STRATEGY OUTLOOK

December 2023

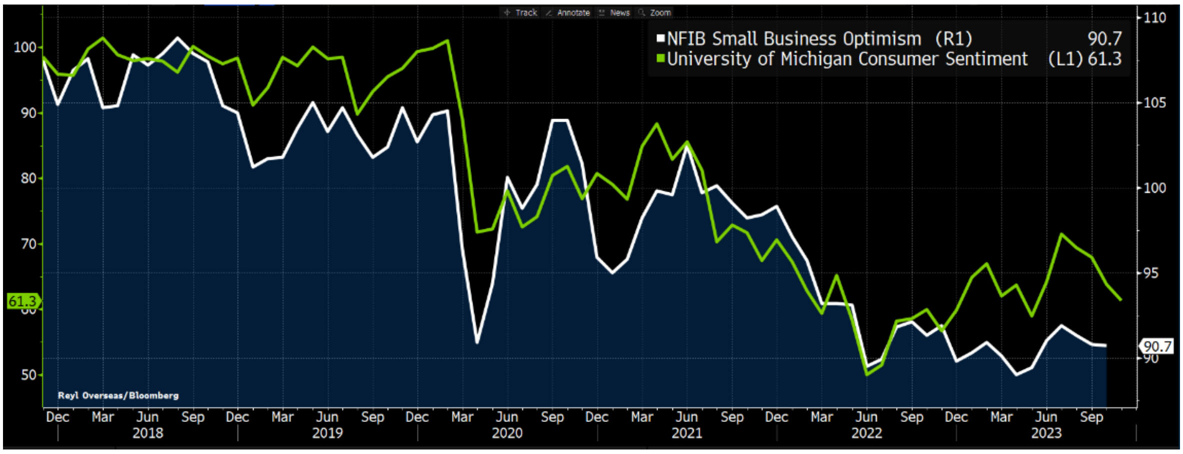
Key takeaways-

- 2024 – investors only expect a soft landing….which is rare
- The only constant is change – Politics since 2016.

It's been a long year, almost cathartic after the declines in 2022. We got a bit of everything, recession fears gave way to growth spurts, inflation threatened, geopolitics raised its head too many times and, overall, markets were positive led by anything AI related. Market outlooks are now being published by the big Banks looking out into 2024. The interest for many investors is to see if 2024 forecasts finally support their current positioning, it's been a long year waiting for a recession that never happened. Indeed, the latest Bank of America survey shows the largest overweight position in bonds since 2009.

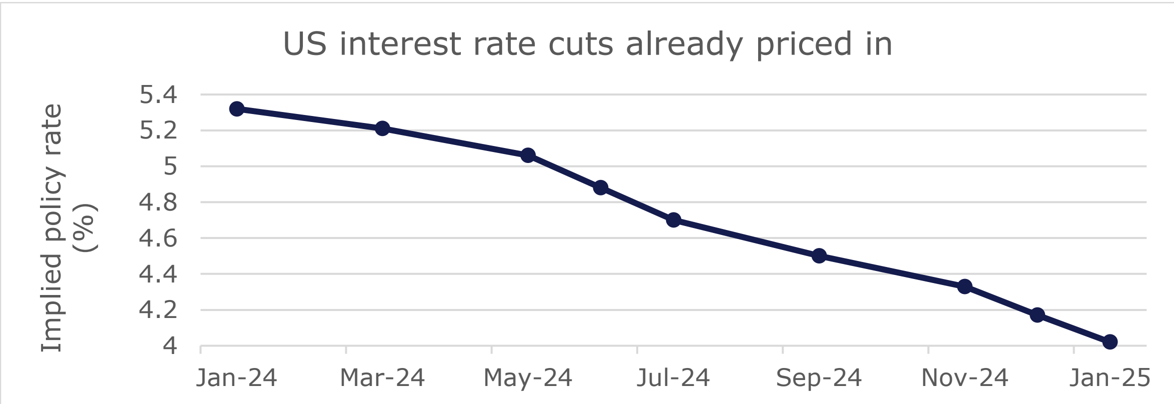
For next year the two key elements are the path of growth and the level of liquidity (provided by central banks). The most important for asset markets is liquidity. With the current stealth liquidity emanating from central banks and the prospect of elections we believe there isn't any apparent reason for turning off the liquidity taps. Economies are trickier. **A soft landing at least seems completely rational** as fiscal stimulus fades and tighter monetary policy slowly feeds into the system. However soft landings are rare, and the market has moved to price in 100bps of cuts next year (see third graph). **The big mistake this year was underestimating the power of fiscal stimulus**. This remains the upside risk. The graph below shows the exporting powerhouses of Germany and South Korea. S. Korean exports have picked up and are something to keep an eye on. To what extent the US performs relative to the rest of the world will be key for the USD. If that growth outperformance fades and inflation continues to slip, then the USD has downside. It doesn't appear that there is an easy asset of choice for next year. Bond supply is going one way and stocks have two years of 12% p.a. earnings growth priced in. Liquidity increases will see crypto, and technology continue to react first.

However, there are black clouds on the horizon. New home sales fell 18% yoy to a level not seen since the 1970s. Home purchase applications tumbled to a level not seen since 1995. Commercial delinquencies are increasing, small business optimism (see second graph) is nearing covid lows and forward indicators remain very sluggish. **A recession would accelerate the need for the Fed to start buying bonds** as the cost of servicing its debt exceeds tax receipts. The current US deficit is around 8% of GDP. Historically the last three recessions have seen that number increase by 6%, 8% and 12% of GDP. Foreign demand is waning. Indeed, for Japanese investors, historically one of the largest UST buyers, when you hedge out the currency risk the yield drops to -2% i.e., the cost of hedging the USD risk is around 5%. Indeed, **Japan is an area to watch**, if inflation holds their (vast) capital may move from bonds to risk assets. For the



US there is an Emerging Market style fiscal issue and is a support to our positions in Bitcoin, Gold etc. December 2024 Brent priced at $80 doesn't look bad value either.

Societal and political change are set to continue, a trend that probably began with Trump and Brexit back in 2016. There are more voters going to the polls globally next year than in the last 200 years. Current governments have no idea what the pulse is on the street. Push people too far and they need and want change. The cartoon on page three is an example of what just happened in Argentina and Holland. The Dutch Government were planning on seizing 3000 farms to meet 2030 climate goals, add in the societal issues of immigration and Geert Wilders found the pulse of the people (will Le Pen in France or Farage in the UK?). What is left and right-wing politics anymore? Many governments seem to be walking a line between an authoritative view of control at the same time as spending freely.



Central will be the US elections a year from now. As an outsider all we see are two elderly men who each have a love/hate relationship with around half of the electorate. **Both are under investigation for corruption.** The President's polls are collapsing with Trump/Haley/Kennedy outpacing on fundraising, ratings, and polls. Potentially dragging Biden down too is his VP. One poll had Harris on a net negative of -17, the lowest for a VP in the history of the poll. Newsom is being positioned for the role, but Democrat leaders seem to blankly assume the rest of the country are on board with California's policies.

Where is the silent majority just like we saw in 2016 and Brexit? Maybe the next President will be an independent and really upset the current setup. Ultimately the winner is only truly relevant depending on whether they also grab power in the other two branches. Political and societal change will only continue and echo's the book by Neil Howe on the Fourth Turning.

Other interesting news flow was from IBM. They are reopening their defined benefit pension scheme (currently the **fifth largest in the US**) but with a twist. IBM will issue long dated bonds to pension holders. There are a lot of unknowns in this. To what extent it becomes a new trend in the pension industry (negative for stocks) and to what extent IBM employees believe this is a good idea to tie themselves to the company even more.

The Fed will likely want to stay as politically inconspicuous by trying to prevent a recession in an election year. After that, **Liquidity really is key, and this is our strongest view that this will remain a strong support.** This then helps us be a little more ambivalent as to what growth trajectory we experience. We have sympathy for the view that a recession is imminent, but we also can see the validity of the argument that the market priced this in last year.

We remain cautious on bonds for the fiscal reasons we've outlined. Overweight positioning too is not attractive. In stocks we continue to hold exposure with as broad diversification as possible from AI to Latin America to Swiss stocks. Our goal remains to look to broaden and diversify away from the ebb and flow of stocks or bonds.

Despite the sheer fervent division of people e.g., on the streets of London over Gaza, geopolitics in markets is fading. Just look at the recent fall in Oil. US funding for Ukraine and Israel are successfully being used by candidates against the sitting President and so these two should fade from the narrative.

To us, we want to labour the point that **what is most important 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.**

If you've got this far in our pontifications hats off but more importantly, we wish you a Happy Christmas and New Year!

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