STRATEGY OUTLOOK

July 2024

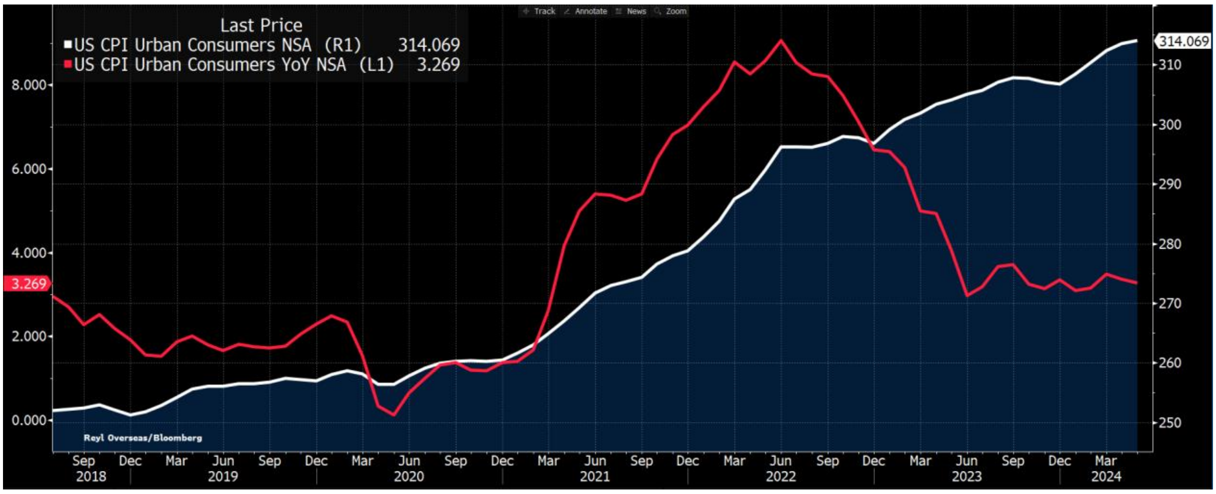
Key takeaways-

- Cost of living increases are what matters at the ballot box.
- Economies have changed since 2019.

The first half of 2024 is now consigned to the history books where we saw the S&P up 14.5% in its best first half performance in an election year. Looking forward we now have a slew of elections and narratives to wade through.

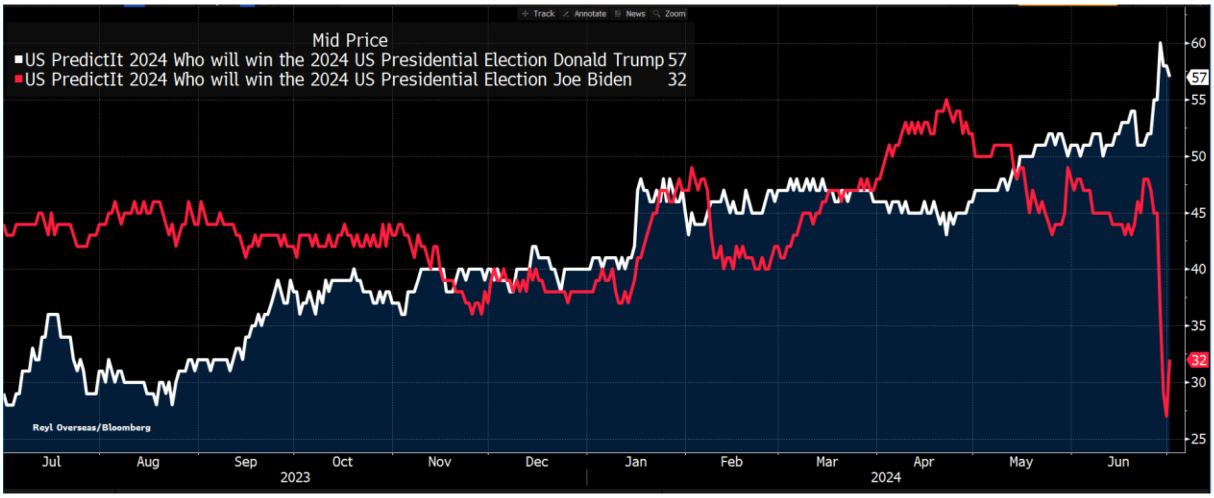
Making this slightly palatable is, here in Europe, we have a feast of sport to enjoy. This also helps make up for the so-called summer weather which seems to be, so far, best described as very 'British' in nature.

Our very brief takeaway remains that we are still dealing with the aftermath of 2019-2021 and the so-called pandemic. **Cost of living increases have been brutal**, and voters will blame the incumbents. Additionally, economies have changed which is adding to the lack of transparency in their trajectories.



The first graph highlights the rise in inflation. Economists care about year-on-year data (the red line) whereas consumers and hence voters are focussed on the white line. **Under Biden the cost of living has risen circa 25%.** Add in the result of the Presidential debate (51m viewers and most watched event in CNN history) and Biden, as incumbent, looks destined to take the fall. It is going to be an incumbent vote against rather than a pro-Trump vote that wins. Questions remain as to why Biden was placed in that position and why the debate was so early in the election year (normally held September) however the **damage is done**. With the Democratic Convention at the end of July change, given the state of the polls (second graph), looks a firm bet.

Current political change is a structural driver that may have begun in 2016 and in Europe earlier. France is witnessing change with the National Party led by Marine Le Pen currently leading in the snap parliamentary elections. Same in Germany, Austria, Spain, or Holland. **War mongering, cost of living crisis (exasperated by energy costs) and immigration are key issues**. The Euro currency is already down 12% in the last 3 years.



For markets, elections are just another short-term narrative without any significant new fiscal packages. The possibility of yet more spending is probably what markets fear the most. **The US has a spending problem**. For an economy not in recession and not fighting an old-fashioned war a deficit of 7% of GDP **is more Emerging market than Developed market** let alone, effective, lender of last resort (thanks to the USD). The historian Niall Ferguson has a thought-provoking view in his article "We're All Soviets Now" if you would like to read more.

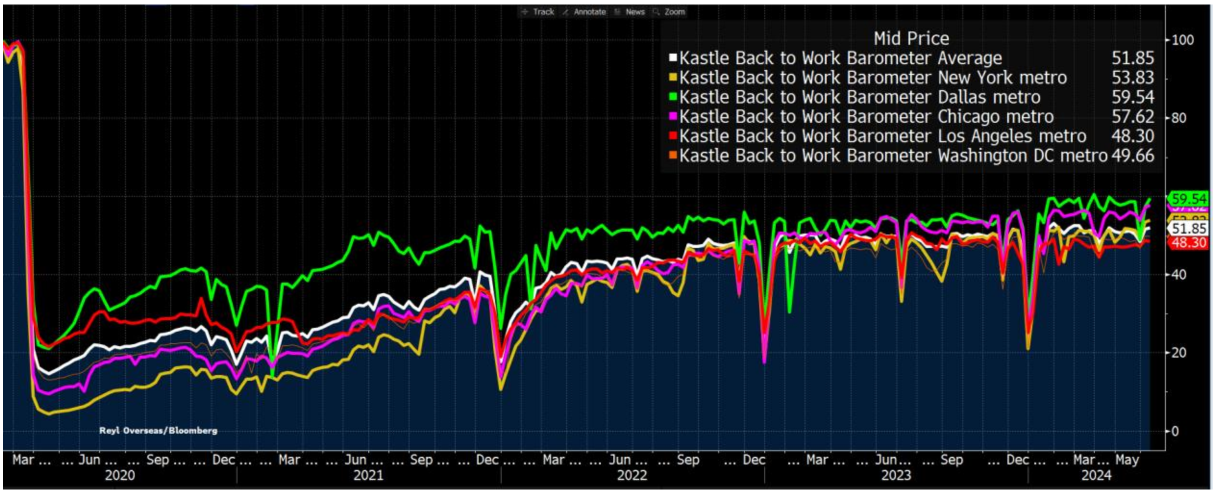
The Congressional Budget office just released its latest estimates which show the US deficit never going below 6% of GDP between now and 2034 and includes 175-200bps of Fed rate cuts, no recessions for the next 10 years (!) and unemployment never going above 4.5% (!). But the US still have the mighty Dollar and are trying to keep its power.

"They're sitting on $10-12 trillion of critical minerals in Ukraine…. I don't want to give that money and those assets to Putin to share with China" Senator Lindsey Graham.

Control of natural resources and trying to prevent the de-dollarisation of global commodity markets seems to be the aim. Bond holders beware.

To a certain extent stocks cannot ever go permanently down. If they did the deficit would blow out which would trigger higher bond yields, volatility, lower tax take, increased international selling of US assets in a perpetuating cycle. **In that environment gold is not the relic many believe it is.**

Economies are in an era of stagflation. Markets are in an era of an AI revolution and ample liquidity. **The two can remain distinct.** The economy continues to confound sceptics. June saw the busiest day of air travel ever in the US, a key discretionary consumable. House prices are up 5.8% yoy despite the Fed's hiking cycle and unemployment remains under 4%. Globally over 60% of countries have manufacturing PMIs above 50 (i.e., expansion) and other forward-looking indicators are strong. **Corporate retrenchment is typically what drives recessions**. However, margins are healthy, profits trend up, corporate debt low and cash is growing at 12% annually. Government fiscals spend is a significant support too as although air traffic has strongly rebounded another cohort of consumers are under pressure evidenced by rising delinquencies in credit cards, autos etc.



This last graph is to help argue how the structure of economies has changed. Work from home is at 26% from less than 5% in 2019. The graph shows, per metro area, the percentage of workers using their badge via the Kastle security system to gain access to their offices with the national average at 53%. This is supported by mobile phone data and by the Federal Transportation data. Comparing economies to pre-2019 and **hence analysing where we are in the cycle today looks to be even more of an inexact science.**

Portfolios remain fully invested with a preference for **assets that are more finite in supply.**

In June we did remove exposure to Nvidia via an AI ETF given current valuations. These proceeds were recycled into Oil. We remain bullish into the election but, as discussed in previous monthlies, we are concerned that the 2-party race is disrupted by Robert Kennedy Junior. With the replacement of Biden that threat falls dependent on the Democratic party's candidate, but Harris/Newsom probably don't dramatically change the odds.

The path of inflation, July/August earnings season and the robustness of the economy will be the focus for markets into the summer. Liquidity remains key given the longer-term challenges/opportunities of sticky inflation, ageing populations, large public deficits, deglobalization, political polarization and massive technological and societal change. How these develop and affect markets remain significant unknowns.

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