

# GLOBAL OUTLOOK

February 2025

# 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 first month of the new Trump Administration (Trump 2.0) has seen a wave of policy initiatives and a cacophony of noise.

Financial markets have shrugged their collective shoulders and decided that all the noise is not a hindrance to enjoying capital gains in both equity and bond markets. The broadening of the performance of equity markets by sector and geography is particularly notable. The best performing sectors in January were Health Care and Industrials and Europe and Emerging Markets were the regional leaders. Even a “hot” US inflation print for January was not enough to derail the positive mood music.

On one level we think this is rational. Earnings season showed that corporates are in rude health, particularly in the US, and the drop in bond yields since their early January peak is helpful for all financial markets.

We also consider the slew of announcements from the White House to indeed be mostly noise. We show in this chartbook that doing some of the things Trump wants to do is going to be hard.

Take the Department of Government Efficiency (DOGE). Elon Musk is a master of self promotion so it is not surprising his efforts are getting a lot of publicity. But the Federal Government spent \$7 trillion last year. That is \$7,000 billion. So, every time DOGE announces that it has found \$1 billion of “waste” one should send a metaphorical chocolate cookie to Musk (or his son) and tell them to get back to work.

Deportations of “illegal aliens” is another policy that has garnered a lot of airtime. But as we show, the US deports around 500,000 people a year. Trump 1.0 actually deported fewer people (1.8 million) than Biden did (2.0 million). We are surprised that some commentators have been raising forecasts for wage growth because of this.

It is possible that there may be fewer illegals crossing the southern border under Trump. We will have to see. If that happens it could have an impact on wage growth in industries such as construction and agriculture that have traditionally turned a blind eye to niceties such as having a social security number, let alone a passport. But it is far too early to tell if that is indeed going to happen.

As for tariffs, the third initiative, they will be inflationary if they are imposed on a wide range of goods. But so far Trump appears to be using them as a bargaining chip. But again, let’s see how this unfolds.

The impact of all these things on the outlook for inflation will be the critical determinant of whether financial markets show more concern than they have up to now. Inflation expectations in the US have ticked up a little but that may be as much to do with the fact that current inflation is higher than had been hoped for. After all, an inflation swap is priced on the average inflation rate over the life of the swap so if the current inflation rate is higher, it makes sense for the swap rate to increase a little.

## SUMMARY OF OUR VIEWS (CONTINUED)

So broadly speaking we share the market's current scepticism about these initiatives having a big impact. But there is no doubt that they are creating new policy uncertainty. Some old timers might think that should be creating a higher risk premium for equities but that is clearly indicating a lack of understanding of the modern zeitgeist.

Our asset allocation committee did suggest trimming equity positions for any portfolios that had seen equity allocations drift up in the fourth quarter of 2024 when global equities outperformed gilts by nearly 10%. We stand by that decision and will be on watch for any hints that the market needs to pay more attention to the uncertainties associated with Trump 2.0.

### EQUITIES (OVERWEIGHT)

The MSCI All Country World Index rose 4.2% in January.

Equity markets are coming off two years of outsized returns and while valuations are not extended on a global basis, the narrow nature of this performance and increasingly concentrated make-up of the S&P500 and, in turn, the MSCI ACWI, creates incremental risk going into 2025. North America now represents 69% of the MSCI ACWI, a historic high.

We entered 2025 with risk appetite amongst investors extended and the equity rally showing signs of tiring. Bond yields have also remained elevated year to date. We have, therefore, reduced equity allocations. For example, the Balanced target allocation is now 61%, versus previous 63%.

Equity markets have shown improved breadth so far this year, with a change of sector and regional leadership, and more value cyclical bias. The S&P500 rose 3.6% in sterling terms in January while the MSCI World-ex-US index rose 4.9%. That trend has continued in early February.

While the US market continues to look expensive at the headline level, equal-weighted measures provide a more accurate reflection of valuation and it is important to highlight not only the dispersion of valuations within the aggregate multiple, but also the higher growth and return on capital profile of the US corporate sector, as well as its breadth and depth.

So, we continue to find attractive US opportunities, reflected in a ~60% allocation in our Global Recommended Portfolio. That is still underweight but clearly the dominant position by region. We prefer to look at the world from a bottom-up industry perspective, however, where we retain an overweight position to well-positioned Industrials and consumer cyclicals, while still meaningfully underweight the Mag7. Over the last six months, we have also started to identify areas of value in China and continue to reduce our underweight exposure to the Asia-Pacific region.

### FIXED INCOME (UNDERWEIGHT)

The overall gilt total return index returned +0.8% in January.

We still see value in government bonds. We also see them as an important diversifier.

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.

## SUMMARY OF OUR VIEWS (CONTINUED)

### 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.

PART 1  
POLITICS, POLICY, BONDS & CURRENCIES



## TRUMP 2.0 POLICIES CREATE UNCERTAINTY: DOGE

One of the surprising things about the first month of Trump 2.0 is the publicity generated by the Department of Government Efficiency. (DOGE). Partly this is because of the media savvy of its leader, Elon Musk.

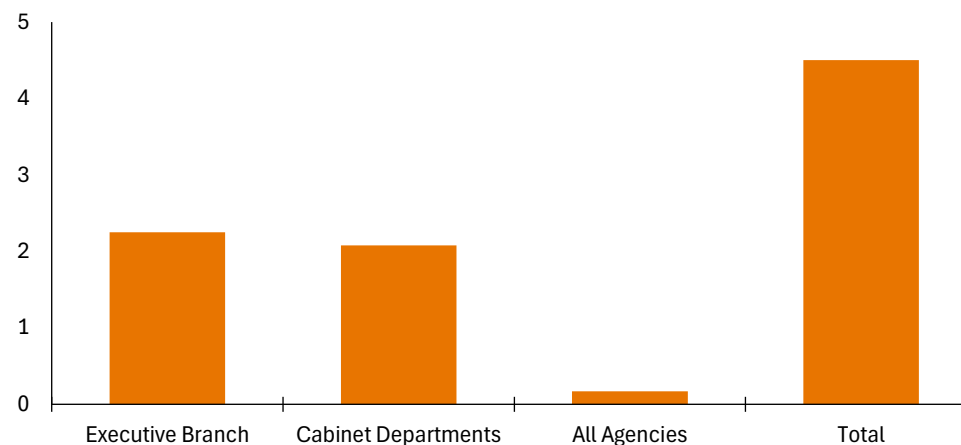
But it has created headlines for finding “waste” across the departments and agencies of the Federal government. And for giving employees cash if they resign. There have also been firings of workers in some Departments and Agencies. The size of the task of restraining government spending though is enormous. The Federal government spent \$7.1 trillion in 2024 according to the National Accounts. That is \$7,100 billion.

To put that in perspective, the 4.5 million Federal Government employees are paid a total of \$422.7 billion, an average salary of \$94,000 per annum. If Musk fired all of them, that would reduce government spending by just 6%.

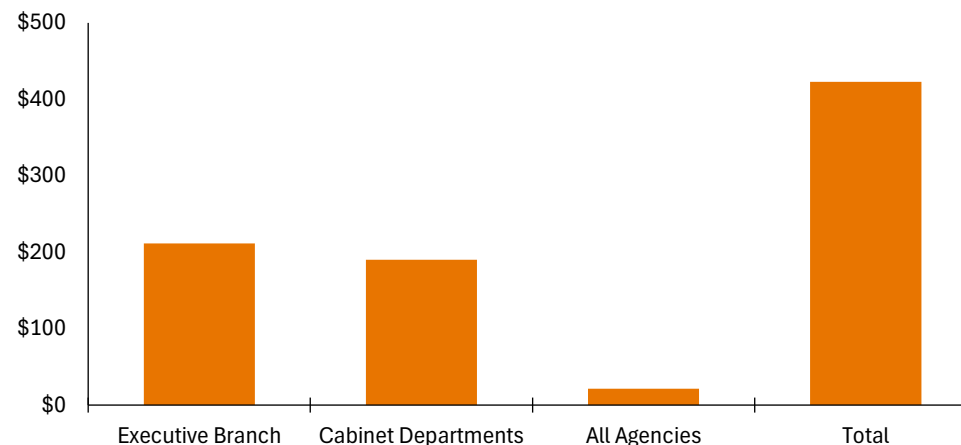
This needs to be taken into consideration when Musk or Trump Press Secretary Karoline Leavitt wave a piece of paper around saying they have found an agency that is spending \$50 million on something they do not like.

Having said that, if in fact DOGE does fire lots of people and reduces government spending more materially than one expects, then whatever the long-term benefits of that, in the short term it would be disinflationary for the economy and reduce growth. That is certainly not being factored in by the market and would have implications. The Federal Reserve may have to cut more than twice this year (the current market expectation) for example. But one suspects that will not happen.

NUMBER OF FEDERAL GOVERNMENT EMPLOYEES (MILLIONS)



SALARIES OF FEDERAL EMPLOYEES (\$BN)



Source: www.doge.gov, London & Capital Waverton. As at 15.02.25

## TRUMP 2.0 POLICIES CREATE UNCERTAINTY: DEPORTATIONS

This chart shows the number (LH scale) of inadmissible or deportable foreigners who have left the country each fiscal year back to 1892. The data is also shown as % of the US population.

Trump is starting at a low base relative to history so may well be that he increases the number somewhat. But more people left by this measure in the Biden administration (2.0 million) than did in Trump 1.0 (1.8 million).

We can track the number of people removed monthly (last data is November 2024) so we can watch this closely. But it is possible that this is a classic "don't let the facts get in the way of a good story". One is sceptical this is going to impact wages, at least in the short term.

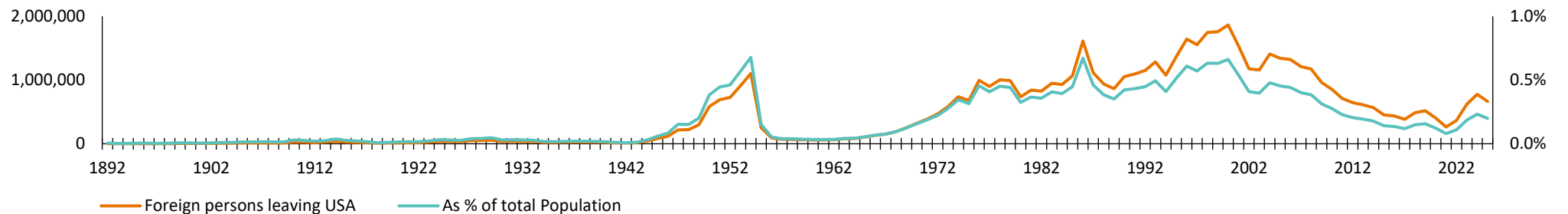
But one accepts that Trump may be making some migrants think twice about crossing the border while this is getting so much publicity.

There were a lot of deportations during World War Two and the Korean War in the early 1950's but it slowed in the latter years of the Eisenhower administration (1953-61). There was another surge under Clinton (1993 – 2001) but that too dissipated.

If there is a material pick up, then it will impact industries such as construction and agriculture that have historically widely used cheap labour and have turned a blind eye to where people came from.

But it is way too early to tell if that will indeed be the case. The market has raised expectations for future inflation in recent weeks but that is likely as much about the level of current reported inflation as it is about immigration policy. To be watched closely, but not yet impacting how one thinks about the investment landscape.

INADMISSIBLE OR DEPORTABLE FOREIGNERS WHO LEFT THE USA, FISCAL YEARS 1892 - 2023



Source: Office of Homeland Security, <https://ohss.dhs.gov/topics/immigration/immigration-enforcement/immigration-enforcement-and-legal-processes-monthly>. As at 30.11.24



## TRUMP 2.0 POLICIES CREATE UNCERTAINTY: TARIFFS

This chart shows the % of Federal tax revenues that come from tariffs. Under Trump 1.0 it increased from 1.9% in 2017 to 3.7% in 2018 but has been falling since then.

In Fiscal 2023 the US raised \$82 billion from tariffs out of an overall tax take of \$2,916 billion.

If Trump imposes a large tariff on virtually all Chinese imports, then the revenue could be significantly higher than we have seen up to now. The US imported \$427 billion worth of goods and services from China in 2023. Indeed, a blanket 20% tariff would roughly double the current total revenue from tariffs.

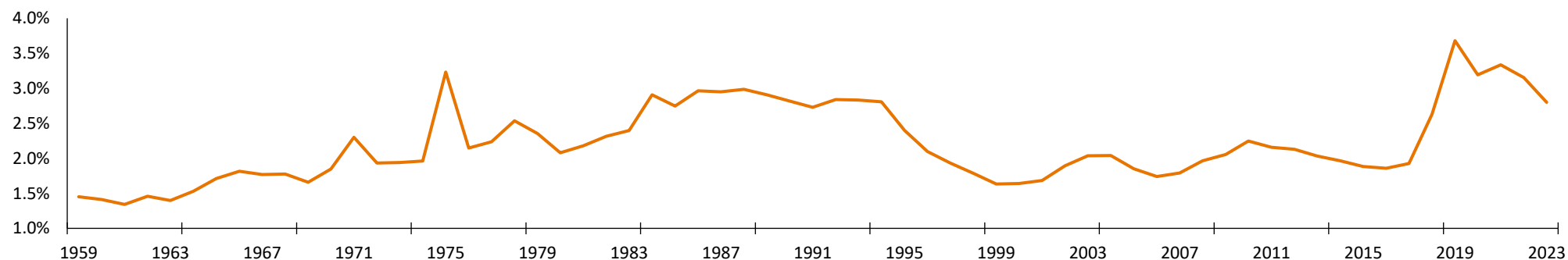
But tariffs are complicated because clearly China would retaliate to such a move.

It could refuse to ship rare earths to the US, for example, which would hurt the information technology industry. Indeed, in December 2024, China has already said it will not export certain rare earths to the US although the ones selected are relatively unimportant. China is clearly going to wait to see what Trump actually does.

Tariffs may also be used as a broader foreign policy weapon. For example, Trump's enthusiasm for getting hold of Greenland could mean that he particularly focuses tariffs on Denmark. The US imported \$12bn of goods from Denmark in 2023, half of which was packaged pharmaceuticals.

All this creates uncertainty and could have implications for inflationary expectations and geopolitical risks.

US TARIFFS AS % OF FEDERAL GOVERNMENT TAX REVENUE FISCAL YEARS 1959 - 2023



Source: St Louis Federal Reserve, Bloomberg, London & Capital Waverton. As at 30.09.23

## FISCAL POLICY WILL BE DOMINANT ISSUE IN 2025

This chart shows the US budget deficit as a % of US GDP. It is currently 7.2% 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 has been reinstated as of 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 this 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 by the summer of 2025.

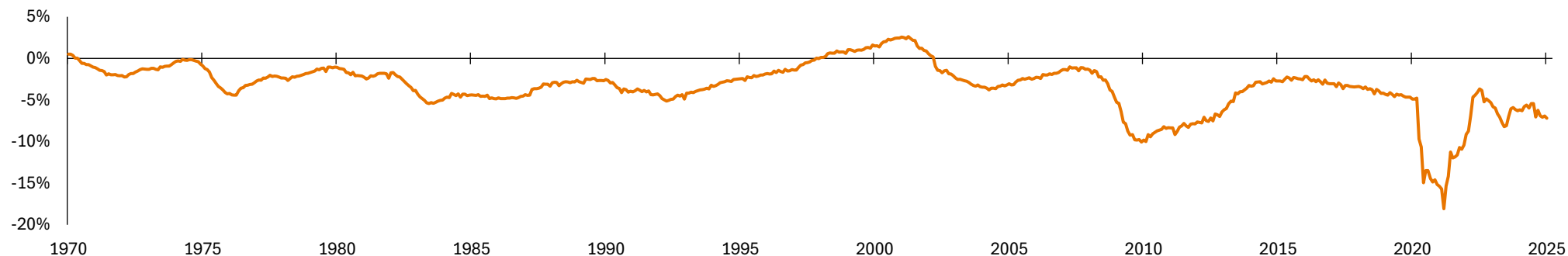
Secondly, the 2017 tax cuts for individuals and small businesses roll off at the end of 2025. If new legislation is not passed to renew them, then taxes will rise by over \$4 trillion.

That is looking likely to happen. 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.

When Trump took office in 2017 the deficit was 3% of GDP. The current situation gives much less leeway for expansionary policy.

Could the bond vigilantes come out of hibernation in 2025?

US BUDGET DEFICIT AS % OF GDP 1970 - CURRENT



Source: Bloomberg, London & Capital Waverton. As at 31.01.25

## FEWER RATE CUTS EXPECTED IN THE US AND UK

The top chart shows current expectations for the US Federal Reserve policy rate over this year and next and how those expectations have shifted since September 20th, the week the Fed cut rates by 0.5%.

There has been a material reduction in market expectations for monetary easing in the months ahead. There is a similar picture in the UK (bottom chart). In the US, two rate cuts are expected by the end of 2025.

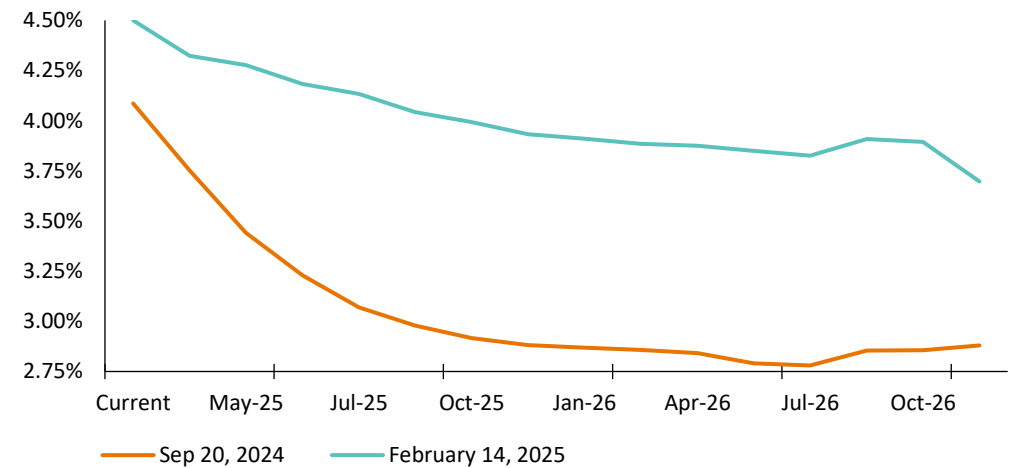
There is more concern about the likelihood of inflationary pressures returning after a stalling in the improvement in reported inflation in recent months and the potential actions of the Trump administration.

The imposition of high tariffs risk a jump in inflation. A presumption that tax cuts will be renewed at the end of this year also contributes to concern as, despite the headlines being made by the Department of Government Efficiency, meaningfully reducing spending is going to be challenging.

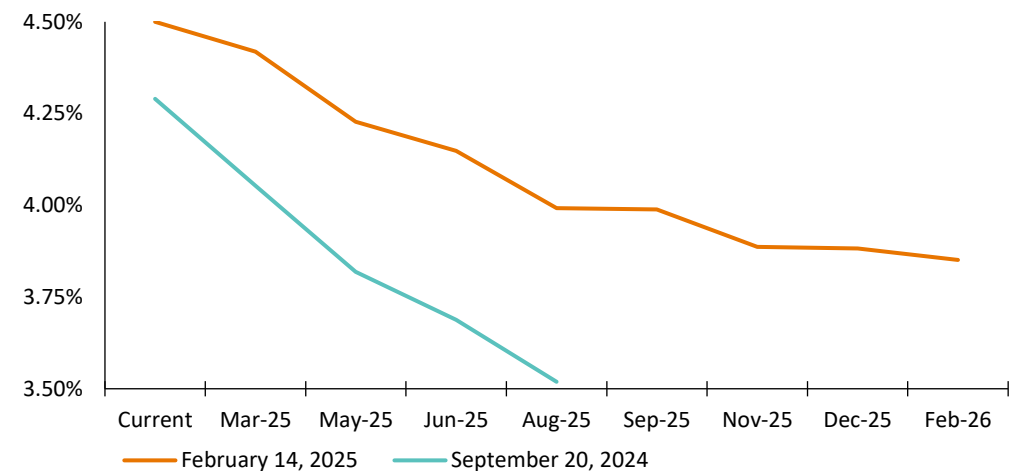
In the UK there is also an expectation of two rate cuts by the end of the year. Given the sluggish economy here it is possible that more may be forthcoming in the months ahead.

Market expectations for inflation are likely to be the critical thing to watch in coming weeks and months. If they do move up materially that will have a detrimental impact on markets.

### IMPLIED US FED FUNDS RATE %



### IMPLIED UK BASE RATE %



Source: Bloomberg, London & Capital Waverton. As at 11.02.25

# 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. Bond yields rose after the Fed cut rates in mid-September, aided by some stronger than expected economic data, but have trended down since peaking in early January. Although commentary in the UK is very focused on the rise in borrowing costs for the UK government being due to Labour party policies, the top chart shows that UK and US government bond yields have not diverged at all.

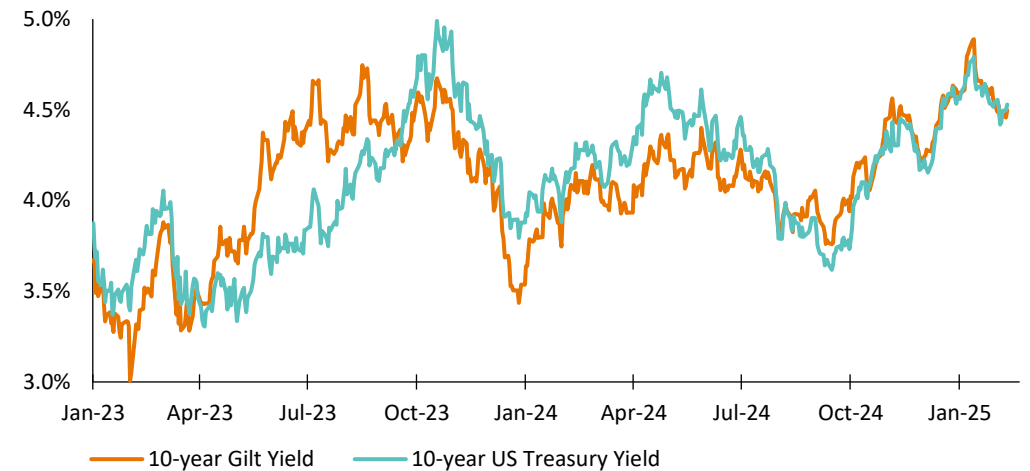
The bottom chart shows those same yields after deducting the current 10-year inflation swap rate in each market. The swap rate is one indication of market expectations for inflation over the life of the bond.

Inflation swaps are priced on RPI in the UK so we deduct 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).

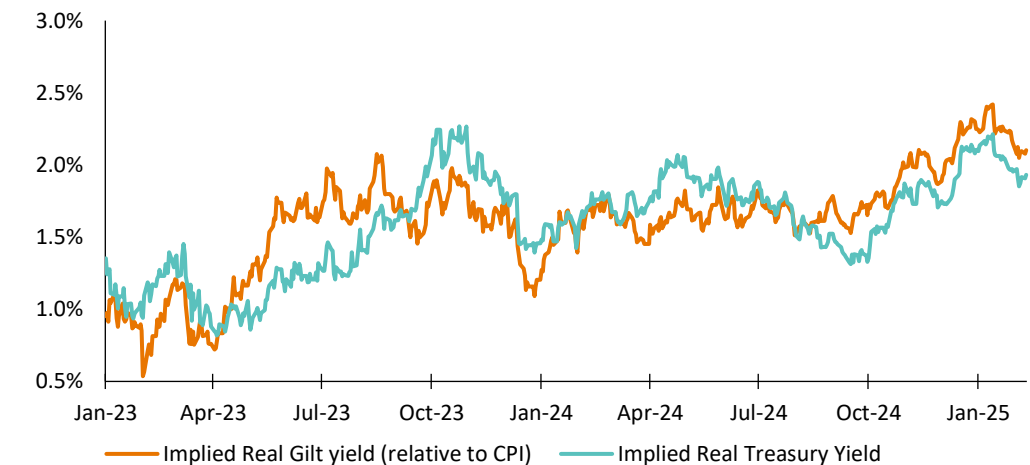
As the chart shows, both markets continue to offer, on this measure, a positive real yield. The rally in the last month or so has seen real yields, as calculated this way, decline but at around 2%, they remain attractive in our view.

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 2.05%. The UK linker market is optically less attractive (the March 2034 linker yields 0.89%) but as this is based on RPI, the total return (thanks to RPI being higher than CPI) is similar between UK and US linker markets. We still think there is 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, London & Capital Waverton. As at 11.02.25

## INFLATION RATES HAVE DECELERATED 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 3.5% and CPI is 2.5%.

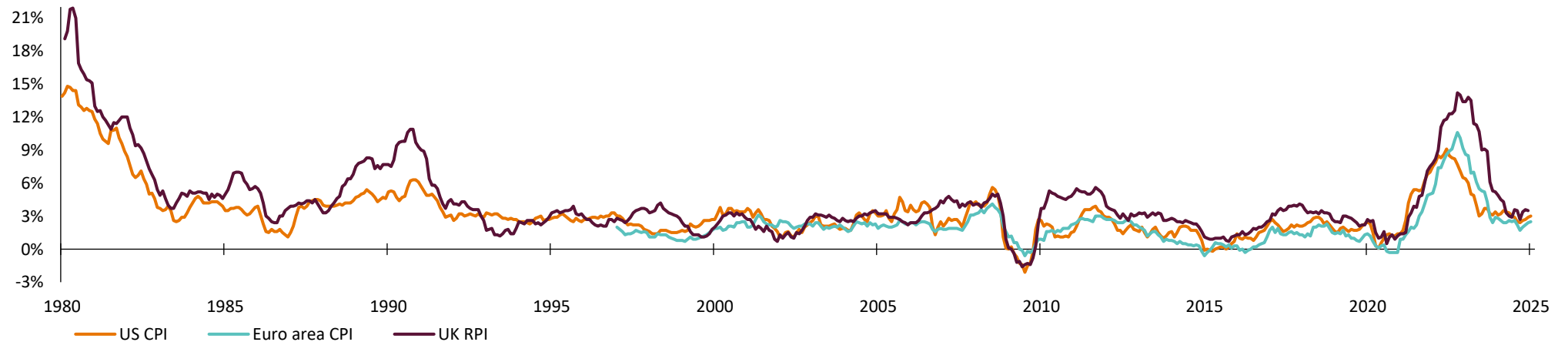
US core inflation (excluding food and energy) peaked at 6.6% in September 2022. It is now 3.3%.

There remain concerns about the inflationary impulse across the developed world. The improvement has stalled in recent months with inflation higher at the end of 2024 than it was in September 2024 in all three countries/regions.

With the impact of Trump's policies being debated some inflation risk premium may reappear.

However, for now, as the next charts show, the market is still somewhat sanguine about future inflation.

INFLATION (% CHANGE YEAR-ON-YEAR) 1980 - CURRENT



Source: Bloomberg, London & Capital Waverton. As at 31.01.25

## EXPECTATIONS FOR FUTURE INFLATION REMAIN REASONABLY SANGUINE

The top chart shows the 5-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 five 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.

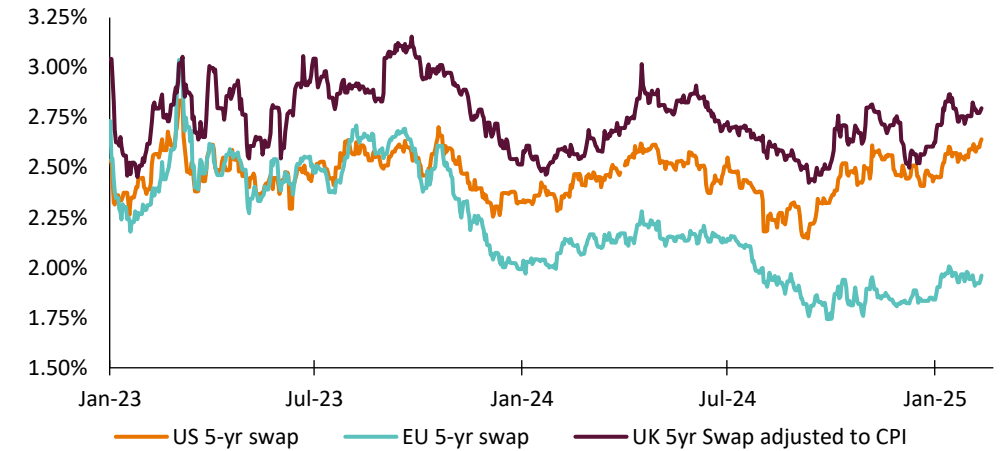
The bottom chart shows longer-term inflation indicators. Here the picture remains encouraging.

The orange line is the 10-year US inflation swap and the teal 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.

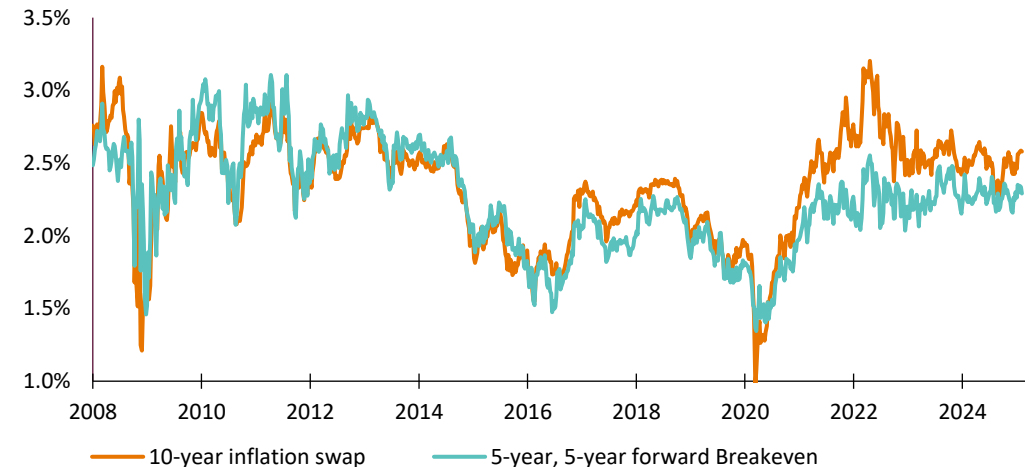
The general picture from both these charts is that the market remains pretty sanguine about future inflation.

One of the critical things to watch in coming weeks will be to see if the Trump Presidency, and the likely imposition of tariffs on a wide range of goods does anything to these measures of expected inflation.

5-YEAR INFLATION SWAP RATE (%)



LONG-TERM US INFLATION EXPECTATIONS



Source: Bloomberg, London & Capital Waverton. As at 07.02.25

# THE BROAD COMMODITY COMPLEX HAS BEEN WEAK

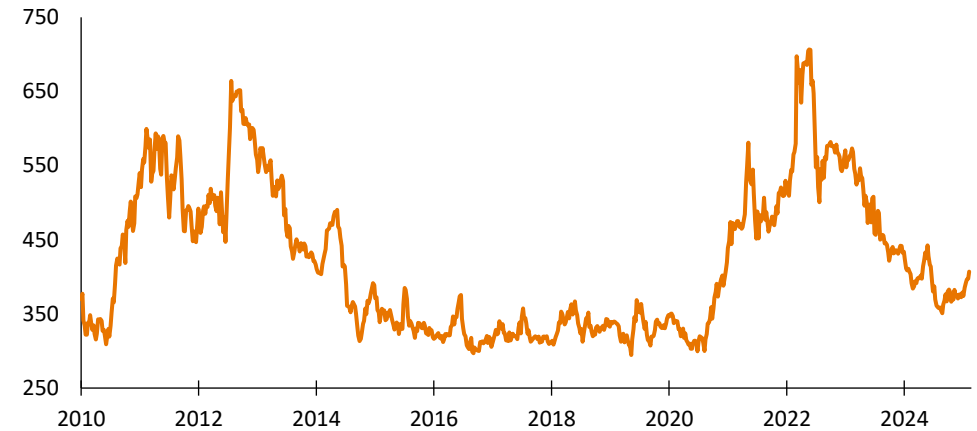
The broad commodity complex is in the doldrums.

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.

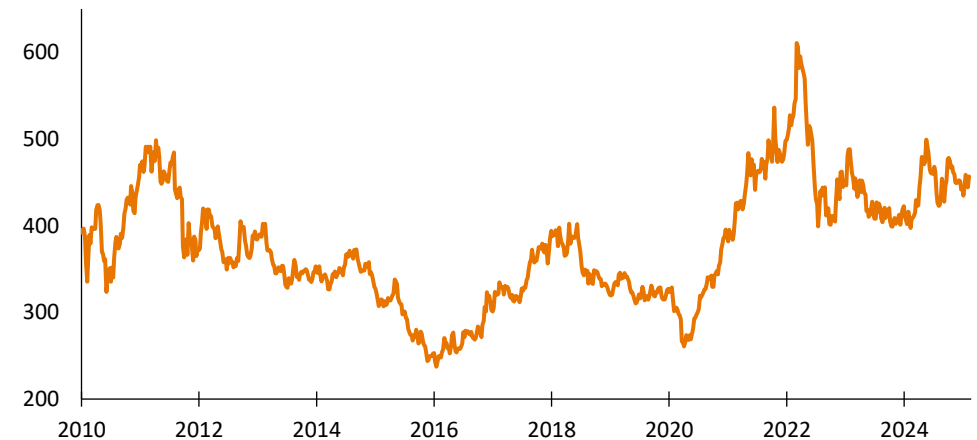
The Industrial Metals index (bottom chart) has been range bound for the last eighteen months.

Demand from the People's Republic of China (PRC) is an important driver of industrial metals prices. There is little to suggest that recent efforts at stimulus are having much impact.

S&P GSCI GRAINS INDEX



S&P GSCI INDUSTRIAL METALS INDEX



Source: London & Capital Waverton, Bloomberg. As at 07.02.24

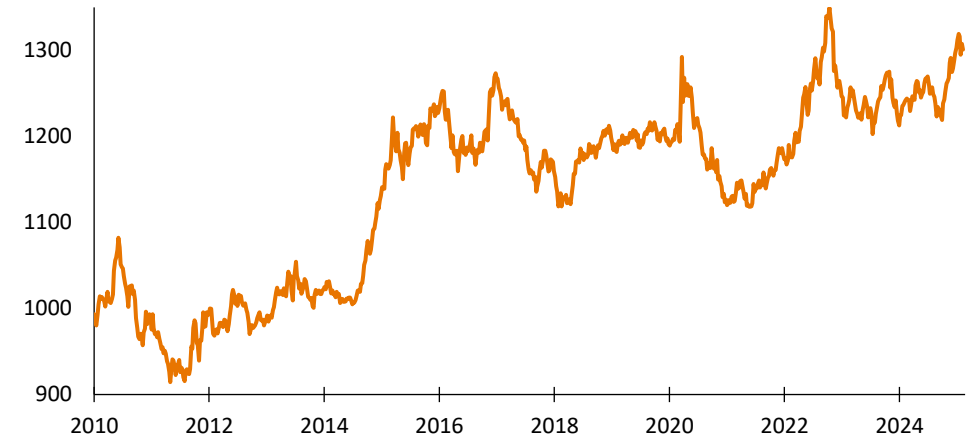
## DOLLAR AT HIGH END OF ITS RANGE

The top chart shows a trade weighted dollar index. It has strengthened in the run up to and post the Presidential election. This also coincides with the shift upward in expectations for where future policy interest rates are going.

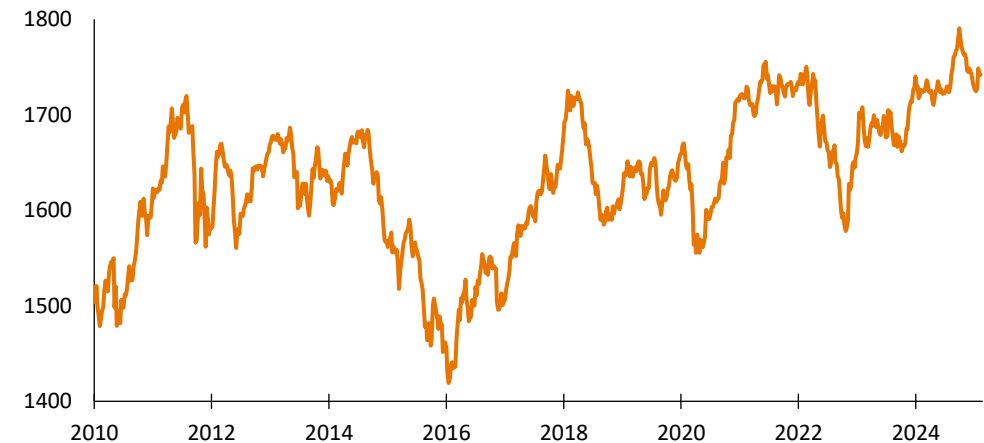
The bottom chart shows that an index of emerging market currencies. This index is weighted by the weighting of each country in the MSCI Emerging Market equity index, so China is the biggest component.

The election of Trump has rationally pushed the US dollar up against EM currencies, including the renminbi which is at 7.24 to the dollar, up from 7.10 at the time of the election. It is at the top end of its range against the dollar.

TRADE WEIGHTED US DOLLAR (BBDXY)



MSCI EMERGING MARKET CURRENCY INDEX



Source: London & Capital Waverton, Bloomberg, MSCI. As at 07.02.25



## STERLING STILL RANGEBOUND AGAINST THE EURO, BUT AT THE HIGHER END

Although there has been a lot of comment about the UK in crisis, as the chart below shows, sterling is still trading toward the top end of its range against the euro since 2016.

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

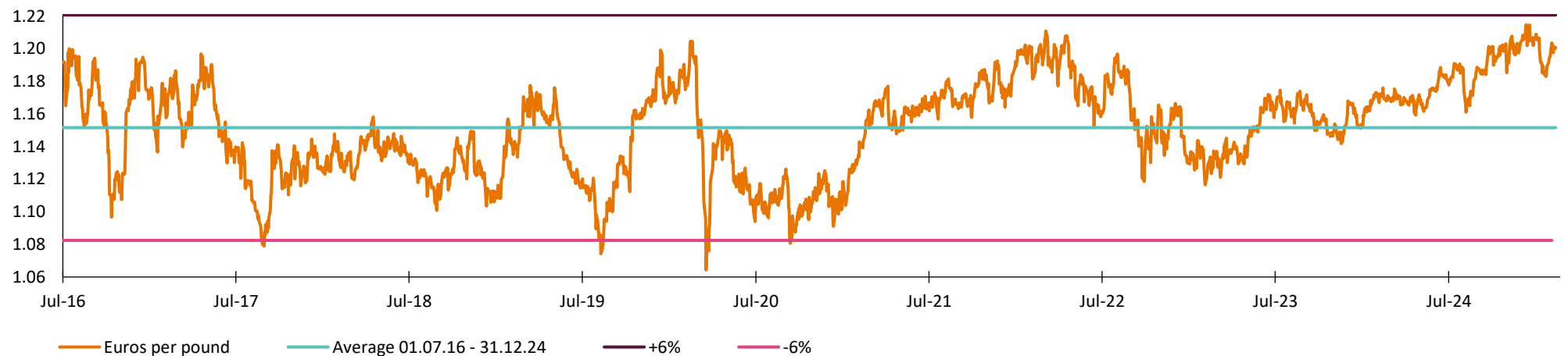
The chart shows the number of euros per pound since 1 July 2016. The average exchange rate since then is shown as the teal line and we show a range 6% either side of that average.

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 2,200 trading days), sterling has only been out of a 6% trading range for ten 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.

EUROS PER POUND (01.07.2016 – CURRENT)



## GOLD AT A RECORD HIGH

As of the end of January 2025, gold is at a record high in US dollars and 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.

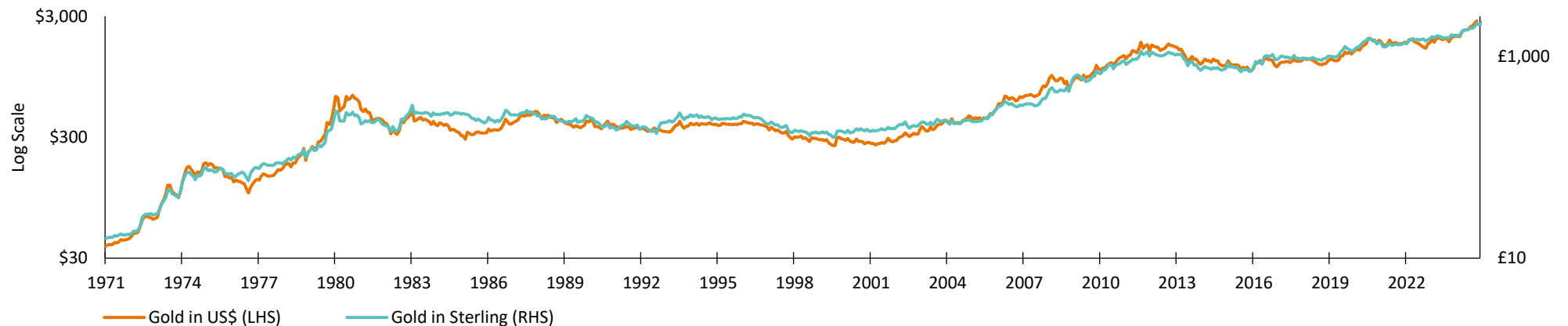
Gold benefitted from the exceptional monetary policy in evidence from 2008 to arguably 2021. With zero or even negative nominal interest rates the opportunity cost of owning gold had never been lower.

In recent months, the rally in gold appears to be based on buying by central banks around the world, including in China. It is also possible that gold has benefitted as a hedge against any reappearance of inflation.

There is also the possibility that the Trump Administration will revalue its gold holdings. It carries them in the accounts at a value of \$42.22 per ounce. The current price is \$2,882. The value of the gold held by the US government is \$11bn at the \$42 valuation. It would be \$750 billion at the current price. That could be used to finance a sovereign wealth fund or just be used to shore up the health of the government balance sheet.

There are lots of devils in the detail of doing that though so count it as unlikely. More important in the short term will be whether the demand from central banks for gold continues.

GOLD PRICE PER TROY OUNCE IN US DOLLARS AND IN STERLING (1971 – CURRENT)



Source: Bloomberg, London & Capital Waverton. As at 31.01.25

PART 2  
EQUITIES & CREDIT



## 2025 EARNINGS GROWTH ESTIMATE +12% GLOBALLY AND +14% FOR THE US

The consensus for the Global Index is for EPS to rise 7% in 2024. For the US the expectation is for an 9% increase. The numbers are unchanged so earnings season has met expectations in aggregate.

For 2025 the consensus numbers remain very robust at +12% and +14% respectively.

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             | 18.4   |          | +6.8%       | +11.9% | +12.5% |
| US                | 22.3   | 121%     | +9.1%       | +14.2% | +13.8% |
| Europe ex UK      | 14.7   | 80%      | (2.3%)      | +7.3%  | +11.0% |
| UK                | 11.8   | 64%      | (1.0%)      | +6.7%  | +10.2% |
| Japan             | 14.6   | 79%      | +8.9%       | +9.5%  | +8.7%  |
| Asia Pac ex Japan | 12.8   | 69%      | +20.9%      | +11.6% | +13.4% |
| Latin America     | 8.4    | 46%      | (16.8%)     | +14.5% | +10.4% |
| Emerging markets  | 13.7   | 74%      | (4.7%)      | +7.6%  | +10.8% |
| World ex USA      | 13.6   | 74%      | +4.0%       | +9.1%  | +10.9% |

## STOCK MARKET VALUATION IN LINE WITH RECENT RANGES

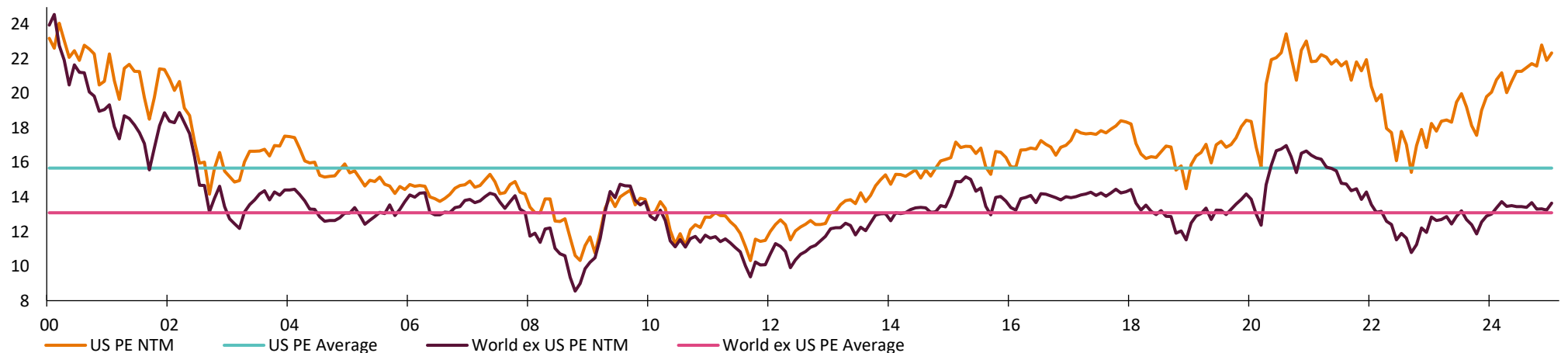
The PE ratio for the US market (solid orange line) is 22.3 times.

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

The World outside the US now trades at 13.7 times earnings, a little above its 20-year average of 13.1.

There is always 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



Source: MSCI, FactSet, London & Capital Waverton. As at 31.01.25

## US MARKET NOT AS EXPENSIVE AS HEADLINE VALUATION SUGGESTS

Although the valuation of the US market is elevated in absolute terms and relative to its own history, a small number of large companies in the index are the cause of that. The narrowness of the leadership in the market in the last two years has exacerbated that.

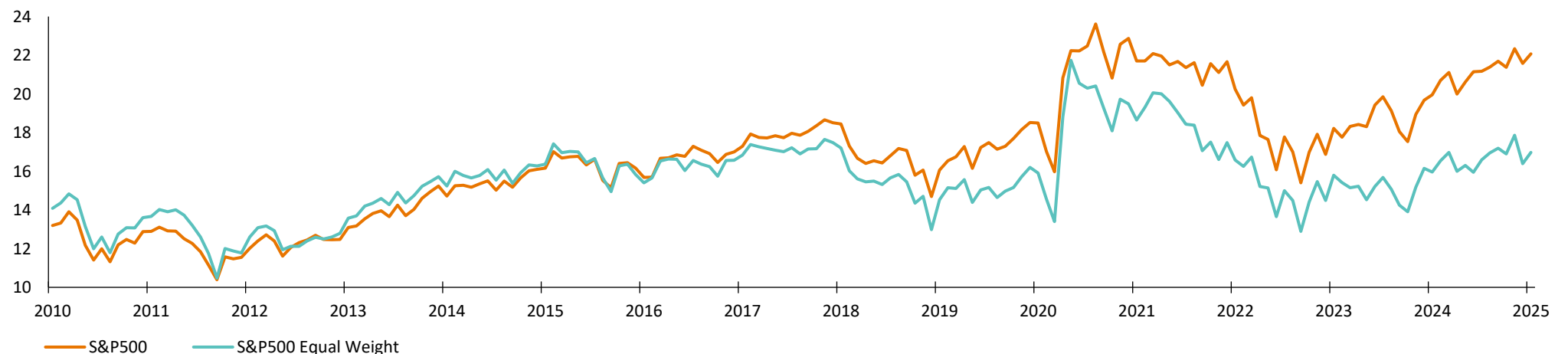
This chart looks at the price/earnings ratio of the index (orange line) and the PE of an equally weighted version of the S&P500 index, both on forward earnings.

The former is at 22 times, the latter is at 17 times.

That is the widest discount seen in recent years. Which is why we have still been able to find value in the US market and have added US stocks to our Global Recommended Portfolio in recent months.

It is important to bear this in mind as it suggests that while elevated valuations pose risks to a few of the largest stocks in the index, the rest of the market is trading at reasonable levels. The 20-year average PE for the US is 15.7 times so the equally weighted index is only slightly elevated relative to that.

S&P500 INDEX AND S&P500 EQUAL WEIGHTED INDEX, PRICE EARNINGS RATIO 2010 - CURRENT



Source: Factset, London & Capital Waverton. As at 31.01.25

## US PROFITS AS % OF GDP REMAIN RESILIENT

This chart shows pre-tax profits of corporate America relative to GDP through Q3 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.

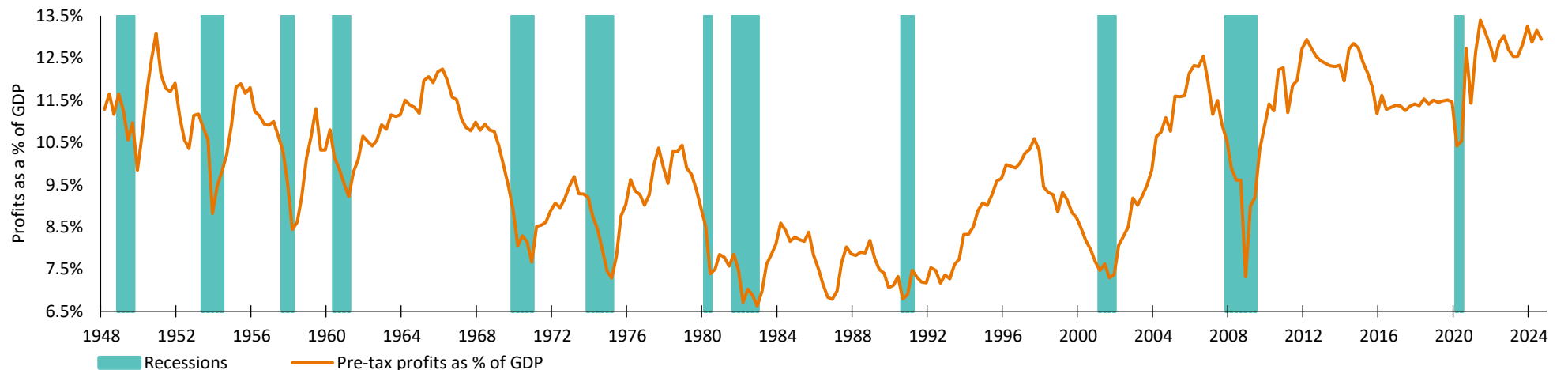
Consequently, this series is not susceptible to financial engineering via such things as share buybacks to boost earnings per share. It is a proxy for profit margins. In every recession except 1982, profits were falling as a % of GDP before it.

But on this measure profits have been resilient in recent quarters. Profits are below the cyclical peak as % of GDP which was 13.4% in Q2 2021.

The profit data has just been given a boost by the annual update of the National Income Accounts. Profits were increased by \$550bn combined in the last three years which equates to an average of over 5% per annum.

The effect of this is to eliminate the drop in profits as % of GDP in 2023 that had added to the indicators suggesting an economic slowdown was likely. Now, this another indicator suggesting a recession in the near term is unlikely, and indeed confirms that the health of the corporate sector is genuinely robust.

US PROFIT CYCLES AND RECESSIONS (%)



Source: MSCI, FactSet, London & Capital Waverton. As at 30.09.24

# 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.

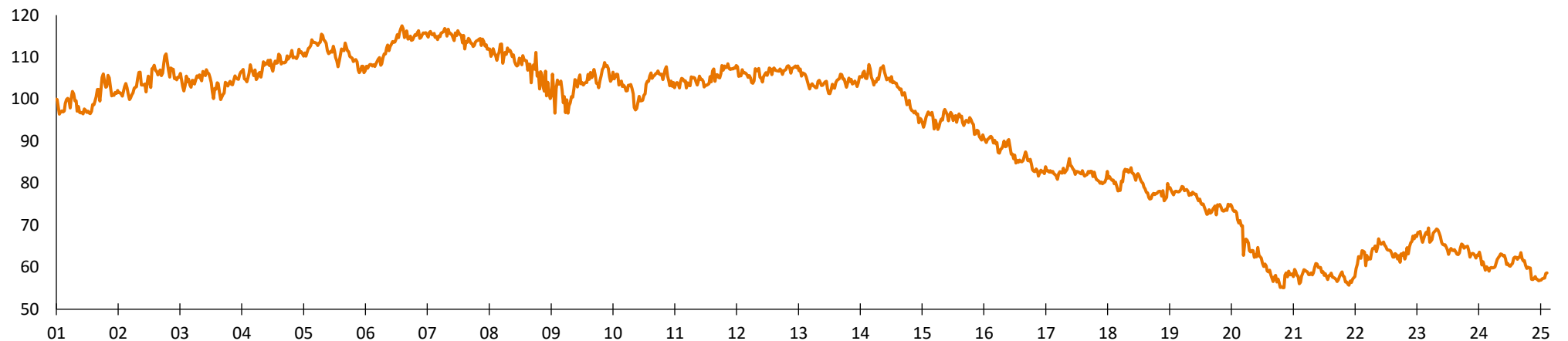
But from May 2014 to October 2020, the UK market underperformed by 49%. It had a better time in 2022 but it has resumed underperformance in the last two years.

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, London & Capital Waverton. As at 07.02.25



## 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.

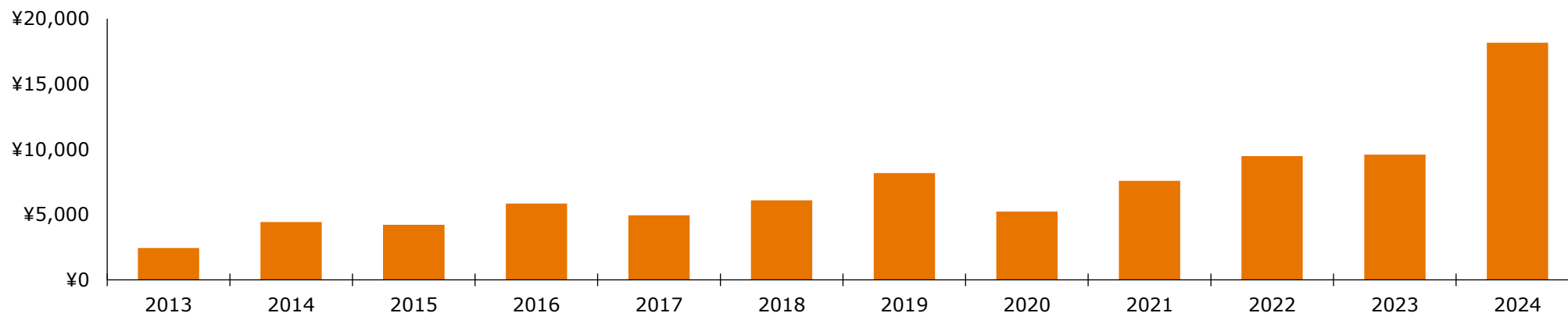
But there have also been significant changes to corporate governance including a sharp increase in the number of independent directors on Boards. Shareholders have benefitted directly from a pick up in the number of buybacks done by Japanese corporates.

This chart shows that buybacks were at a record level in 2024, 89% 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 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 MILLIONS OF JAPANESE YEN



Source: Mizuho, Bloomberg, London & Capital Waverton. As at 31.12.24

## 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.

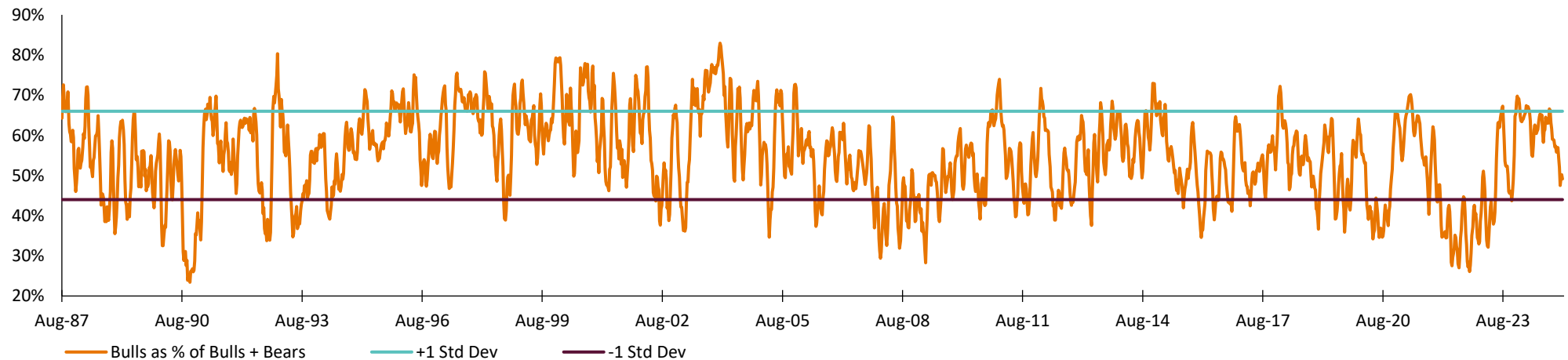
The two horizontal lines are showing one standard deviation above (teal line) the average level and one standard deviation below (purple line).

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

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

This sentiment measure has followed the market by staying at the top end of the bullish range in recent weeks. Don't think one could describe as investor sentiment as euphoric, but there may be a little complacency around.

AMERICAN ASSOCIATION OF INDIVIDUAL INVESTORS SURVEY, BULLS AS % OF BULLS PLUS BEARS



Source: AAI, Bloomberg, London & Capital Waverton. As at 06.02.25

# CORPORATE BALANCE SHEETS YET TO SHOW REAL STRESS

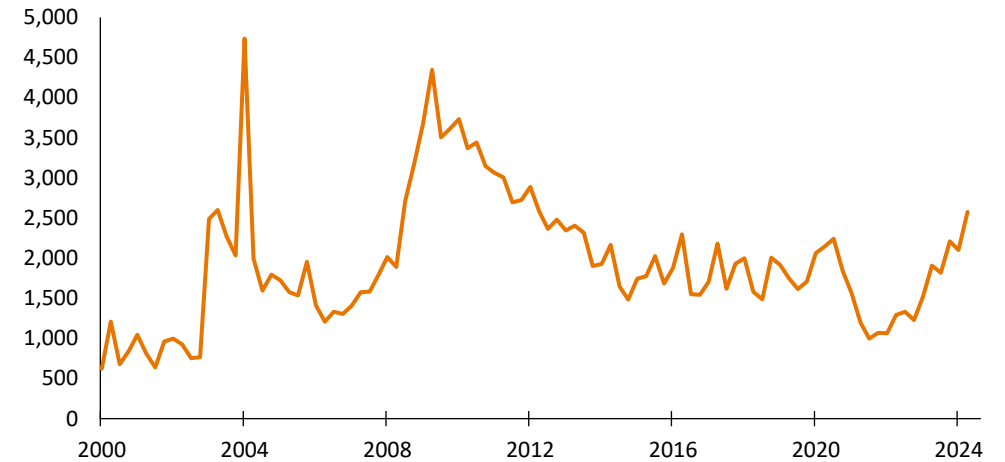
The top chart is a quarterly series showing the number of US corporate bankruptcies (officially called “Chapter 11” filings). It hit its lowest level for 18 years in Q3 2021.

It has moved up since then and moved further up in Q2 2024.

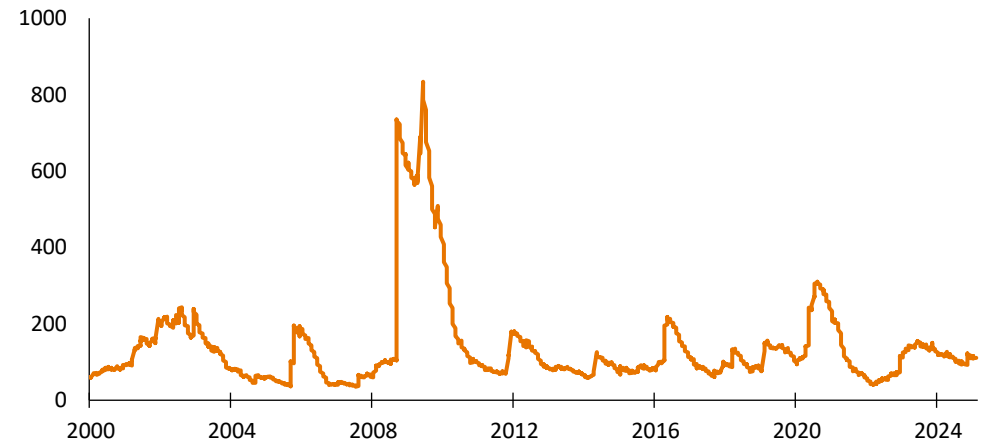
The Bloomberg Index in the bottom chart is of economy wide US bankruptcies and takes into account the size of the bankruptcy as well as the number of them. Hence there were more big bankruptcies in 2009-10 than in 2003-04. That index is at historically very low levels.

It remains the case that corporate balance sheets are holding up well in the face of higher interest rates.

US BANKRUPTCY FILINGS (2000 TO CURRENT, QUARTERLY)



BLOOMBERG US CORPORATE BANKRUPTCY INDEX (2000 – CURRENT, WEEKLY)



Source: Bloomberg, London & Capital Waverton. As at 07.02.25

## CORPORATE CREDIT MARKETS BULLED UP

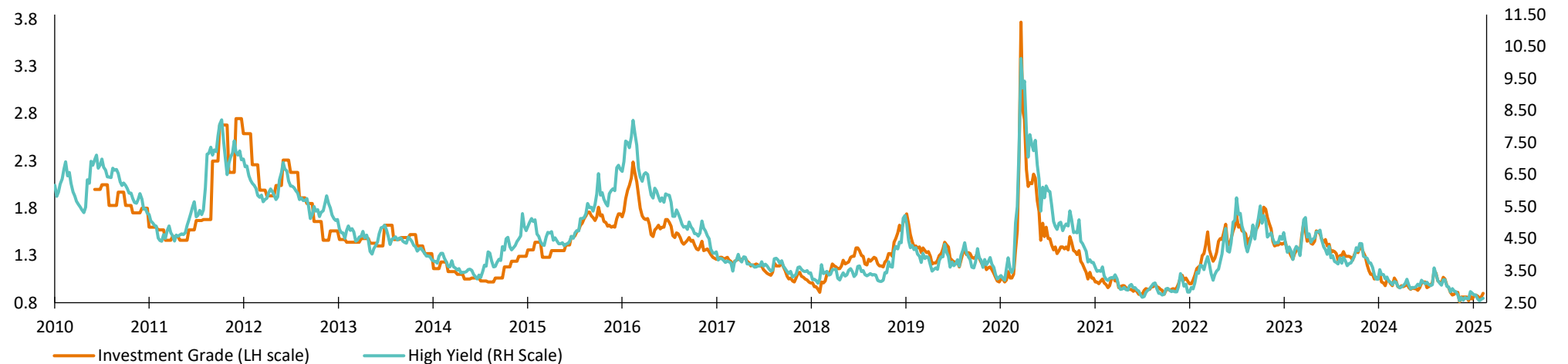
Credit spreads have tightened as the risk-on rally continued in recent weeks.

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

We remain 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 London & Capital Waverton. As at 07.02.25

## CORPORATE BONDS, S&P500 EARNINGS YIELD & T-BILLS HAVE SIMILAR YIELDS

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 January 2025, the numbers were 6.1% versus 4.5%.

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.

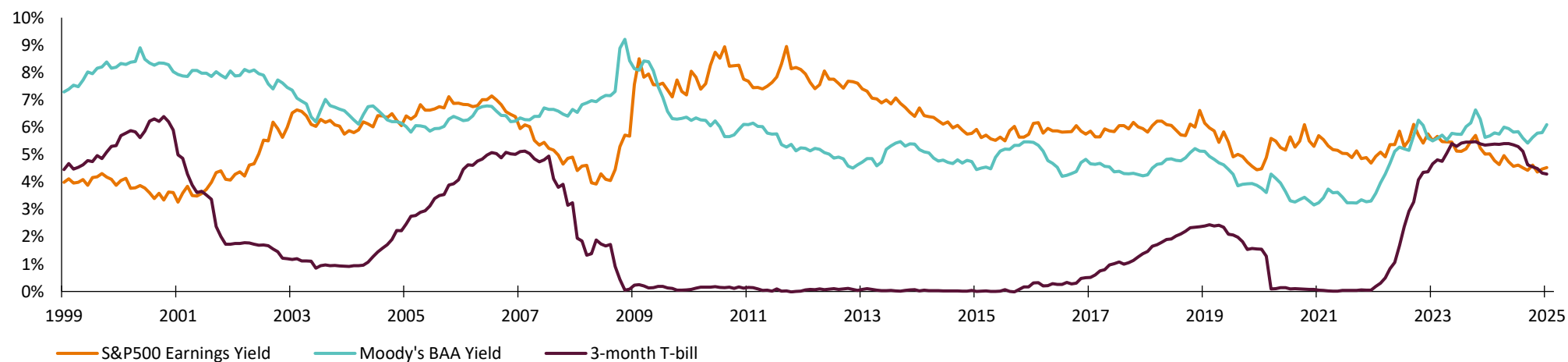
Normally it would be perceived that equities had some valuation challenge from corporate bonds when this is the case but in 2023 both gave good returns.

That the earnings yield and the Baa yield have both moved down over the summer reflects the strength of both markets.

The purple line is the 3-month Treasury bill rate which is currently 4.3%, only slightly below the S&P500 earnings yield. Cash remains 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 London & Capital Waverton. As at 31.01.25

## WEAKNESS OF CHINESE CURRENCY NEEDS TO BE WATCHED

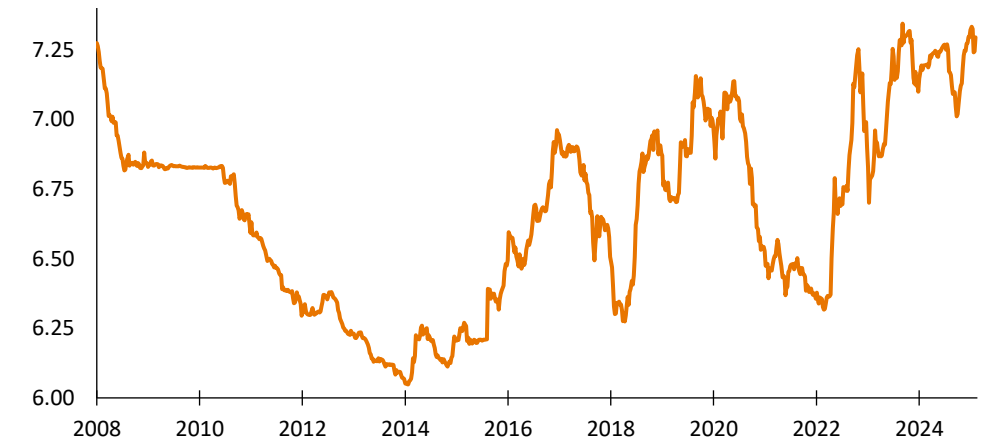
The Rmb has been weak since the US Presidential election in early November. As my colleague Benjamin Hall points out, in China, despite consistent messaging on a commitment to stimulus, including directly from Xi, investors have reverted to “I’ll believe it when I see it” mode. These conditions led to broad based weakness across Asian markets and currencies during the quarter.

As Ben also says, it was positive to see some constructive data points from the real estate market. Primary transaction volumes have been on an uptrend since the government’s policy changes three months ago, while inventory levels have been declining given the drop in new project starts. So far, the real estate downturn hasn’t pushed too many homeowners into negative equity, due to China’s low LTV ratios and the huge deposit build up since COVID. Putting a floor under the real estate market at this stage to avoid that happening (and the consequent asset impairments for the banking system) remains critical. The government seems to be proceeding with a targeted and incremental stimulus response. They appear to be focussing on the underlying faults in the system, notably local government debt and the real estate market; investors seem to still wish for a bazooka to be fired at the symptoms (i.e. weak consumer spending).

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.

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 DOLLAR PER US DOLLAR



Source: Bloomberg, London & Capital Waverton. As at 07.02.25

# PART 3

## OUR APPROACH TO INVESTING RESPONSIBLY



# OVERVIEW OF RESPONSIBLE INVESTMENT AT L&C

Signatory of:



## L&G 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



## ETHICAL RESTRICTIONS

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

## ENGAGEMENT AND VOTING

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



# 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:



## IMPORTANT NOTICE

The value of investments and any income from them can fall as well as rise and neither is guaranteed. Investors may not get back the capital they invested. Past performance is not indicative of future performance. The material is provided for informational purposes only. No news or research item is a personal recommendation to trade. Nothing contained herein constitutes investment, legal, tax or other advice. This document does not represent primary research; it provides the views of the London & Capital investment team examining the fundamental background, economic outlook and possible effect on asset markets. This document is not an invitation to subscribe, nor is it to be solely relied on in making an investment or other decision. The views expressed herein are those at the time of publication and are subject to change. Correct at time of going to press. © London and Capital Asset Management Limited. All rights reserved.

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