Alpha Beta
PARTNERS

INVESTMENT UPDATE

JULY 2024

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A confluence of the business and debt refinancing cycles and some subtle electioneering from the US Treasury in the form of fiscal QE gave rise to further progress at portfolio level and for risk assets in general during June. Valuations in America particularly, pushed higher again. Some important detail resides beneath the surface, which we will investigate in customary fashion in the update that follows.

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The US Presidential election campaign kicked off earlier than usual with a TV debate gauntlet laid down by President Biden to his main contender, Donald Trump. The performance differences were marked and assuming voter reactions are carried forward to the ballot box, we can anticipate President Trump's return in January 2025.

Could Mr Biden be replaced as Democrat leader during the August convention? Both contenders, Messrs Biden and Trump plan to spend around $6 trillion, albeit in different ways, but the deficit implications are not radically different. The good news of course is that US equities continue their march upwards and added lustre to portfolios again in June. Valuations are high and progress is dominated by larger firms with the current stock market darling Nvidia's market capitalisation valued higher than all UK stocks combined. A slip in earnings progress could bring prices sharply lower. However, the VIX volatility index for equities remains low and stable, a good sign.

The main economic drivers persist in good shape with PCE inflation falling in line with expectation; close now to the Federal Reserve's 2% target. The market anticipates 2 interest rate cuts this year, which may well be reduced to a single cut if the economic barometer remains set fair. We have identified some early weakness in the labour market, and continue to monitor developments. Should weakness develop here the likely reaction of the Federal Reserve would be to cut rates more quickly, although Treasury yields of around 4.2% for the 10-year suggest nothing radical. Likewise, the business cycle in America, denoted by the Institute of Supply Management study is enjoying an expansion.

The table shows US rate cut probabilities, courtesy of CME FedWatch 1st July 2024.

	CME FEDWATCH TOOL - CONDITIONAL MEETING PROBABILITIES								
MEETING DATE	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550
7/31/2024				0.0%	0.0%	0.0%	0.0%	8.8%	91.2%
9/18/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	5.4%	59.9%	34.7%
11/7/2024	0.0%	0.0%	0.0%	0.0%	0.0%	1.9%	24.2%	51.2%	22.7%
12/18/2024	0.0%	0.0%	0.0%	0.0%	1.4%	18.5%	44.3%	30.0%	5.8%
1/29/2025	0.0%	0.0%	0.0%	0.8%	10.7%	32.5%	36.5%	16.9%	2.7%
3/19/2025	0.0%	0.0%	0.5%	6.8%	23.9%	34.9%	24.6%	8.3%	1.1%
4/30/2025	0.0%	0.2%	3.0%	13.7%	28.3%	30.8%	18.0%	5.4%	0.6%
6/18/2025	0.1%	1.8%	9.1%	22.0%	29.7%	23.5%	10.8%	2.7%	0.3%
7/30/2025	0.7%	4.3%	13.5%	24.6%	27.6%	19.2%	8.0%	1.9%	0.2%

Source: CME FedWatch

The refinancing cycle for trillions of dollars of debt is supported by liquidity pumped into the system to prevent seizures and issues with collateral. Liquidity's side effect is supporting the value of risk assets. Mrs Janet Yellen, Chief Secretary to the Treasury, is adding further liquidity in the form on Treasury Bills and spending from the Treasury General Account, whilst tapering back Quantitative Tightening by $25 billion per month adds further support.

Share ownership is broad in America, so higher values deliver a wealth effect and may help the Democratic cause come the November elections. We expect ongoing liquidity support during 2024. The US dollar remains robust against other currencies.

In China, the troublesome debt mountain resulting from over-capacity in the property sector weighs heavy on the People's Bank of China, which is beginning to deliver support and potential bail outs. The currency has seen a subtle devaluation, as we forecast, to support the export drive of green technology and battery electric cars to westerns markets. Super attractive prices will help China's cause but headwinds in the form of aggressive tariffs, notably in America and less so in Europe, will slow progress.

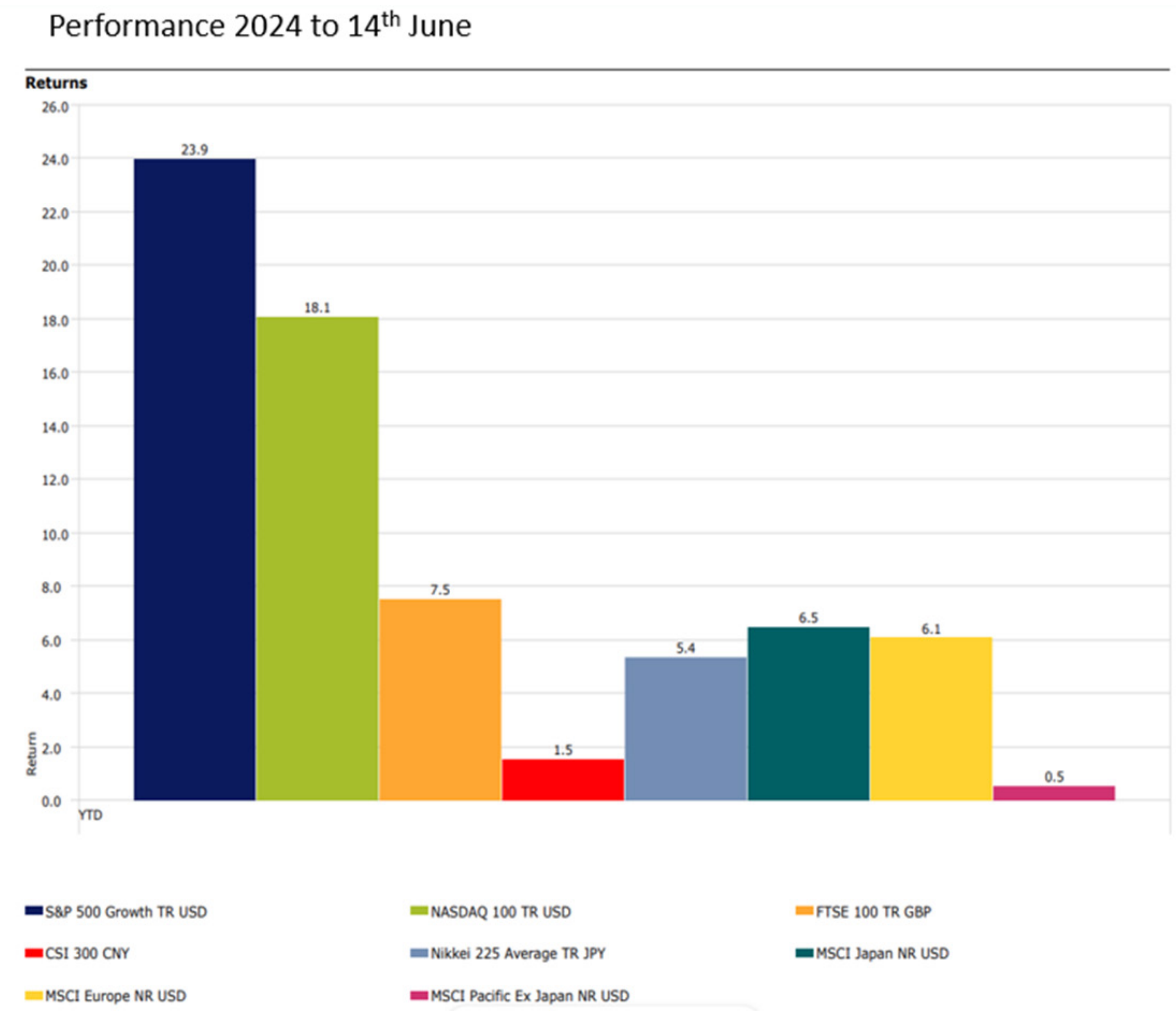
We note China has halted her purchase programme for copper, the essential ingredient in modern products. China has developed a healthy reserve supply of the metal considered to be a leading indicator in economic expansion. Another interesting observation is that China has halted her purchase programme for gold in recent weeks; gold being a notable store of real value over time and may have been hoarded to protect against the weaker currency.

Japanese equity performance remains attractive, although an ongoing weaker currency will need to be addressed by the Bank of Japan before too long as it makes servicing of foreign debt more expensive. Certainly, a weaker currency has stimulated exports, but multi-year lows for the yen will likely be combated by the Bank of Japan by selling dollars and / or potentially higher domestic interest rates. We note the creation of a currency czar to address the issues of a fixed exchange rate, free capital movements and independent monetary policy.

Elections across Europe show the return of populist parties following waves of migration and hikes in the cost of living. The euro has traded weaker and stock markets have demonstrated some volatility. Many of Europe's larger companies are well insulated against local factors, although the German automotive industry has clearly been buffered by reduced Chinese demand and acute price-led competition. Christine Lagarde at the European Central Bank cut rates by 0.25% during June in a notable decision ahead of the Federal Reserve this cycle. Sweden cut her rates and Switzerland (notable for stability and measure) cut her rates twice to provoke growth. The Purchasing Managers Index for Europe pointed to a positive uptick, which is clearly good news.

At home in the UK, Consumer Prices Inflation fell back to 2% target which is pleasing indeed, although core underlying inflation remains stubborn and wage settlements, particularly in the services and public sector remain elevated. Hugh Pill and Governor Bailey at the Bank of England will likely keep interest rates on hold until autumn, attempting to correct the inflation picture before joining other developed markets in a new rate cutting cycle. The UK economy would certainly benefit from lower interest rates. The forthcoming General Election appears to herald a change of government, although from our side of the desk the changes so far set out do not appear to veer away from a balanced budget; although the tax and spending journey by which we arrive at the balanced budget will clearly vary by resident of number 11 Downing Street.

The chart shows performance for major equity markets to 14th June 2024 in GBP.



Source: Morningstar Direct

Portfolios have enjoyed a decent half year with US equities the driving force behind growth. Our most recent portfolio changes during May are bearing fruit. Higher US weightings, overweight Japan, with Europe and UK adding nicely. Lower weightings in China and Asia Pacific (ex-Japan) and subtly shorter duration in the fixed income allocation. With lower rates due before year-end, we expect a contribution from appropriately positioned fixed income allocations later this year too.

As we head into the summer season, we wish readers a happy holiday in the knowledge portfolios remain well managed with anchored risk and decent returns under our belts for the half year. We would be pleased to field any questions you may have.

Written by the Alpha Beta Partners Investment Team.

All sources Bloomberg unless otherwise stated.

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The Defaqto Five Diamond Rating awarded on Alpha Beta's Core and Core Plus range

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