REYL OVERSEAS

STRATEGY OUTLOOK

October 2024

Key takeaways-

- Bull markets climb a wall of worry.
- China have turned the monetary taps back on.

Markets are climbing a wall of worry. Recession fears, yield curve inversion, tech sector overvaluation, geopolitics etc have all combined to create, perhaps, undue, worry among investors. Indeed, up to the Fed's 50bps rate cut in September investors were paid handsomely in money market accounts to stay somewhat sceptical.

Last month we highlighted the positives from **lower oil, dollar, and bond yields**. These remain and have now been joined by Chinese liquidity. As well as cutting domestic interest rates the Chinese have injected money into their system. As the graph highlights this has propelled Chinese stocks higher albeit in the context of a 3-year-old bear market. **Irrespective global liquidity remains positive to date and gives ongoing support to risk assets.**

The economic data is slowly improving and, at least in the short term, inflation pressures are easing. US rail traffic is strong as are shipping container traffic through e.g. the Port of Long Beach. Exports from the Far East support the picture too. There are always areas of weakness and fragility however we believe the picture remains robust. The Fed therefore probably eased interest rates 0.5% more due to fiscal worries than any other macroeconomic factor. Interest expense for the US Treasury is simply not sustainable. **The Government are spending $1.39 for every $1 it collects in revenue.**

Therefore, reducing interest rates helps reduce bond yields, juices receipts and helps weaken the Dollar. Higher inflation, we think, is downgraded in importance to paying and sustaining the debt markets. Just to labour the point in August the federal government took in $307bn in revenues against $688bn of outlays for a single month deficit of $381bn**. If this wasn't bad enough, this is in a part of the cycle where employment is near full employment.**

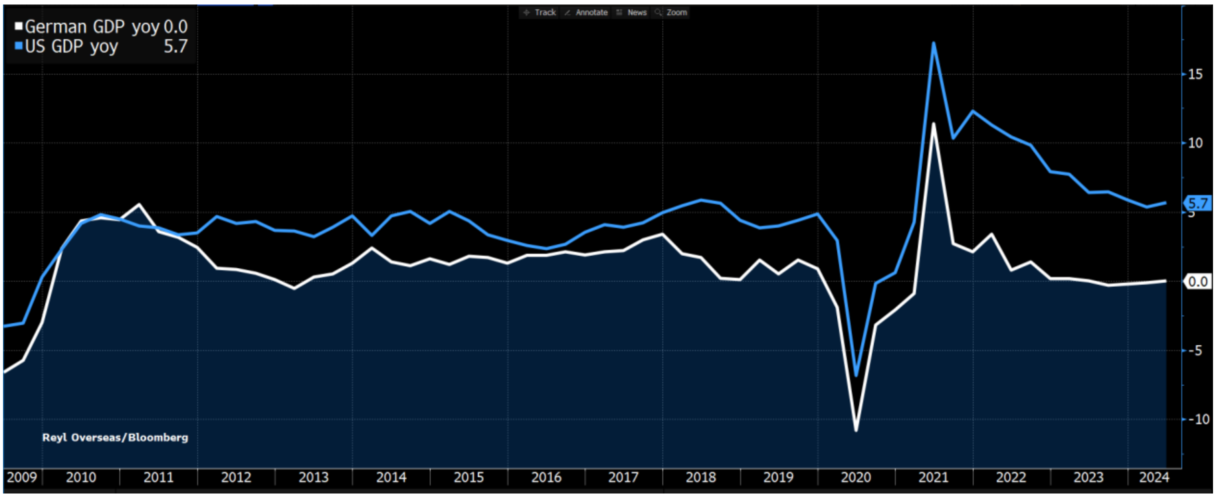
That's why Gold is rallying – it has limited supply and is vastly under owned by institutions and individuals. Perhaps some political uncertainty is also being priced in.

If it's possible to forget any political allegiances for a minute, which is clearly easier for a non-American to do, then it's quite amazing what has been thrown at one Presidential candidate. Impeached twice, 6 court cases, $2t in deficit spending and two assassination attempts. As a Brit/Scot I must be careful as UK politics and credibility is far from where it once was.

The polls tell us nothing. This election is the first in 30 years when the Boomer generation are no longer the majority voting bloc, November sees the 65m Gen Z and Millennial generation outnumber the 50m Boomers. The risk may be that **voter turnout weakens**. Out with a result whereby a clear winner isn't announced then markets probably keep going on their merry way and move onto the next event.

Following on from comments from Oracle's Larry Ellison last month Microsoft announced a significant deal with Constellation Energy Corp. Microsoft has agreed to purchase 20 years' worth of power for its data operations in one of the largest power deals ever. This will include the reopening of **Three Mile Island nuclear reactor**. This trend has a long way to play out given the needs of data centres, reshoring and the infrastructure required. This is an area where portfolios have exposure to.

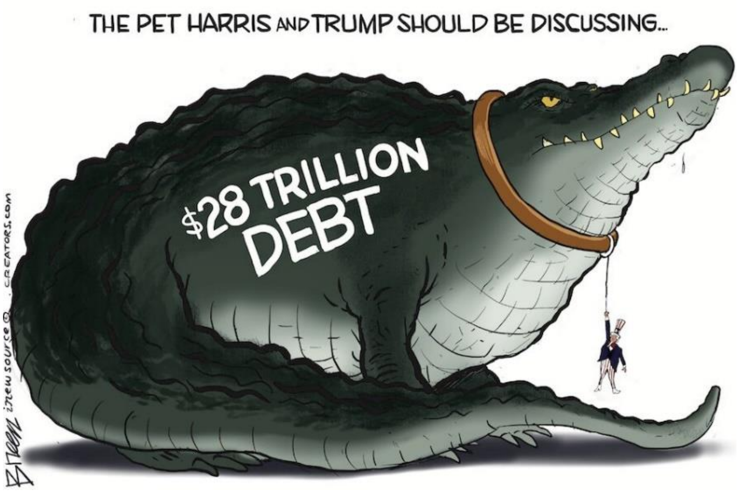
New car registrations in Europe fell 18% yoy, the largest fall since 2022. Electric car sales fell 43.9% for the 4th consecutive decline. VW are considering unprecedented **factory closures** as EV sales are down 68% in Germany and demand elsewhere isn't much better. Not surprisingly Mercedes & VW cut their full year profit forecast for the 2nd time in less than 2 months with sales volume in China blamed. Stellantis too has been hit by slowing demand and a lack of return from re-tooling to EVs. Job losses and inventory purging are very likely.



The eurozone has scarcely grown for 7 quarters, Germany has seen no accumulated growth since 2018 (as per chart) and both it and Italy are tightening their belts. Giorgia Meloni, Italy's PM put it well **"America innovates, China replicates and Europe regulates".** Indeed, Meta is not releasing its multi model Llama 3 AI model for video, audio and images in the EU and has suspended its AI assistant stating restrictions on the training of models is unworkable. Apple Intelligence too. Europe faces a stark choice which Mario Draghi stated as "With the world on the cusp of an AI revolution, Europe cannot afford to remain in 'middle technologies and industries' of the previous century ". Economically and politically the EU faces a significant number of challenges.

We appear to be in a **sweet spot of growing earnings, easing financial conditions, a growing economy (albeit slowing), significant government spending all of**

which are helping the merry go round of capex, dividends, and buybacks. The breadth of the rally is also broadening from a select few stocks, but valuations are clearly not cheap. It feels like we are closer to the end of the cycle than the beginning exactly where markets keep climbing despite the worry. This remains true in an election year and as authorities increasingly kick the can down the road on a fiscal outlook that looks far more emerging market than developed market. The rating agencies probably won't blink but most asset markets relative to bonds have.



Portfolios remain fully invested with a preference for **assets that are more finite in supply.** We added exposure to Small Caps and Solana over the month.

Improving financial conditions will take time to seep into the system however we see more upside to the economic data than downside from here. How markets price in political uncertainty closer to November will be interesting. The Fed will be fully aware and will seek to keep liquidity ample and markets functioning. **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.

"Democracy must fall because it will try to tailor to everyone. The poor will want the wealth of the rich, and democracy will give it to them. Young people will want to be respected as elderly, and democracy will give it to them. Women will want to be like men and democracy will give it to them. Foreigners will want the rights of the natives, and democracy will give it to them. Thieves and fraudsters will want important government functions, and democracy will give it to them. And at that time when thieves and fraudsters finally democratically take authority because criminals and evil doers want power, there will be worse dictatorship than in the time of any monarchy or oligarchy" Socrates.

J. Loudoun

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