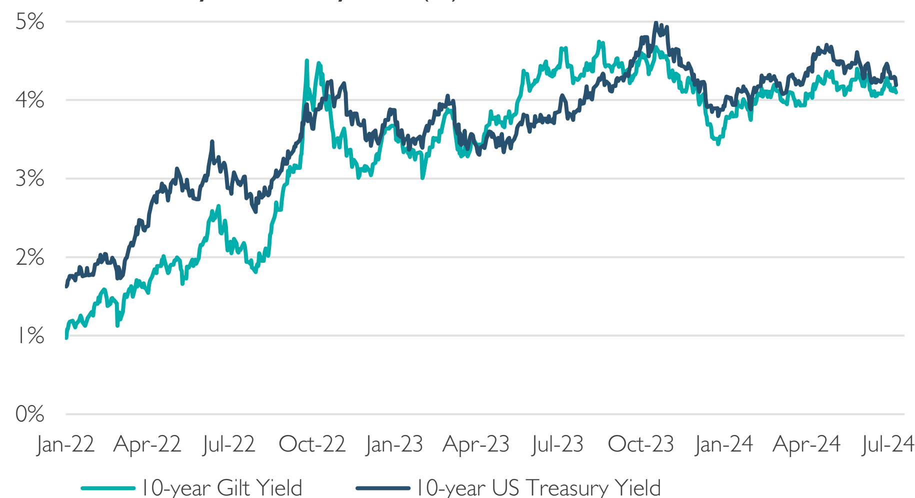
As the chart shows, both markets continue to offer, on this measure, a positive real yield.

The inflation linked bond market is saying something similar in the US where the Treasury Inflation Protected Securities market is giving a positive real yield. The January 2034 TIPS yields 1.91%.

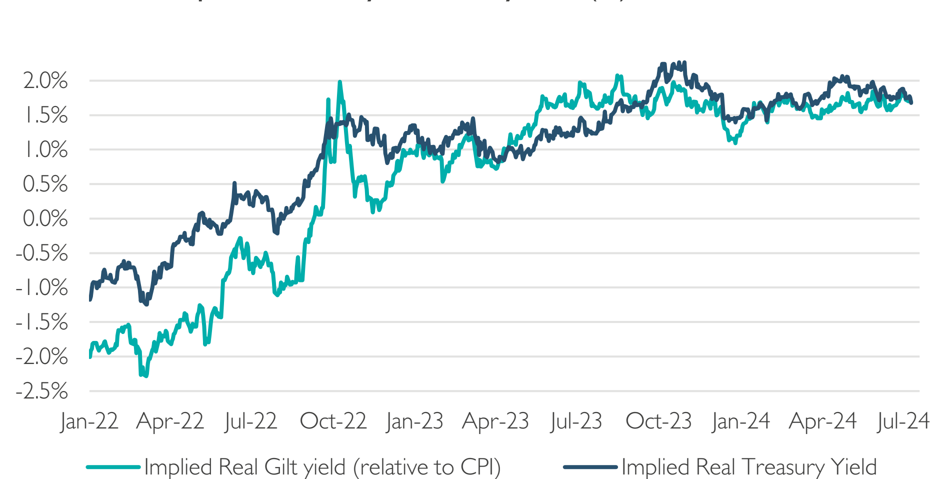
The UK linker market is less attractive (the March 2034 linker yields 0.52%).

We still think there is some value in government bonds given the positive real yields on offer.

US and UK10-year bond yields (%)



US and UK implied real 10-year bond yields (%)



Source: Bloomberg, Waverton. Data as at 11.07.24

STERLING RANGEBOUND AGAINST THE EURO

Sterling has strengthened a little against the euro in recent weeks as the expectations for the extent the Bank of England will cut interest rates this year has reduced. The current rate is above the average rate of 1.15 euros per pound since the Brexit referendum in June 2016.

We continue to think that the exchange rate versus the euro is a better measure of the market view of UK specific risks is the sterling/dollar rate.

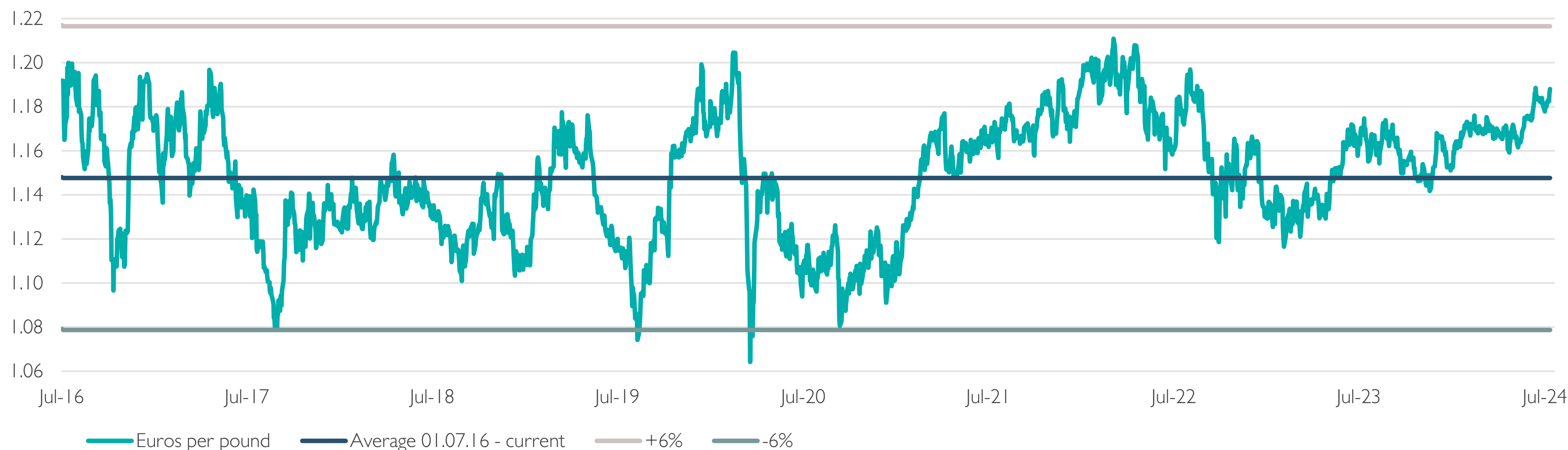
The chart shows the number of euros per pound since 1 July 2016. The average exchange rate since then is shown as the green line and we show a range 6% either side of that average.

We use 6% as that was the range sterling was allowed to trade against its DM2.90 central rate when it was in the Exchange Rate Mechanism (ERM). Famously sterling was forced out of the ERM in September 1992 when it was unable to hold within that range.

We note that over the period shown (over 2,000 trading days), sterling has only been out of a 6% trading range for five days.

For now, there is little sign of an elevated UK sovereign risk premium on this measure at least. If anything, the market is more worried about the euro area after the inconclusive French election.

Euros per pound (01.07.2016 – current)



Source: Bloomberg, Waverton. Data as at 11.07.24

INFLATION RATES SLOWLY DECELERATING AROUND THE WORLD

The peak for US inflation was in June 2022 at 9.1%. It is now 3.0%. The euro area peaked in October 2022 at 10.6% (now 2.5%) and the UK also peaked in October 2022 when RPI was 14.2%, and CPI 11.1%. RPI is now 3.0% and CPI is 2.0%.

US core inflation (excluding food and energy) peaked at 6.6% in September 2022. It is now 3.3%.

Despite the recent improvements, there remain concerns about the inflationary impulse across the developed world. The detail of recent inflation reports shows a slower reduction in price increases and Service inflation, in the US in particular is a concern.

However, as the next charts show, the market is still somewhat sanguine about future inflation even though the recent data in the US in particular has not been as good as the market had hoped for.

Inflation (% change year-on-year)

1980 - current

21%
18%
15%
12%
9%
6%
3%
0%
-3%

1980 1985 1990 1995 2000 2005 2010 2015 2020

US CPI — Euro area CPI — UK RPI

Source: Bloomberg, Waverton. Data as at 30.06.24

EXPECTATIONS FOR FUTURE INFLATION REMAIN SANGUINE

The top chart shows the 2-year inflation swap rate which is one reflection of the market's view on future inflation. One can buy or sell the swap. If you think inflation will average more than the current price, you buy the swap and vice versa. The payoffs are roughly linear. If you buy at 2% and the outcome is 2.2%, you make about 10%.

The moves in rate markets and inflation swaps are clearly interlinked. The market remains sanguine about inflation over the next two years.

But if future inflation actually takes longer to return to target that will be an issue for investors as it will almost certainly see a reversal upward in rate expectations.

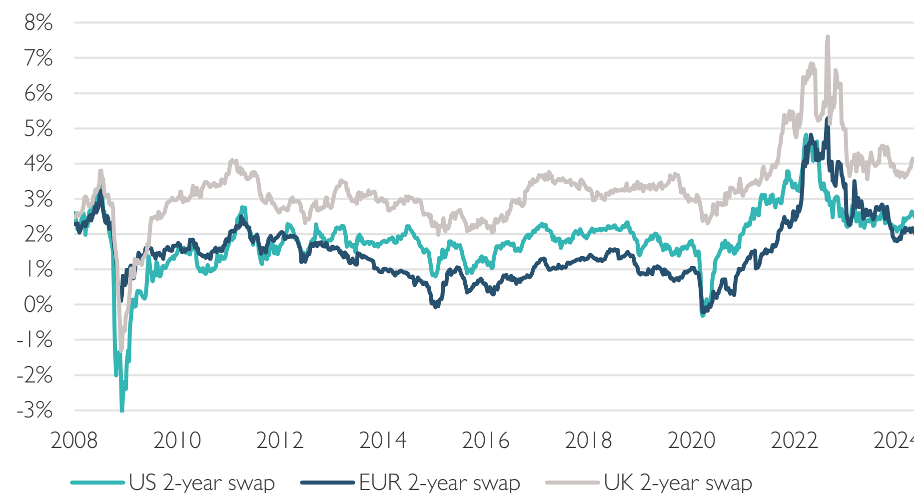
The bottom chart shows longer-term inflation indicators. Here the picture remains encouraging.

The green line is the 10-year US inflation swap and the black line is the inflation rate calculated from the spread between five year nominal and inflation linked bonds five years forward. Both have been rangebound in recent months.

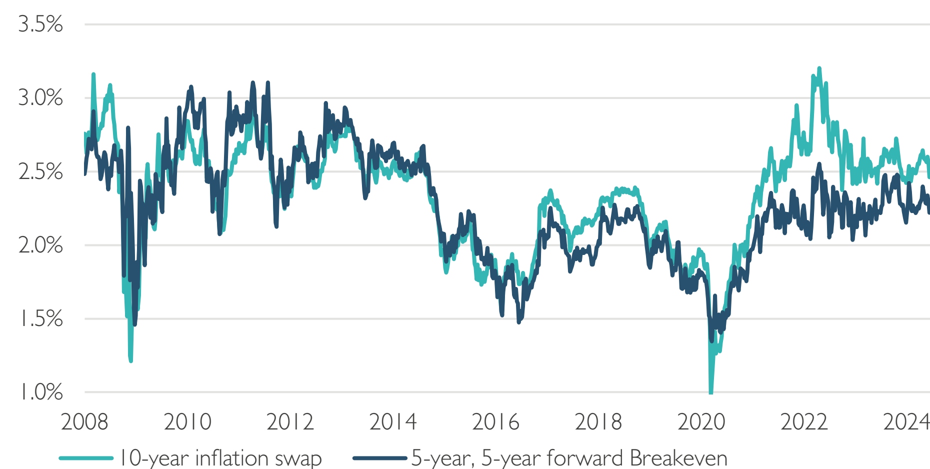
The general picture from both these charts is that the market remains pretty sanguine about future inflation.

One of the critical things to watch in coming months will be to see if anything shifts upward market expectations for future inflation. The risk of a Trump Presidency would be that the imposition of tariffs on a wide range of goods will raise headline inflation levels. And the likelihood of an increased budget deficit could also be seen as inflationary.

2-year inflation swap rate (%)



Long-term US inflation expectations



Source: Bloomberg, Waverton. Data as at 11.07.24

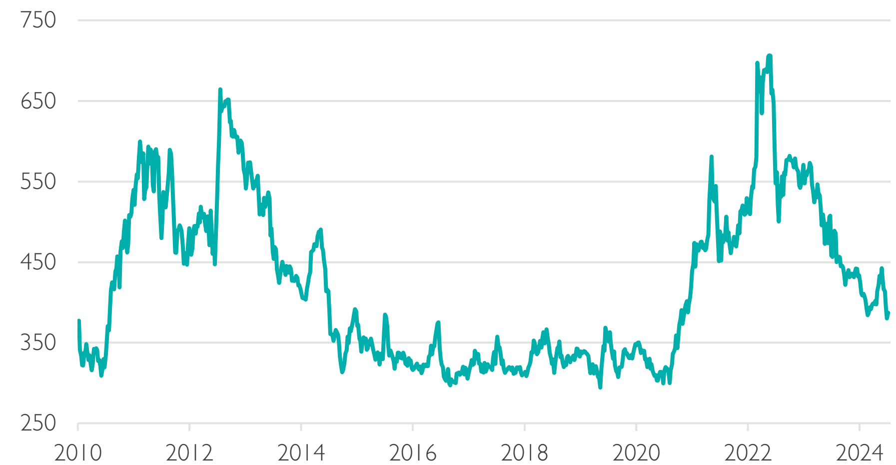
THE BROAD COMMODITY COMPLEX HAS BEEN WEAK

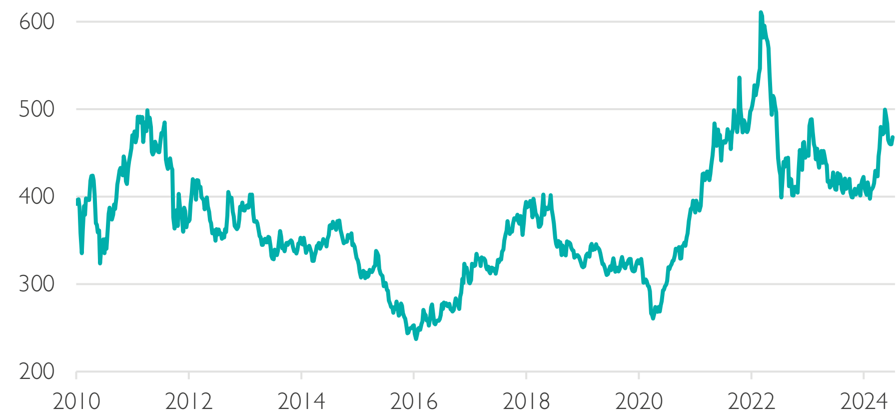
The broad commodity complex is in the doldrums.

Grain prices have been falling as fears of supply disruption from Ukraine, the bread basket of Europe, and Russia, have not materialised sufficiently to support prices.

The Industrial Metals index (bottom chart) had picked up in recent weeks. Copper had been particularly strong and iron ore and nickel had also risen but they have given back those gains in the last two months.

Demand from the People's Republic of China (PRC) is an important driver of industrial metals prices but that is less likely to be driving the move in the last month. The price action in copper had been partly driven by a short squeeze on traders who were bearish of the price in New York. The pullback in the price of Copper suggests there is no sign of stronger economic demand.





Source: Waverton, Bloomberg. Data as at 05.07.24

DOLLAR RANGEBOUND

The top chart shows a trade weighted dollar index. It has been range bound in recent weeks.

The bottom chart shows that an index of emerging market currencies. This index is weighted by the weighting of each country in the MSCI Emerging Market equity index, so China is the biggest component.

In the first weeks of 2024 the US dollar appreciated against EM currencies again. Likely helped by the narrative that US rate differentials with the rest of the world will not shrink as much as had been expected toward the end of 2023.

Trade Weighted US dollar (BBDXY)

MSCI Emerging Market Currency Index

Source: Waverton, Bloomberg, MSCI. Data as at 11.07.24

GOLD AT RECORD HIGH

As of the end of June 2024, gold is within $1 of an all-time high and is at an all-time high in sterling terms.

With all the uncertainty highlighted on previous pages of this presentation, we are of the view that gold has a role to play in diversified portfolios.

Gold benefitted from the exceptional monetary policy in evidence from 2008 to arguably 2021. With zero or even negative nominal interest rates the opportunity cost of owning gold had never been lower.

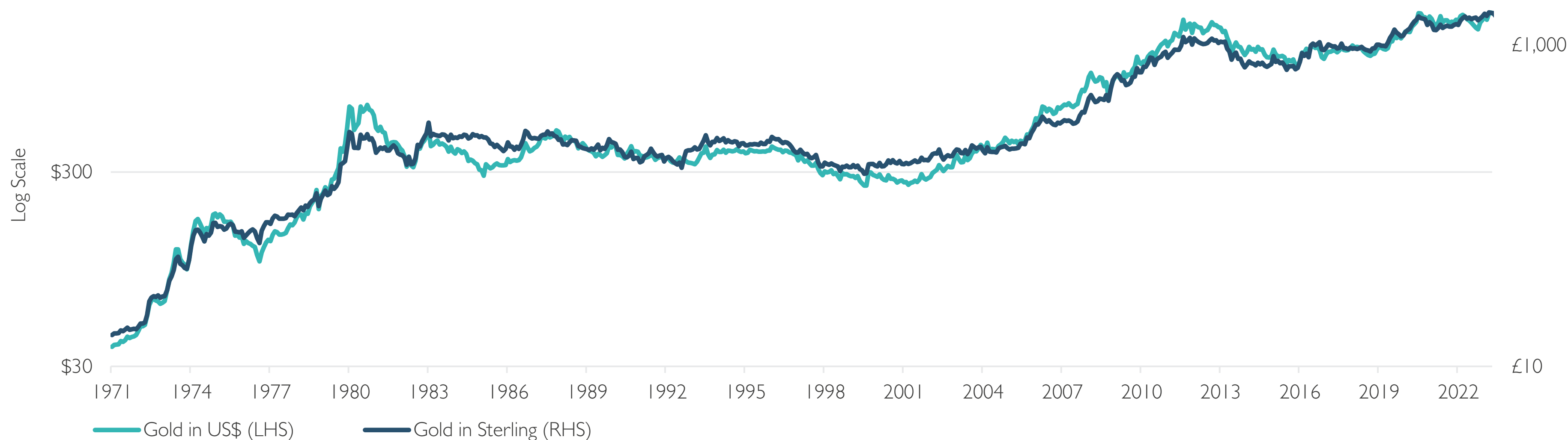
In recent months, the rally in gold appears to be based on buying by central banks around the world, including in China. There is also some evidence that Chinese retail investors have been buying gold.

Given the recent US inflation data has been disappointingly elevated, it is also possible that gold has benefitted as a hedge against that.

It could also be benefitting as a hedge against fears about broader currency debasement in a world of elevated government budget deficits.

Gold price per troy ounce in US dollars and in sterling

1971 - current



Source: Bloomberg, Waverton. Data as at 30.06.24

Part 2

EQUITIES & CREDIT

2024 EARNINGS GROWTH ESTIMATE +10% GLOBALLY AND 11% FOR THE US

The consensus for the Global Index is for EPS to rise 10% in 2024. For the US the expectation is for an 11% increase.

The Global number is effectively unchanged from a month ago or indeed from the month before.

It remains the case that there are valuation excesses in some of the leading companies in the US but valuations in the rest of the US market, and in the rest of the world, are not stretched.

Earnings per share calendar year growth rate

			GROWTH RATE		
REGION	PE NTM	RELATIVE	2024	2025	2026
World	17.9		+9.6%	+13.0%	+10.3%
US	21.6	121%	+10.8%	+14.6%	+11.4%
Europe ex UK	14.2	79%	+5.5%	+10.2%	+9.5%
UK	11.5	64%	+4.0%	+8.5%	+8.6%
Japan	15.9	89%	+4.3%	+8.9%	+9.0%
Asia Pac ex Japan	13.4	75%	+21.7%	+16.0%	+11.5%
Latin America	8.3	46%	(0.0%)	+10.7%	+5.9%
Emerging markets	12.8	71%	+4.4%	+9.8%	+9.4%
World ex USA	13.6	76%	+8.3%	+11.2%	+9.1%

Source: MSCI, FactSet, Waverton. Data as at 10.07.24

STOCK MARKET VALUATION IN LINE WITH RECENT RANGES

The PE ratio for the US market (solid dark green line) is 21.6 times.

It is again above its 20-year average of 15.7 times (the green horizontal line).

The World outside the US now trades at 13.5 times earnings, a little above its 20-year average of 13.1.

There is uncertainty about the EPS these valuations are predicated on but particularly outside the US there is a reasonable amount of that uncertainty priced in.

MSCI US and MSCI Global ex US price–earnings ratio based on next 12 months earnings

24
22
20
18
16
14
12
10
8

00 02 04 06 08 10 12 14 16 18 20 22 24

US PE NTM
US PE Average
World ex US PE NTM
World ex US PE Average

Source: MSCI, FactSet, Waverton. Data as at 28.06.24

UK MARKET HAS BEEN A DISAPPOINTING ONE FOR MANY YEARS

The UK stock market has significantly underperformed the World index in recent years.

Between 2001 and 2014 there was not a lot of difference between the two.

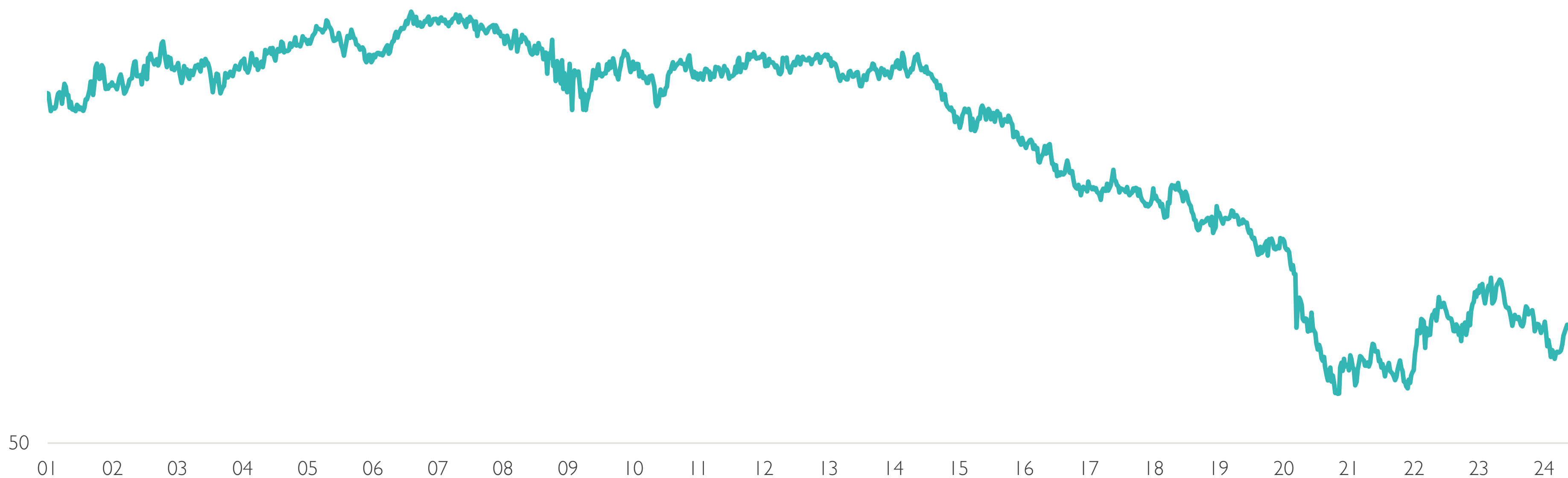
But from May 2014 to October 2020, the UK market underperformed by 49%. It had a better time in 2022 but it has resumed underperformance in the last twelve months.

One of the issues for the UK is that it has few technology or communication service companies that have been the market leaders in recent years. They are a combined 4% of the UK market.

Another issue is that recently the weakest sectors in terms of earnings growth have been energy, healthcare, materials and financials. They are a combined 52% of the UK market.

It will be interesting to see if the recent rotation out of technology related sectors produces a better performance from the UK.

MSCI UK relative performance to MSCI All-Country World, both in sterling



Source: MSCI, Bloomberg, Waverton. Data as at 05.07.24

JAPANESE MARKET HAS SEVERAL TAILWINDS

The Japanese stock market has been aided by a number of tailwinds in recent years. The market first hit new all-time highs in March when it finally (as measured by the Nikkei 225 Index) closed above its 29 December 1989 previous high.

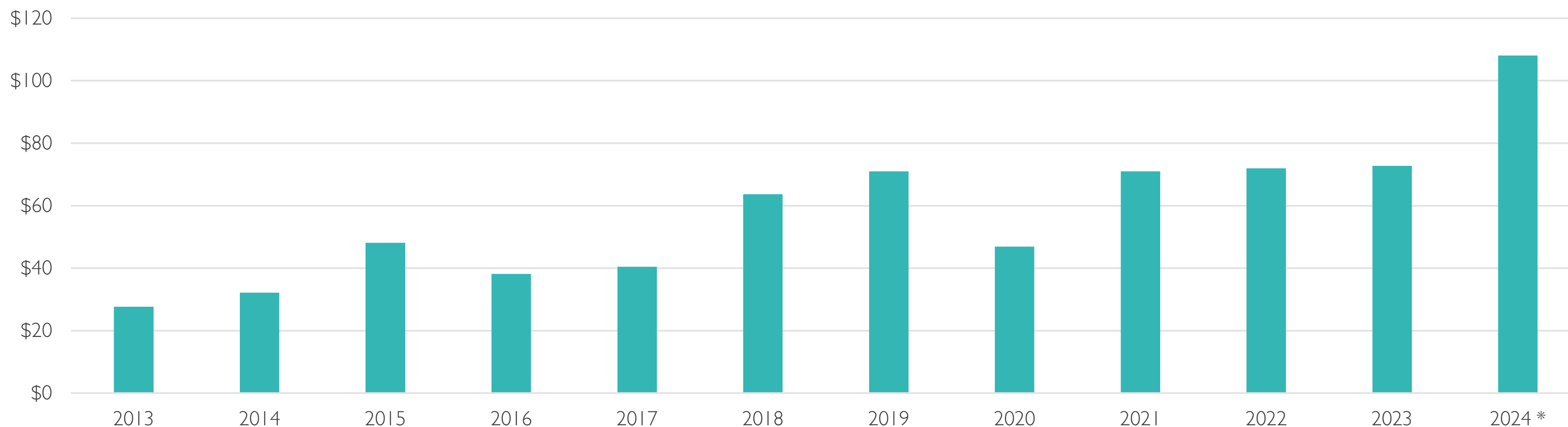
Macro factors have played a role. The Bank of Japan has bucked the trend of other developed world central banks by, coincidentally also in March, only ending negative policy rates recently. The policy rate is at +0.1%. The apparent ending of deflation enabled this to happen although policy rates obviously remain very negative in real terms.

But there have also been significant changes to corporate governance including a sharp increase in the number of independent directors on Boards. Shareholders have benefitted directly from a pick up in the number of buybacks done by Japanese corporates.

This chart shows that buybacks are heading for a record level this year, 50% above the level of last year.

On top of that, foreign investors have been more bullish and have also been buying the market. We continue to like a number of Japanese companies and are overweight the market in aggregate in our global equity portfolios.

Japanese corporate share buybacks 2013 – current in US$ billion



Source: MSCI, Bloomberg, Waverton. Data as at 15.05.24

STOCK MARKET IS INDEED DRIVEN BY EARNINGS OVER TIME

This is a simple chart but an important one. The stock market moves with earnings and has continued to do so over the last 20+ years despite the various shocks investors have had to absorb over that time. These include the 2008 crisis and Covid of course, but also the policy response to each of those events.

As the chart shows, the market reacted to the robust fiscal and monetary stimulus packages of 2020 by rising very strongly into 2021. Earnings recovered too but not as quickly. The market pullback in 2022 brought prices back to the point where they were below the earnings line.

The rally in recent months has pushed the price line well above the earnings line.

The chart includes a horizontal line for the level of EPS in twelve months' time (July 2025) expected by the current consensus forecast. One could argue that prices have fully discounted that level of expected EPS.

MSCI Global Price Index and earnings per share

December 2002 = 100

July 2025
EPS est.

400
350
300
250
200
150
100
50

2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025

Price Indexed
EPS Indexed

Source: MSCI, FactSet, Waverton. Data as at 28.06.24

US INVESTOR SENTIMENT LESS BULLISH

This is the weekly survey of its members done by the American Association of Individual Investors. The chart shows the % of respondents who are bullish among those that express a view (so it is Bulls as a % of Bulls plus Bears).

This could not be a simpler sentiment measure, but it is worth knowing about.

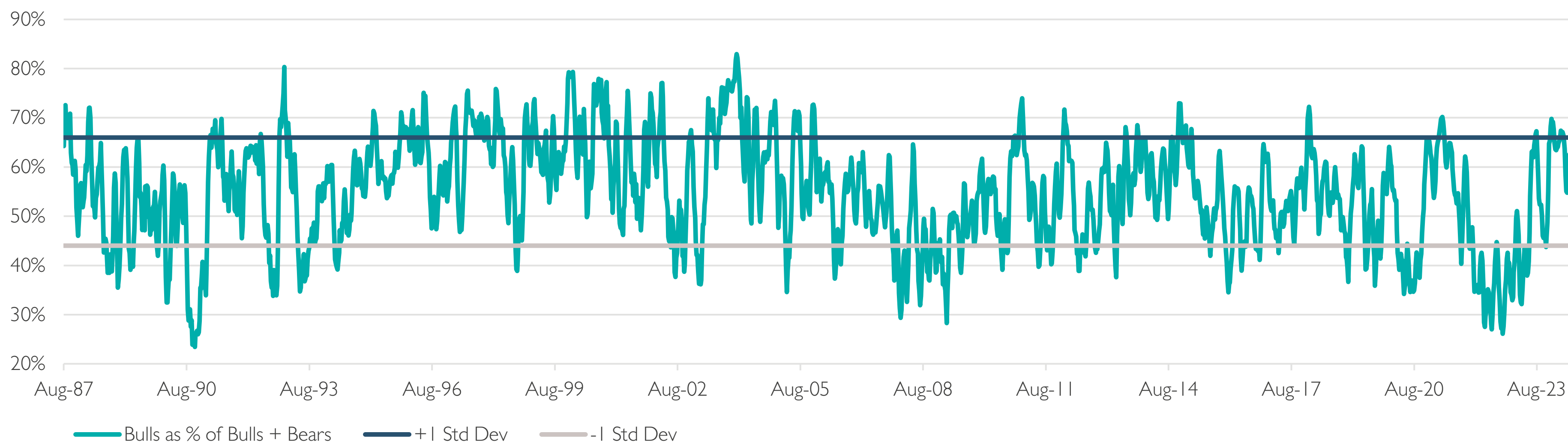
The two horizontal lines are showing one standard deviation above (grey line) the average level and one standard deviation below (pink line).

If you buy the market when the green line is below the yellow line your average return in the next year is +15%.

If you buy the market when the green line is above the black line your average 12-month return is +6%.

This sentiment measure has followed the market a little lower in recent weeks and is in the middle of its long-term range.

American Association of Individual Investors survey, Bulls as % of Bulls plus Bears



Source: AAII, Bloomberg, Waverton. Data as at 11.07.24

CORPORATE BALANCE SHEETS YET TO SHOW REAL STRESS

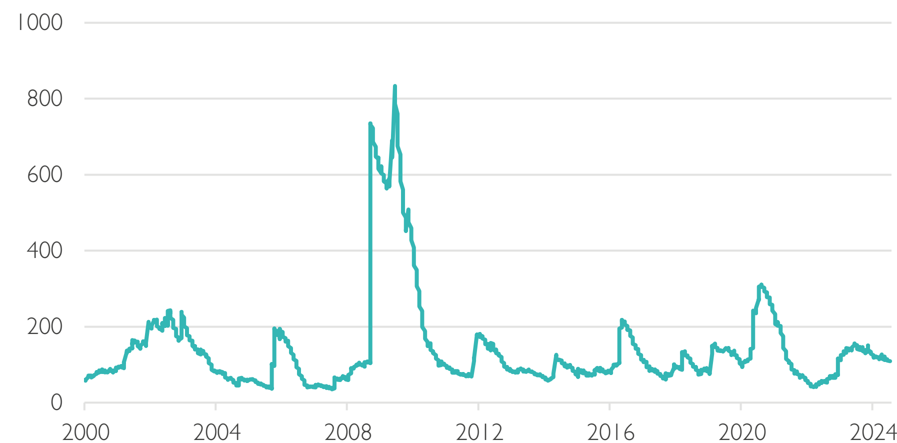
The top chart is a quarterly series showing the number of US corporate bankruptcies (officially called "Chapter 11" filings). It hit its lowest level for 18 years in Q3 2021. It has moved up since then and moved further up in Q4 2023 but came down a little in Q1 2024. But it is at the top end of the range it has been in since 2013.

The Bloomberg Index in the bottom chart is of economy wide US bankruptcies and takes into account the size of the bankruptcy as well as the number of them. Hence there were more big bankruptcies in 2009-10 than in 2003-04. That index is at historically very low levels although it has picked up from its lows in April 2022.

It remains the case that corporate balance sheets are holding up well in the face of higher interest rates. We have seen an increase in corporate bond yields in recent weeks, but spreads remain low.

US bankruptcy filings (2000 to 2023, quarterly)

Bloomberg US Corporate Bankruptcy Index (2000 – 2023, weekly)



Source: Bloomberg, Waverton. Data as at 05.07.24

CORPORATE CREDIT MARKETS NOT STRESSED

Credit spreads have tightened as the risk-on rally continued in recent weeks.

Spreads will widen if there is a risk of higher inflation and tighter monetary policy for longer than currently expected.

We are of the view that credit spreads reflect some investor complacency.

Hence our lowest allocation to credit in our bond funds since their inception.

US corporate bond spreads (%)

3.85 3.35 2.85 2.35 1.85 1.35 0.85

10.60 9.60 8.60 7.60 6.60 5.60 4.60 3.60 2.60

2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024

Investment Grade (LH scale) High Yield (RH Scale)

Source: Markit, Bloomberg Waverton. Data as at 05.07.24

CORPORATE BOND YIELDS, S&P500 EARNINGS YIELD & T-BILLS YIELD THE SAME

The Moody's Baa yield (a benchmark for the investment grade market) has been above the earnings yield of the S&P500 Index at end of each month since January 2023. At the end of June 2024, the numbers were 5.8% versus 5.0%.

The last two periods when this was the case were the run up to the Dotcom peak in 2000 and its unwind. Then this happened again during the Global Financial Crisis of 2007-09.

Normally it would be perceived that equities had some valuation challenge from corporate bonds when this is the case but in 2023 both gave good returns.

We suspect both the earnings yield and the Baa yield will move upward in the rest of 2024.

The grey line is the 3-month Treasury bill rate which is currently 5.4%, back to being slightly above the S&P500 earnings yield. Cash is the most competitive it has been to equities since 2001.

This chart also suggests it is rational for investors to be more favourably disposed toward cash today than has been the case since pre the GFC.

Moody's current Baa Corporate yield, S&P500 forward earnings yield, 3-month Treasury bill yield (%)

Source: Moody's, Bloomberg Waverton. Data as at 30.06.24

NO SIGN OF TENSION IN GREATER CHINA IN CURRENCY MARKET

The Rmb weakened for most of 2023 before rallying in the last two months of the year. But the currency is still at the low end of its range since 2008.

The Taiwan dollar is stable, despite the scaremongering headlines about Taiwan that appear regularly.

We continue to remain sceptical about the PRC conducting a military operation against Taiwan. But the sabre rattling around the issue will continue.

The Presidential election in Taiwan on 13 January has passed without material incident despite being won by Lai Ching-te. He and his party are in favour of Taiwan's independence but he has presented himself as a continuity candidate who does not wish to disturb relations with Beijing.

We will continue to watch the Taiwan dollar to see if the market is taking any threat from Beijing more seriously than it apparently does, quite reasonably, at the moment.

Renminbi per US dollar

Taiwan dollars per US dollar

Source: Bloomberg, Waverton. Data as at 05.07.24

OUR APPROACH TO INVESTING RESPONSIBLY

OVERVIEW OF RESPONSIBLE INVESTMENT AT WAVERTON

Signatory of:

Waverton research process

- Integration of ESG factors into fundamental analysis and decision-making
- Incorporated into research process across all asset classes
- Specialist thematic, sustainable and impact fund research

Engagement and voting

- Direct engagement with company management
- Collaborative engagement activities
- Proxy voting by Glass Lewis

Ethical restrictions

Client-specific ethical exclusions can be applied at the portfolio or fund level

RESPONSIBLE STEWARDSHIP OF CLIENTS CAPITAL

We aim to identify responsible allocators of capital ensuring business resilience and long term financial sustainability

How we incorporate ESG

- Integrated approach to the assessment of ESG factors
- Detailed fundamental analysis avoids greenwashing
- Mitigates poor data quality and inconsistent third-party ESG ratings
- Focus on engagement over an exclusion/divestment strategy
- Identify those successfully adapting to ESG opportunities/risks
- Acknowledge when ESG risks are integral to transition solutions
- Pragmatic approach focussed on high or improving ESG standards

The advantages of our investment approach

- Global: largest universe of investment opportunities
- Direct: greater transparency around ownership
- Active: flexibility to avoid areas at risk of capital loss
- Concentrated: in-depth identification / monitoring of risks
- Experienced team: library of knowledge is an advantage
- Engaged: long-term relationships create a two-way dialogue
- Strong ESG outcomes: natural result of our approach

Signatory of:

GLASS LEWIS

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The returns for structured products may fluctuate according to different market conditions; you may get back less than you originally invested.

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