

# GLOBAL OUTLOOK

August 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

There was a particularly sharp downturn in global equity markets on August 2 and August 5, led by Japan. On August 5 the Japanese equity market fell over 12%, its worst day since the October 1987 crash.

Different factors drove the market declines but the most important were first the significant positioning unwind in the Japanese yen which has had impacts in other markets. The yen carry trade had worked well in the last 18 months with only minor blips, as the Bank of Japan maintained zero interest rates while other developed market central banks were raising rates. This contributed to a weakening yen which added to the returns for those borrowing in yen to invest in higher yielding assets. The sharp rise in the yen that began in early July accelerated in the first days of August and created margin calls for those borrowers.

Second, there was a growth scare. Weaker than expected data on the US labour market released on 2nd August added to worries from other recent data such as the August Purchasing Managers' Survey which suggested the US economy could be beginning to slow more rapidly. This led to a significant repricing of expectations of what the Federal Reserve would do over the balance of this year. A month ago, the market was expecting two 0.25% interest rate cuts between now and the end of the year. Today the market is expecting four cuts including fully pricing at least one cut at (or before) the September 18th policy making meeting.

The market has stabilised in the last two weeks as there has so far not been any indication that the sharp declines have created significant losses at any large financial institution creating more selling pressure. Economic data reported for July has tended to be slightly better than expected recently so the growth scare is abating.

The slightly better than expected inflation report for July has increased confidence that the Federal Reserve will cut interest rates in September and then cut further in coming months. The knowledge that monetary easing is potentially near has also calmed markets.

Meanwhile the last month has seen great drama in the US political scene. Since President Biden announced he would not seek the nomination of his party for another term, Vice President Harris has cemented her position as the presumptive nominee which will be confirmed at the Democrat National Convention from August 19-22.

Opinion polls are suggesting that Harris has gained momentum against President Trump and the betting markets have responded by making her the favourite to win in November.

From a market perspective a Harris victory would likely be regarded calmly if she runs on an extension of Biden's economic policies.

It will be interesting to see if she can maintain momentum through the convention as that will put Trump further on the back foot. The resurgence in Democrat fortunes makes it again likely that the party will take control of the House of Representatives. It has been regarded as difficult for the Democrats to retain control of the Senate but even that may be a possibility if Harris does well in the debates against Trump. They have each agreed to debate on September 10.

This has been a remarkable few weeks, not least because of the way Harris appears to have performed well both behind the scenes and at rallies. She appears to be a much stronger candidate than she was in 2019-20 when she ran for the nomination unsuccessfully. Let's see how her August 22 speech accepting the nomination is received.

**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 15.08.24



## SUMMARY OF OUR VIEWS (continued)

### Equities (overweight)

Our global equity exposure remains focused on larger cap companies able to deliver future Free Cash Flow growth while also maintaining our valuation discipline. We focus on identifying industry leaders from a global (rather than regional) perspective, without making calls on specific markets and/or currencies. Currency moves, even when dramatic, tend to wash out over time.

Through this earnings season, results have exceeded expectations at both the top and bottom lines in aggregate. Extended valuations in select parts of the market, heightened expectations for Q2 earnings (especially amongst the AI beneficiaries) and the extreme concentration we have witnessed in markets YTD, however, left equity markets susceptible to downside risks.

Our bottom-up view is that the fundamental outlook has not meaningfully changed, making this rotation more technical than fundamental in nature. The US economy is slowing as companies within select industries have already been alluding to all year. This is consistent not only with what the Fed has been attempting to engineer through higher rates, but also with the normalisation of post-pandemic trends.

Consumer-related results to date have again highlighted weakness across the low-income cohort in particular, but also that the growth in travel & entertainment spend is normalising and that consumers more broadly are increasingly price-sensitive.

Turnover within the global equity strategies remains low. As ever, the team will continue to use market fluctuations to review both existing holdings for potential upgrades and/or top-ups, as well as new names for potential inclusion in the Global Recommended List.

### 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, as they were in the first week of August.

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.

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Part I

# POLITICS, POLICY, BONDS & CURRENCIES

# RATE CUTS EXPECTED IN THE US AND UK

The top chart shows current expectations for the US Federal Reserve policy rate over the next two and a half years.

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

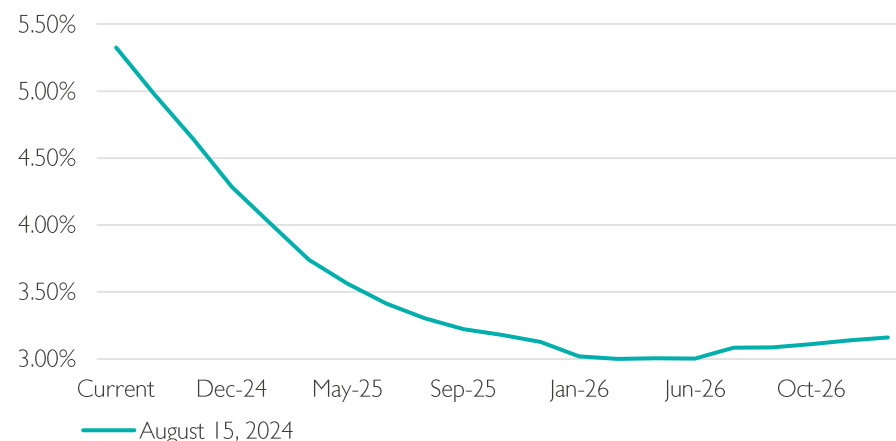
The extended period we are able to show for expectations of future interest rate moves reveals that the market thinks the low point for the Fed Funds rate will be 3.0% which the market expects it to get to in early 2026.

Such forecasts so far in the future are generally unreliable in terms of precision. But the direction of travel is important to understand. If the direction of travel is accurate it implies that the US economy will indeed have a soft landing with slower growth, slower inflation but no recession. Such an outcome would be good for both equities and bonds.

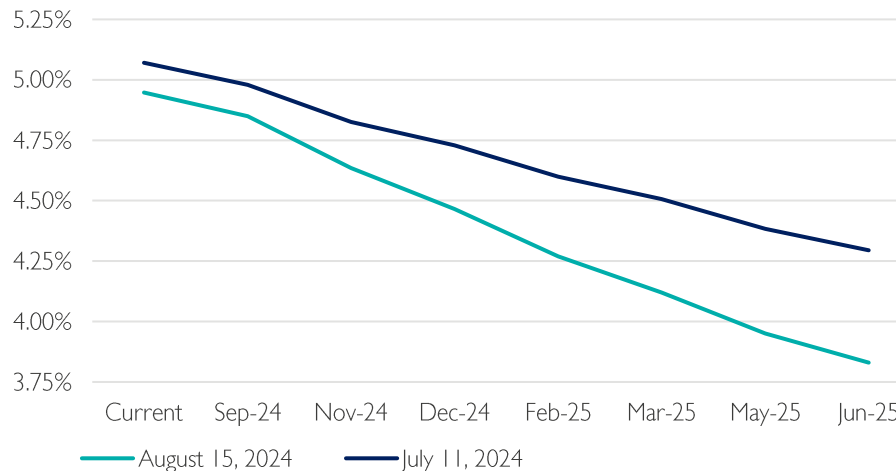
The bottom chart shows current expectations for the Bank of England's base rate and those expectations last month. The Bank is now expected to cut rates four times by June 2025. Last month, three cuts were expected.

Better inflation data has increased market confidence that interest rate cuts are coming on both sides of the Atlantic. The Bank of England lowered rates at its August meeting which the market was not sure it would do. It seems reasonable to think the Bank will cut again later this year. 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 15.08.24



# HARRIS HAS MAINTAINED MOMENTUM ACCORDING TO 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](http://www.predictit.org). As of August 15, the probability of Vice President Harris winning is 58%, of Trump winning is 45%.

This is a remarkable turnaround. A month ago, Trump was given a 60% chance of winning. Harris has given the race renewed energy. This partly reflects some skill on her part in consolidating her position so decisively. But it also reflects that a large proportion of the electorate were completely uninspired by a rematch of Biden versus Trump.

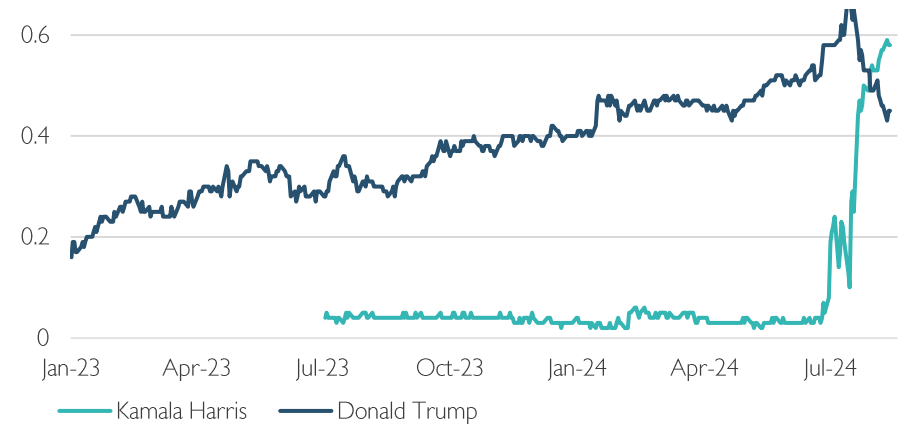
Interestingly, Nikki Haley, who ran against Trump in the Republican primary stated on February 10, 2024, that either she or Harris would be the next President because the party that dumped Biden or Trump for one of them would win the election. She may be proved correct.

The bottom chart shows the latest opinion poll data for the six key “swing states” that are likely to determine the election outcome. Most states tend to consistently vote for one party or the other but these six have alternated in recent elections. One of the reasons for the betting markets to have reversed course on who is the favourite is the fact that Harris is ahead in each and materially ahead in Michigan, Pennsylvania and Wisconsin.

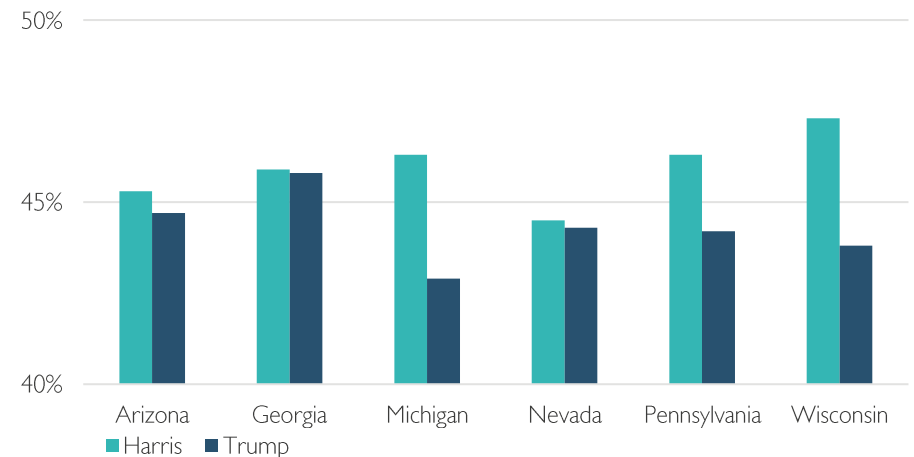
Financial markets are relaxed about Trump winning. Trump cut taxes and had a light touch on regulation in his term.

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

Probability of Harris or Trump winning election %



Latest Opinion Polls in six Swing States%



Source: Bloomberg, [www.predictit.org](http://www.predictit.org), [President: general election : 2024 Polls | FiveThirtyEight](https://www.fivethirtyeight.com/polls/president-general-election-2024) Waverton Data as at 15.08.24

# 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 220 – 212 with three vacant seats. The current consensus is that the Republicans look like they are leading in 209 seats, the Democrats in 203. So, the majority will be determined in the other 23 seats.

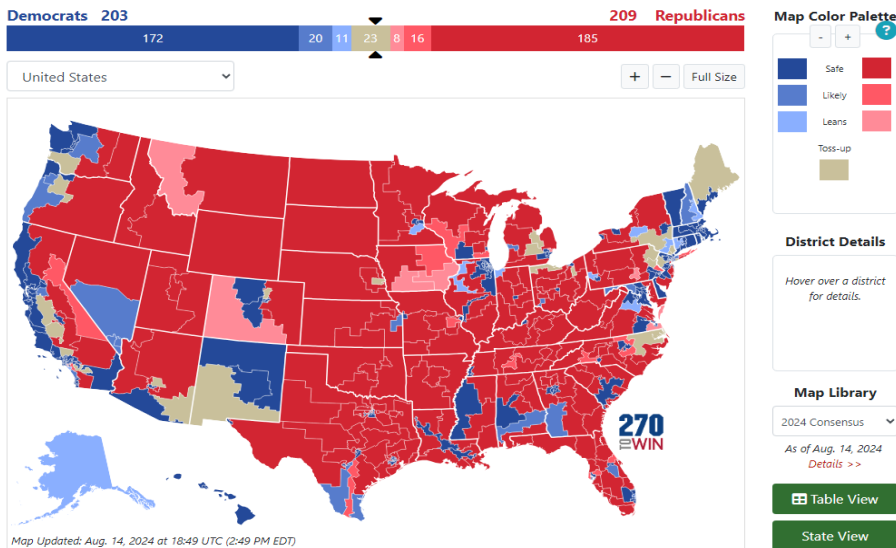
A big reason that the Democrat party persuaded Biden to withdraw was concern that apathy about him would reduce the turnout and hurt the

Democrats chances of taking the House. Those chances now again look good.

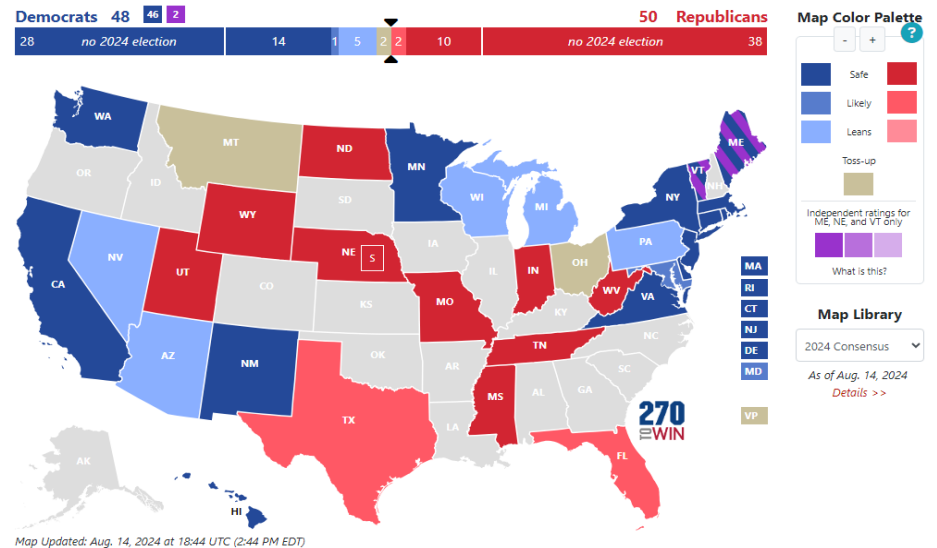
The Democrats currently control the Senate by 51 – 49. The consensus is that the Republicans are likely to take control of the Senate. The party is favoured in the majority of the 34 seats up for election. At the moment, that is seen giving the party at least 50 seats with the Democrats looking likely to have 48 seats with Montana and Ohio too close to call.

A divided Congress is generally seen as a market friendly outcome.

## US House of Representatives projection after 2024 election



## US Senate projection after 2024 election



Source: <https://www.270towin.com/> data as of 14.08.24





## 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.

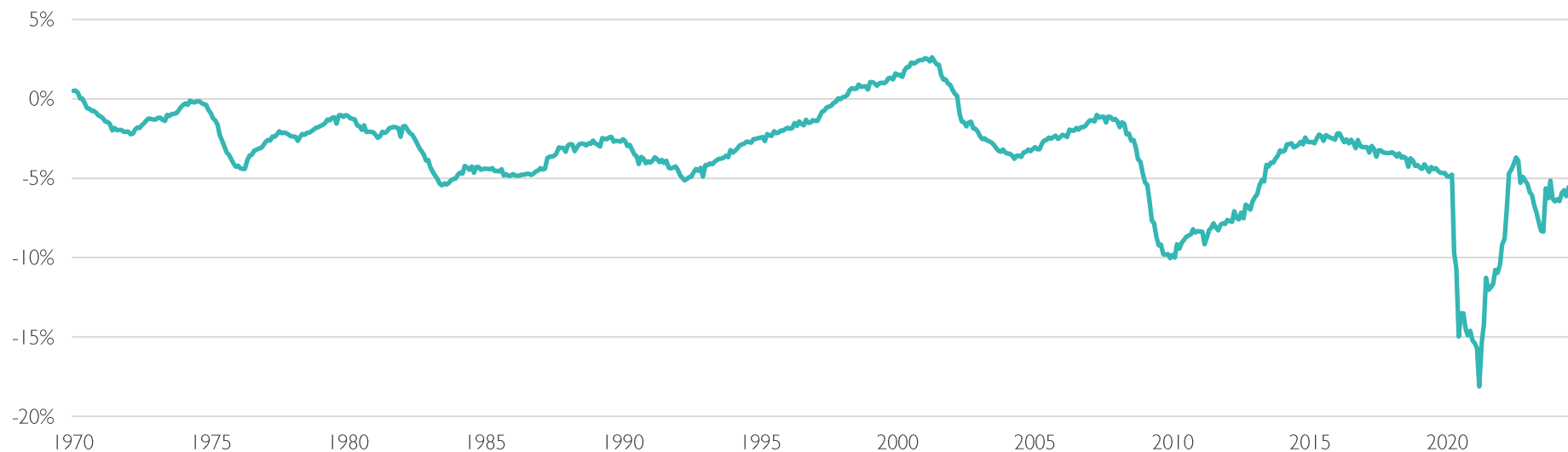
Firstly, the Federal government debt limit will be reinstated on 2 January 2025 at the level that includes all borrowing since the June 2023 suspension of the debt limit by Congress. So, it is a legal requirement that at some point next year Congress will have to raise the debt limit to permit more borrowing. 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 30.06.24

# US PROFITS AS % OF GDP REMAIN RESILIENT

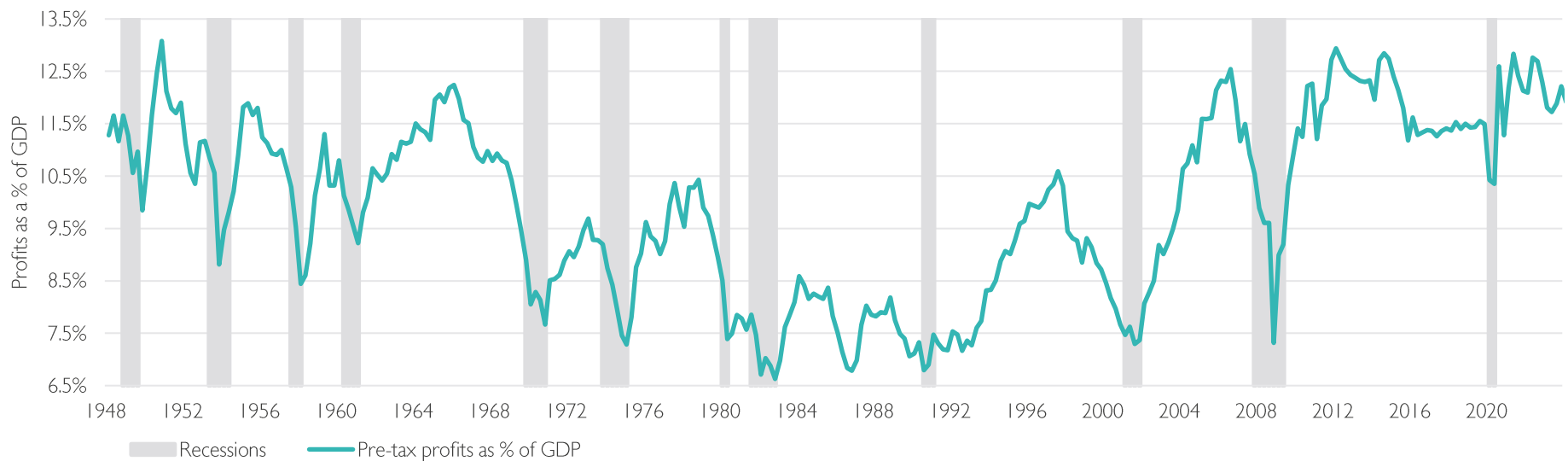
This chart shows pre-tax profits of corporate America relative to GDP through Q1 2024, the most recent data available. This profit series shows aggregate profits across the whole economy and shows them in US dollars, not as earnings per share.

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

## US profit cycles and recessions (%)



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

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. Bonds have rallied after the equity market wobble in early August and the continued deceleration in the trend of inflation increases which has increased confidence in rate cuts on both sides of the Atlantic.

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).

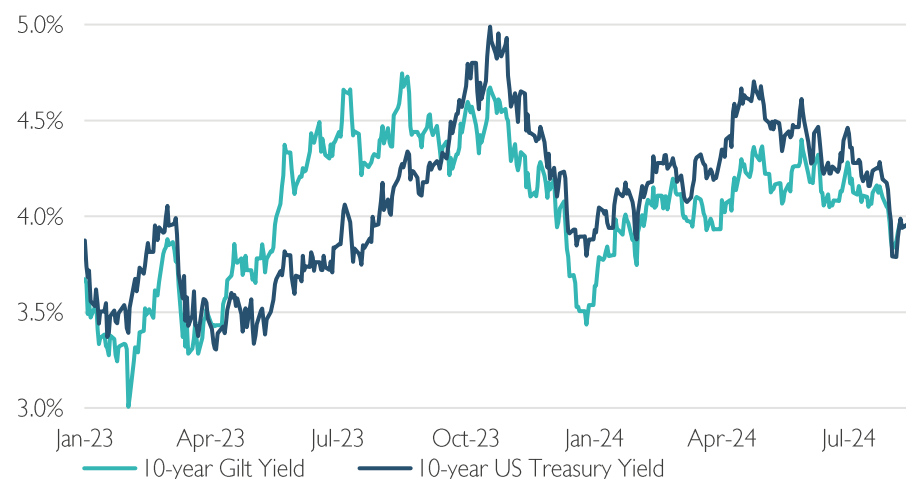
As the chart shows, both markets continue to offer, on this measure, a positive real yield.

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 1.79%.

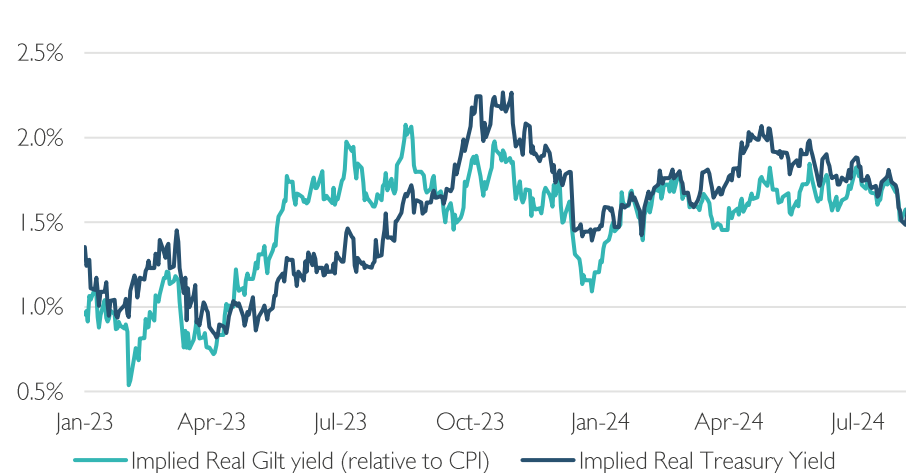
The UK linker market is less attractive (the March 2034 linker yields 0.44%).

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

### US and UK 10-year bond yields (%)



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



Source: Bloomberg, Waverton. Data as at 12.08.24



# 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 just under 1.15 euros per pound from the Brexit referendum to the end of 2023.

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.

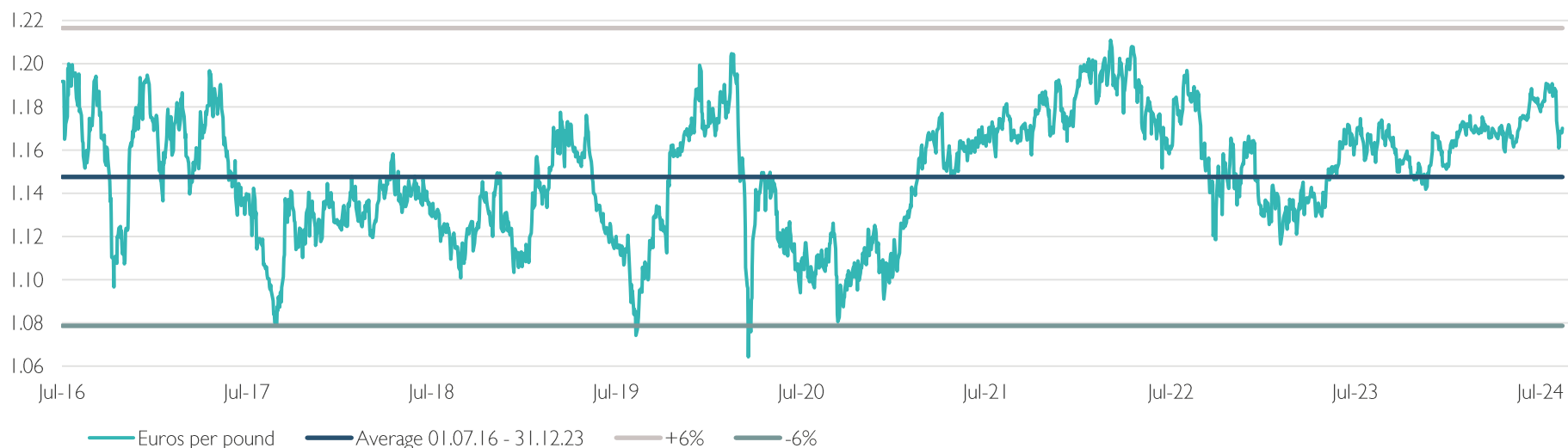
The chart shows the number of euros per pound since 1 July 2016. The average exchange rate since then is shown as the green line and we show a range 6% either side of that average.

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 2,100 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 13.08.24



# 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 2.6%) and the UK also peaked in October 2022 when RPI was 14.2%, and CPI 11.1%. RPI is now 3.6% and CPI is 2.2%.

US core inflation (excluding food and energy) peaked at 6.6% in September 2022. It is now 3.2%.

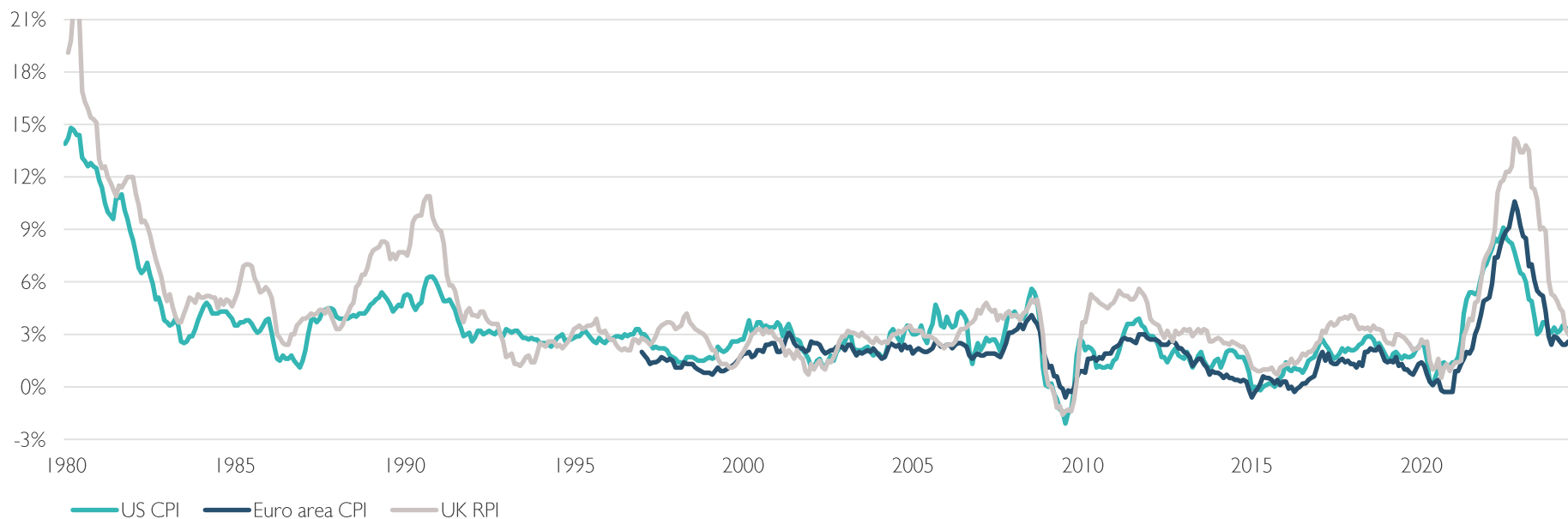
Despite the recent improvements, there remain concerns about the

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.

## Inflation (% change year-on-year)

1980 - current



Source: Bloomberg, Waverton. Data as at 31.07.24



## 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.

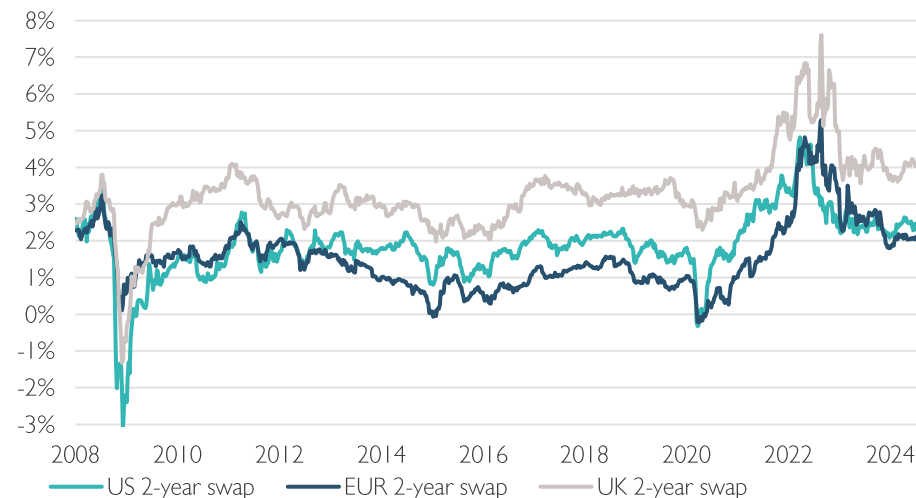
The bottom chart shows longer-term inflation indicators. Here the picture remains encouraging.

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 09.08.24



# THE BROAD COMMODITY COMPLEX HAS BEEN WEAK

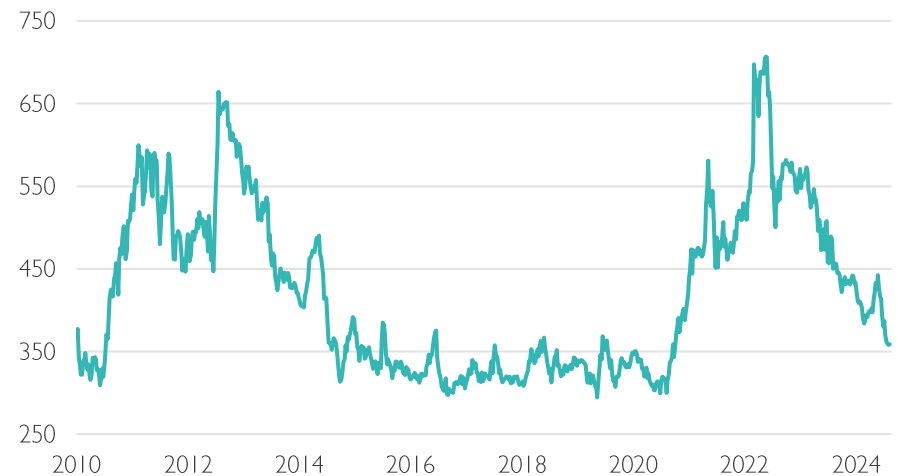
The broad commodity complex is in the doldrums.

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.

**S&P GSCI Grains Index**



**S&P GSCI Industrial Metals Index**



Source: Waverton, Bloomberg. Data as at 09.08.24



# 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 2024 the EM Currency Index has held up well. Recently the renewed expectation for interest rate cuts in the US has helped by the narrative that US rate differentials with the rest of the world will shrink, as had been expected toward the end of 2023.

EM currencies remain relatively robust against the US dollar.

### Trade Weighted US dollar (BBDXY)



### MSCI Emerging Market Currency Index



Source: Waverton, Bloomberg, MSCI. Data as at 09.08.24





# GOLD AT RECORD HIGH

As of the end of July 2024, gold is at an all-time high in US dollars and is also 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

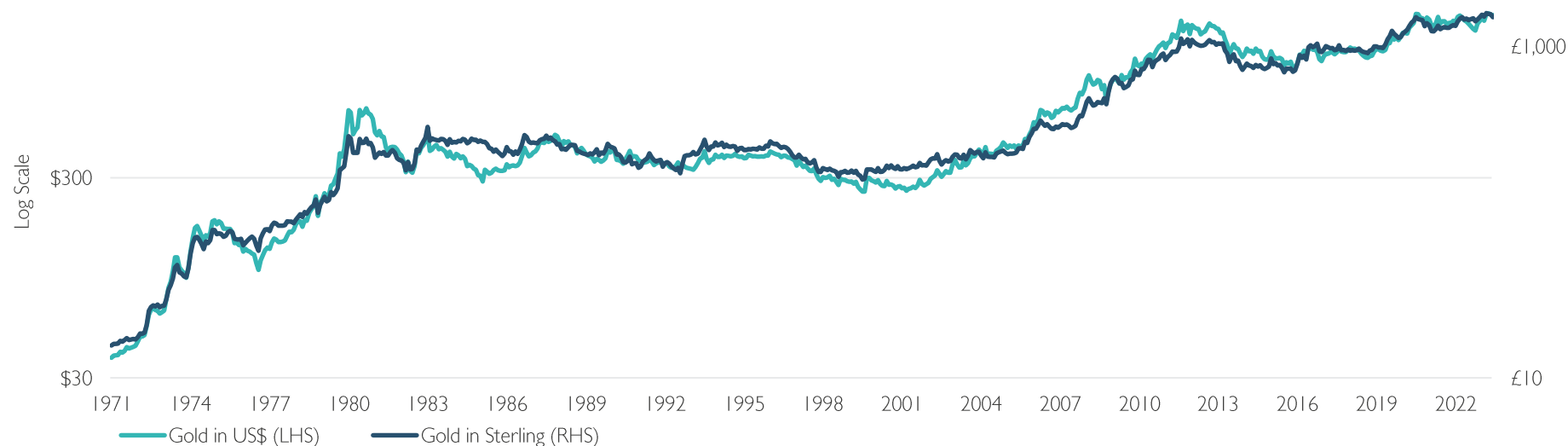
central banks around the world, including in China. There is also some evidence that Chinese retail investors have been buying gold.

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 31.07.24





Part 2  
EQUITIES & CREDIT

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

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

| REGION            | PE NTM | RELATIVE | GROWTH RATE |        |        |
|-------------------|--------|----------|-------------|--------|--------|
|                   |        |          | 2024        | 2025   | 2026   |
| World             | 16.9   |          | +10.1%      | +13.5% | +12.6% |
| US                | 20.5   | 121%     | +10.2%      | +15.3% | +14.5% |
| Europe ex UK      | 13.6   | 80%      | +5.9%       | +10.2% | +9.6%  |
| UK                | 11.4   | 67%      | +2.7%       | +9.8%  | +7.1%  |
| Japan             | 13.4   | 79%      | +15.2%      | +9.0%  | +8.7%  |
| Asia Pac ex Japan | 12.4   | 74%      | +23.9%      | +16.0% | +11.6% |
| Latin America     | 8.3    | 49%      | +1.3%       | +12.0% | +5.8%  |
| Emerging markets  | 12.1   | 72%      | +4.1%       | +10.0% | +9.5%  |
| World ex USA      | 12.8   | 76%      | +10.0%      | +11.4% | +9.0%  |

Source: MSCI, FactSet, Waverton. Data as at 09.08.24

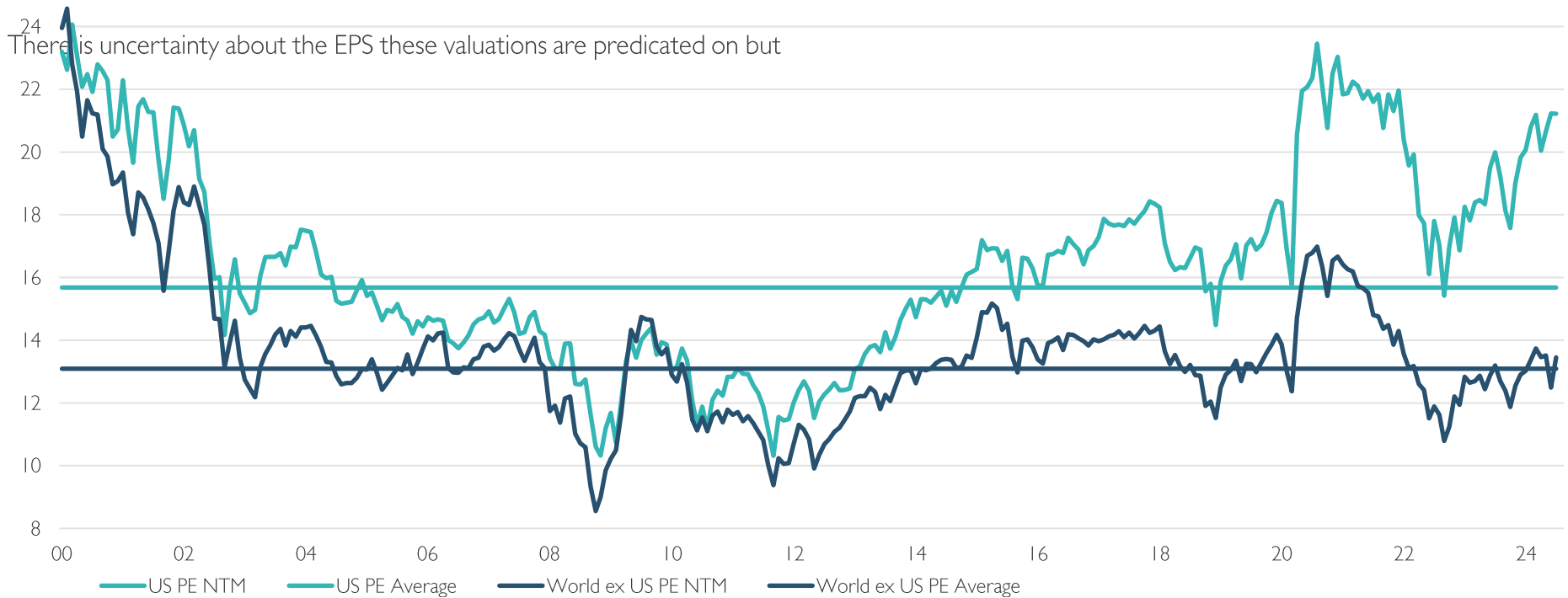
# STOCK MARKET VALUATION IN LINE WITH RECENT RANGES

The PE ratio for the US market (solid dark blue line) is 21.2 times. It is again above its 20-year average of 15.7 times (the teal horizontal line).

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

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



Source: MSCI, FactSet, Waverton. Data as at 31.07.24



# 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.

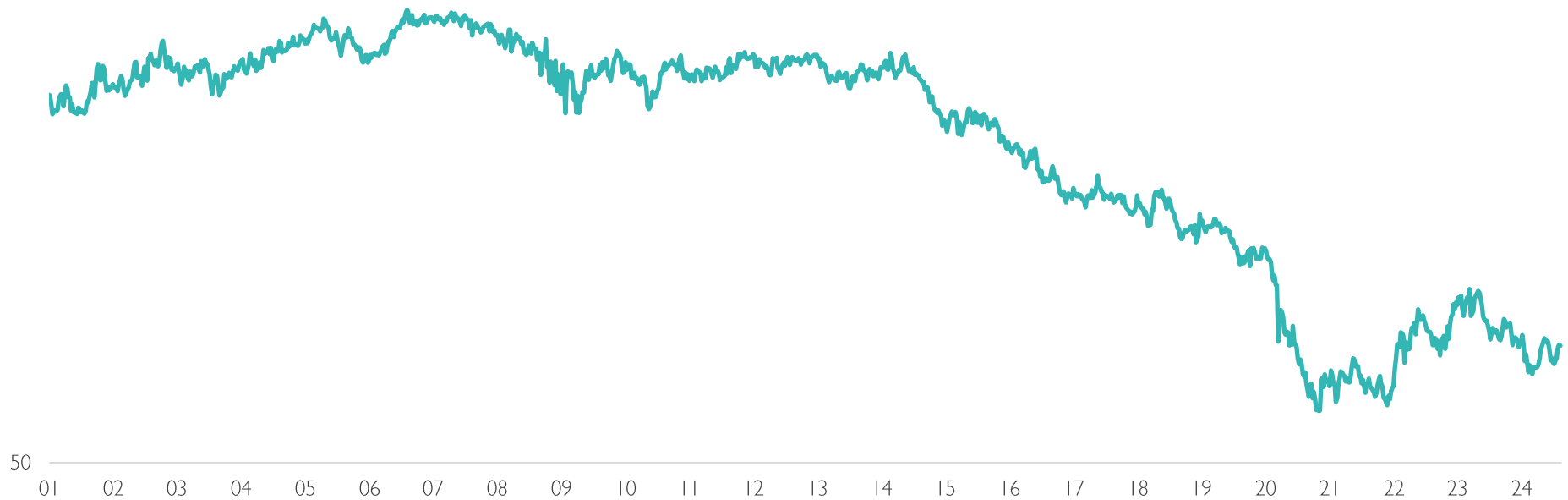
But from May 2014 to October 2020, the UK market underperformed by 49%. It had a better time in 2022 but it has resumed underperformance in the last twelve months.

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 08.08.24



## 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 +0.25%. 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

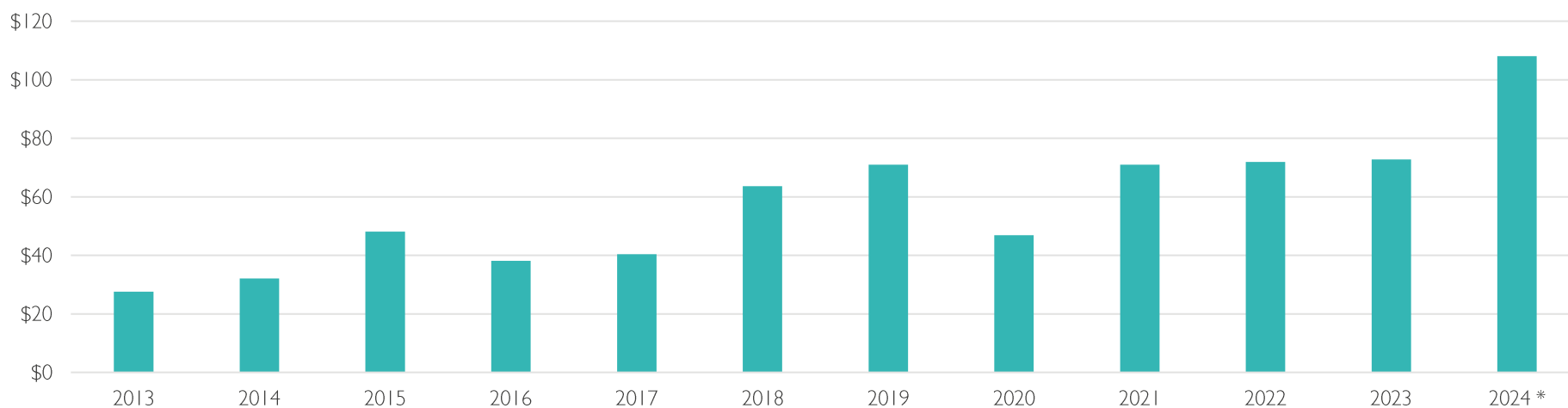
number of buybacks done by Japanese corporates.

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.

These secular tailwinds make us confident that select Japanese equities have an important role to play in 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

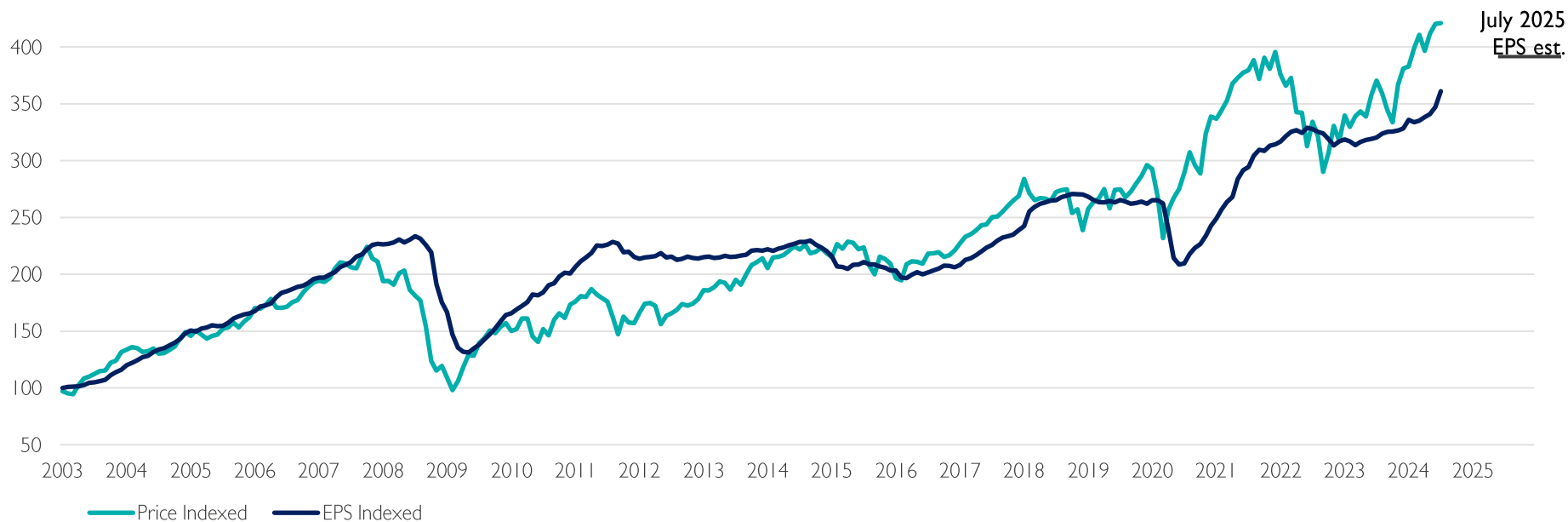
recovered too but not as quickly. The market pullback in 2022 brought prices back to the point where they were below the earnings line.

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



Source: MSCI, FactSet, Waverton. Data as at 26.07.24



# 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 (dark blue line) the average level and one standard deviation below (grey line).

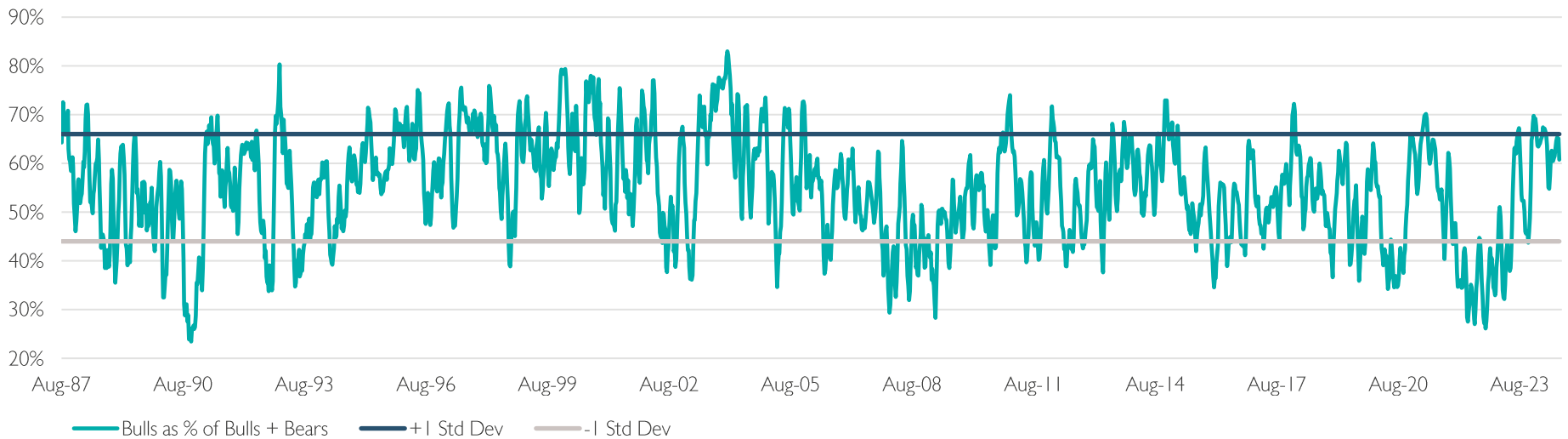
If you buy the market when the green line is below the yellow line your

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: AAI, Bloomberg, Waverton. Data as at 08.08.24





# 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 Q2 2024.

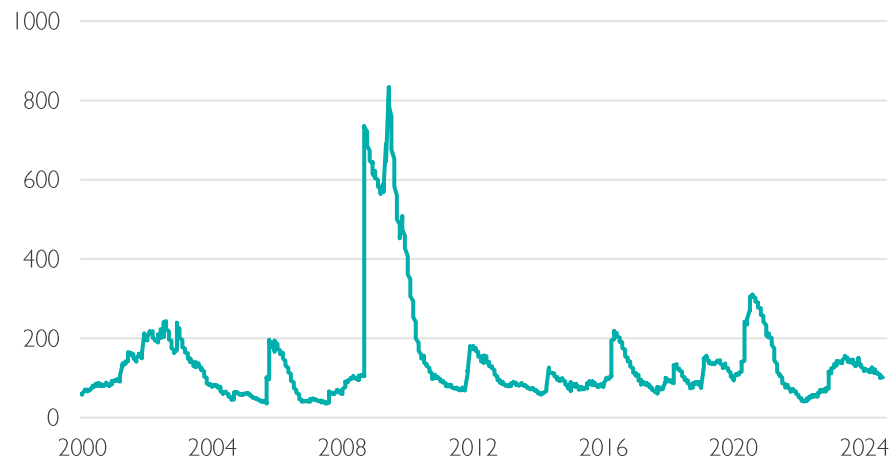
The Bloomberg Index in the bottom chart is of economy wide US bankruptcies and takes into account the size of the bankruptcy as well as the number of them. Hence there were more big bankruptcies in 2009-10 than in 2003-04. That index is at historically very low levels although it has picked up from its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



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



Source: Bloomberg, Waverton. Data as at 09.08.24



# 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 (%)



Source: Markit, Bloomberg Waverton. Data as at 09.08.24



# 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 July 2024, the numbers were 5.8% versus 5.1%.

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 5.3%, 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 31.07.24



# 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 09.08.24





Part 3

# 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:



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Should you require anything further in respect of the information included in this presentation please address all enquiries to:

William Dinning  
Waverton Investment Management Limited  
16 Babmaes Street  
London  
SW1Y 6AH

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