REYL OVERSEAS

# STRATEGY OUTLOOK

July 2023

**Key takeaways-**

- Playing hide and seek – where is this recession?
- Lagavulin 16yr, Coal & RKJ for President?

Where is the recession hiding? It's been the most anticipated downturn on record. The popcorn is ready, and everyone is positioned comfortably awaiting the kick-off. It's not as if we haven't had some trials already. Last year set the scene but today we still face well above target inflation, aggressive interest rate hikes, banking sector turmoil and the drama of a debt ceiling in the US. **To say stocks have been resilient is a bit of an understatement.**

The NASDAQ is up 31%, the Nikkei +29%, Eurostoxx 15%, SMI +5% and FTSE +1%. A degree of hyper-financialisaton must be at play on top of weak equity positioning and the reality that the economy is not the equity market. **Strong economy does not equal strong equity market, indeed today, it's most likely the opposite.**


Yet stocks do feedback into the economy via the behaviour of CEOs.

Indeed, the economic data, although very mixed, is showing some signs of robustness maybe drive, in part, by this financialisation.

There is still however a two-tier economy. Consumer confidence has bounced, US housing rose for a third straight month and government spending strong. Going into the election the White House must be happy, but the Fed aren't. The economic cracks are clear, the ultimate indicator – the yield curve has been signalling a recession for nearly a year but the labour market will be key and we are seeing softening but its slow.

Ford has just been awarded a $9.2bn loan for the construction of three battery factories. Ford plans to make as many as 2 million Electric Vehicles (EV) by 2026, a huge increase from the roughly 132,000 it produced last year. China has an iron grip over the world's battery supply chain with 80% of lithium battery capacity located in China today. The bipartisan support on countering China far outweighs the 'debate' over clean energy. We wrote more about this area in a LinkedIn post but the $2.4trn 10yr spending plan is seeing a resurgence of US manufacturers capex. Interestingly Ford expects to lose $3bn on its EV business this year but aims for a 8% margin by the end of 2026. Similar is happening in Canada with VW and Stellantis NV.


The New York Times

*After Extra Large Rate Increase, Bank of England's Critics Multiply*

Pressure is building in Britain for the bank's governor, Andrew Bailey, to show that policymakers have a handle on the inflation problem.

Give this article

Over the month central bank tightening continued with the Fed, ECB, SNB, BOE and the Norges Bank hiking rates. In the case of the Brits and Norwegians the increases were double expectations.

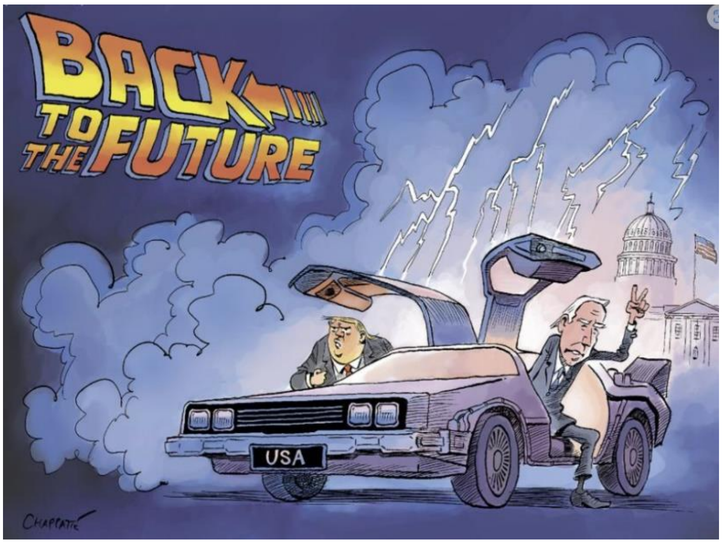
In the UK the Bank of England reacted to the latest inflation print of +8.7% yoy CPI and raised 50bps. **Another 100bps is already priced in which would take UK interest**

**rates to levels last seen in 2000**. Mortgage misery and food crisis headlines abound (along with the usual issues of Brexit, the NHS etc etc) most of which are overblown however the psychology matters here for consumers. **What this leaves is a lot of bad news priced into UK assets**. The FTSE sits on a P/E of 10.5 with a dividend yield of 4.2%. Investors can pick up the likes of Rio Tinto and HSBC with yields of 8.1% and 8.8% respectively and single digit P/Es. GBP is perhaps a different argument.

**Time will tell whether the BOE panicked.** Indeed, it's interesting that the EM countries are now cutting rates having begun their rate hike cycle over a year earlier than the West, who were caught napping with the return of inflation. The Fed paused this month but as the Australians and Canadians have shown that does not therefore mean another hike isn't possible at the next meeting (priced). Oil continues to help the inflation dynamic -15% ytd but that may change.

But Inflation remains. **Japan just printed the highest inflation for 42 years!** For every graph showing disinflation we can show the opposite. Even here in Switzerland where headline CPI is running at 2.2% yoy. On a visit this past weekend to his local Co-op the writer was concerned to see perhaps **Scotland's greatest export** – Lagavulin 16yr whisky had risen 48%!. Now clearly this increase is not enough to turn the writer to Irish whisky but price increases are happening to a range of products.

Elsewhere we had Christine Lagarde's claim that inflation was being caused by climate change (rather than the endless printing of trillions of Euros and Dollars by central banks!) We therefore thought it would be interesting to look at the ultimate persona non grata industry (albeit maybe not for the Germans last year). This is not investment advice and for what its worth we believe nuclear is the answer rather than panels and windmills. Interestingly although Sweden have just ditched their renewable energy goals 40 years after phasing out nuclear. **Irrespective coal exists** and Peabody Coal is a listed miner. So, for $21 per share you could buy the firm for circa $3bn. For that you buy $1.3bn in cash and earnings next year of $1.3bn and the year after (if prices are steady). Assets are at book value and if assuming nothing untoward happens from a policy viewpoint the return on investment is brisk to say the least. These assets are cheap.




**The 2024 Presidential election is going to be fascinating.** Political interest, it feels, is at rock bottom. Trump got in on promises to "drain the swamp". Brexit happened because people wanted change. There is a lot more change coming.

**The US have a history of electing newcomers**. Clinton and Obama were fringe players at best. Both Trump and George W Bush were not taken seriously on the campaign trail until it was too late. This could be another election where a dark horse enters the fray. Age is a clear issue, but both are now very much tainted by corruption claims. It could be that party politics becomes less important to "a breath of fresh air". With that thinking RKJ looks a very interesting bet made more interesting for the suppression of his interviews by Youtube an American company. **The White House are scared.**

Maybe Sir Winston Churchill was correct "The Americans always do the right thing, after they've exhausted all the alternatives"

Broadly we remain slightly underweight in equities. The full effect of interest rate hikes is only beginning to develop. Ultimately, we believe stocks are bottoming and are looking for opportunities to get bullish. Just as the questioning of where the recession is, the question ongoing is to why we hold bonds. The Fed have and are pushing interest rates higher at the fastest pace in 40 years, and this is the ultimate imprecise game. Inflation is in a near term disinflationary trend but what happens if oil turns? **Indeed, liquidity is returning** driven by China and Japan and we suspect a degree of **stealth QE** from the Fed. The question for the second half of year goes back to the comment earlier that a strong economy doesn't necessarily equal a strong equity market. Whether we have a recession or a soft landing and to what extent the global economy is interest rate sensitive remain important questions. **Perhaps most importantly however is to figure out to what extent global liquidity i.e. the pool of cash and credit sloshing around financial markets will be positive or negative. If there is money sloshing about the system, then asset prices are going up.**

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