



STRATEGY OUTLOOK

May 2024

An aerial photograph of a dam and reservoir. The dam is a long, low wall made of reddish-brown earth and rocks, stretching across the middle of the image. Below the dam, the water is a mix of light blue and green. A large, curved graphic overlay in shades of teal and blue covers the right side and bottom of the image. The text "SUCCESS. TOGETHER." is centered over the dam and water.

SUCCESS. TOGETHER.

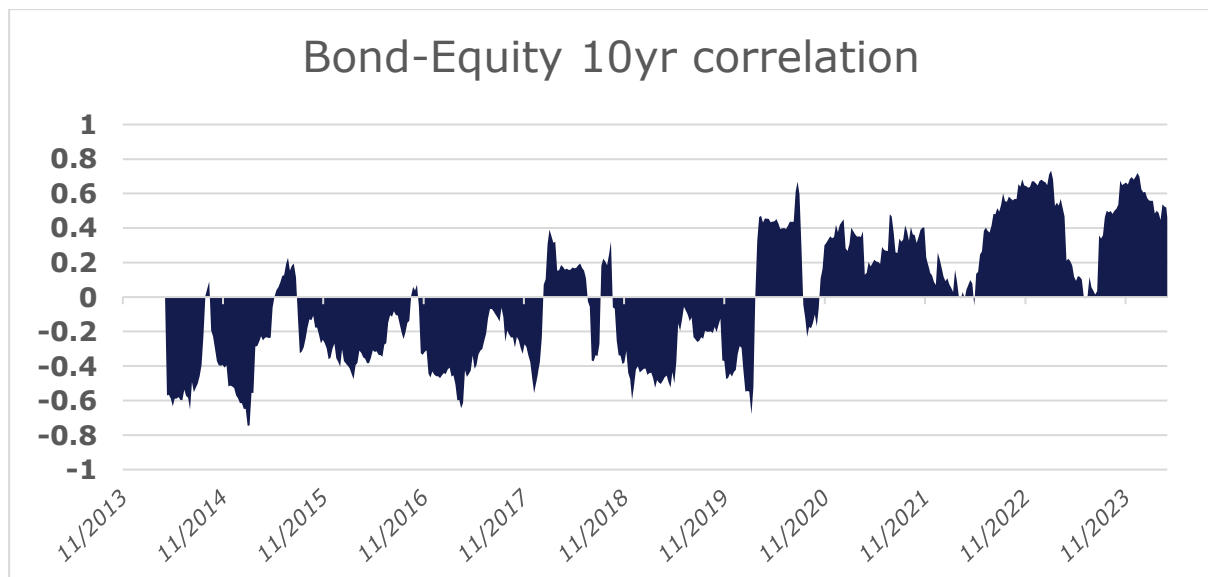
Key takeaways-

- Rising bond yields and inflation give stocks cause for concern.
- Still bullish.

Markets wobbled in April. How long this so-called wobble continues is unclear but after 6 months of 22% gains it's both not surprising to see weakness but also a sign of a reasonably healthy market. Geopolitics may have been a partial spark but ultimately, we believe the ongoing issue is the **relationship between inflation, real rates, and valuations**. Geopolitics is impossible to predict and ultimately, we believe, in a US election year the pressure to de-escalate will be intense.

Perhaps the description of a mere wobble doesn't do the longest losing streak since October 2022 justice. The trend however remains bullish, and, in short, we believe you want to **own assets that can't be readily printed**. Fiscal and monetary policy remain stimulative, the economy robust, unemployment low (albeit hiring trends are slowing), earnings are growing at double digit rates and it's an election year. What could go wrong?

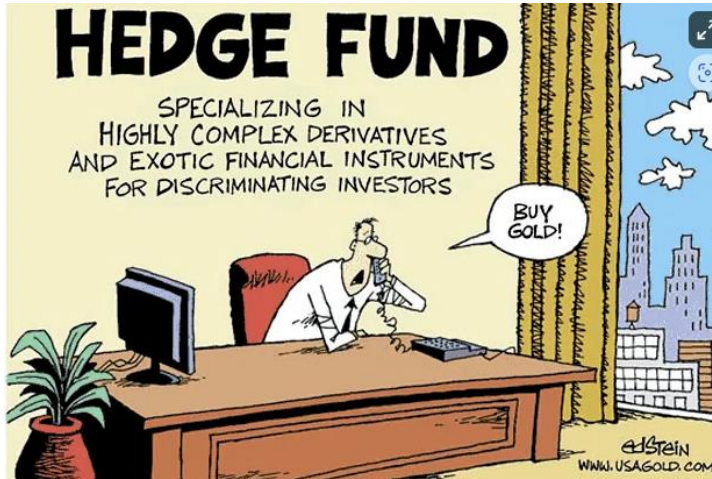
With US growth firm and European growth turning the corner global growth is doing ok. The global exporters are experiencing demand and most forward leading indicators point to growth and, at least, not the slowdown which was being priced in in January. Indeed, the six US interest rate cuts that were priced in January **have dwindled to one**. Out with the politically motivated narrative of a cut for the election (which would need to happen soon to have any effect) there remains little obvious reason to cut rates. Inflation has, if anything, reaccelerated and although a heavily backward-looking statistic oil and commodity prices aren't today weaker.



This all caused bond yields to move higher (2y US treasury +40bps) and pressure equity valuations. Valuation is just a present value calculation of future expected cash flows and discounting these at a higher cost of capital (i.e., the bond yield) brings down valuation metrics. Cash flows are expanding but they, in April, met US stock market valuations that were already well priced.

Where the theory can't be relied upon is e.g., with the release of Tesla earnings this month which were very weak. Irrespective the stock rallied 11% in that part of any valuation metric which doesn't but should be labelled **promises, hopes, and dreams**.

A regular talking point in these monthlies has been the "fiscal issues" of the US that resemble more an Emerging Market than a Developed Market. Government spending is out of control another non-social hangover effect from the Covid years. The news of another \$95bn for Ukraine certainly wasn't a positive for the bond market but it's become all too regular. Within the new law the Biden government is also looking to seize Russian assets held in US banks. The war is clearly economic and shouldn't be any



surprise that other global central banks are moving away from US Treasuries, trading commodities away from the USD and buying assets away from the reach of the US Government.

Gold's performance over the month **was perhaps the most interesting** and supports our view. Gold rallied even as the Dollar strengthened, interest rates rose, and speculation of Fed cuts collapsed. It has pushed through its all-time highs but, not yet been followed by Silver or the miners. Indeed, the data shows that retail and institutional demand remains weak which indicates that `Government` is the only buyer. There has been increased geopolitical tensions, but Central Bank buyers are typically slow and steady accumulators. Chinese retail, who have seen property weakness, will again, be another steady accumulator but, largely, unconcerned about what is happening in the Middle East. As discussed, concerns over public finances are growing but more importantly, there appears no will to correct these and Gold is potentially warning of this.

Bonds have had a woeful few years. **The 60/40 portfolio was designed when bonds had a negative correlation** to stocks and were a hedge to a larger allocation to stocks. As the graph highlights those days have gone and commodities and indeed precious metals are an alternative. But these are very early days in the commodity bull market we are starting to get evidence of. **The only other evidence is the recent performance of a few soft commodities like Cocoa, Tin, and Aluminum**. We have recently increased the ability of portfolios to take additional exposure to commodities within our guidelines in preparation.

Another asset "they can't print" is Bitcoin which over the month had its 4 year "halving". This reduces the mining rewards for miners to 3.125 BTC which is, in effect, a deflationary supply profile. There was no impact on the price as the general tone of equity markets saw profit taking from what has been a strong rally. Since the SEC approval of ETFs there have been inflows of over \$12bn with the market cap of Bitcoin now sits at around \$1.3tn. As a comparison Gold has a market cap closer to \$17trn. We remain positive on the asset, however, we are equally aware that Governments are all

about control. **Just as confiscation of Gold was seen in the 1930s, in the present world, we would not wish to underestimate the lengths to which Governments will reach.** Indeed, the current trend is one of reduced civil and economic liberties as evidenced this month with a few examples. UK banks announce further stringent cash limits to customers, Australian police announcing "Police will be the source of truth, and not social media and misinformation" and the unappealable ruling in the European Court for Human Rights that the Swiss government have violated the human rights of 2000 Swiss Grannies in not doing enough on 'climate change'. The London Times had an article based on a joint statement from the Treasury and UK Investment Association allowing investment funds that invest in weapons companies to badge themselves as "ethical" or "sustainable". We will all have a view on these, but the point is that government reach is not declining.

"Sooner or later, we will all sit down to a banquet of consequences "
Robert Louis Stevenson.



Tactically portfolios remain fully invested with a preference, argued earlier, that stocks will outperform bonds. **We believe assets that cannot be printed will outperform.** We remain bullish into the election but, as discussed last month, we are concerned that the 2-party race is disrupted by RKJ. Liquidity remains key but the long-term environment may have changed. Sticky inflation, ageing populations, large public deficits,

deglobalization and massive technological change are a few. How these develop and affect markets remain massive unknowns.

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