MONTHLY REVIEW – DECEMBER 2023

OUR PERSPECTIVE

Over the course of 2023 many investors misjudged the multiplier effects from fiscal policy and the benefits this brings from a liquidity perspective. The cherry on the cake was the long-awaited and much anticipated Fed-Pivot as the global economy benefitted from disinflation, robust labour markets, and continued upside surprises to consumption.

This month we ask, are the benefits from fiscal and monetary policy sustainable?

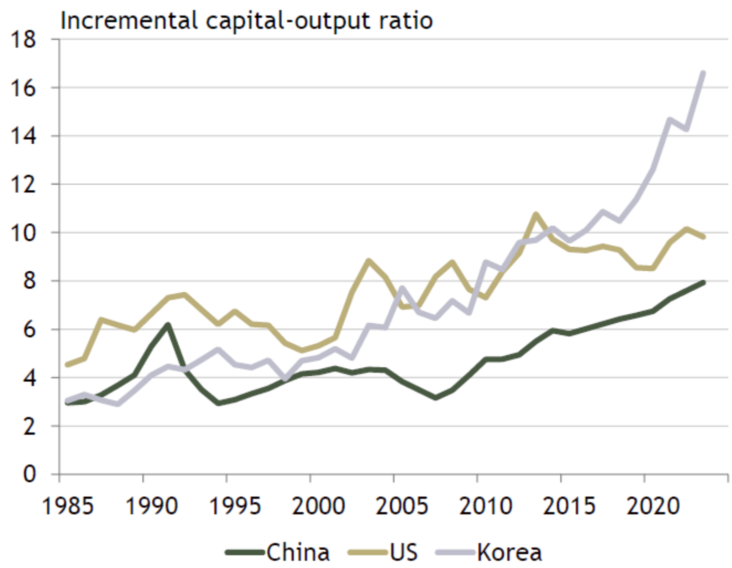
The benefit from monetary policy is really the marginal change in interest rates – or more specifically: the cost-of-capital – relative to the absolute level, and the resulting benefits this has on credit creation. However, one needs to also consider the incremental Capital-Output-Ratio which highlights the number of units of investment (think debt!) required to generate one unit of GDP growth. *Chart 1* highlights the level for the U.S, China and South Korea. The point is, an enormous amount of debt is needed and the cost of this debt is paramount. At prevailing market rates, further credit creation is problematic at all levels: corporate, government and household debt.

From a fiscal perspective, monetary policy has knock on effects given the amount of debt in the system, the cost of debt and already large deficits. An even bigger concern is Net National Saving. Net Saving (different from saving**s**) comprises three elements: private saving (from households and businesses), foreign saving (inverse of the current account), and government saving (the inverse of government spending). Adequate saving is essential for the sustained growth of a country's capital stock. It is crucial for budget deficits to be reduced during economic expansions so that when bad times hit, we are able to fight back. Typically, when a downturn occurs, private saving declines whilst government dissaving increases due to a surge in spending and a drop in tax collections.

Chart 2 highlights that Net National Saving in the US has gone negative only twice before in history, during the GFC and Covid. Both of these were driven by surges in government dissaving. The fact that we are already at negative levels today is a significant concern and will not only impair economic growth well after the Fed start to cut policy rates, but our ability to support a recovery.

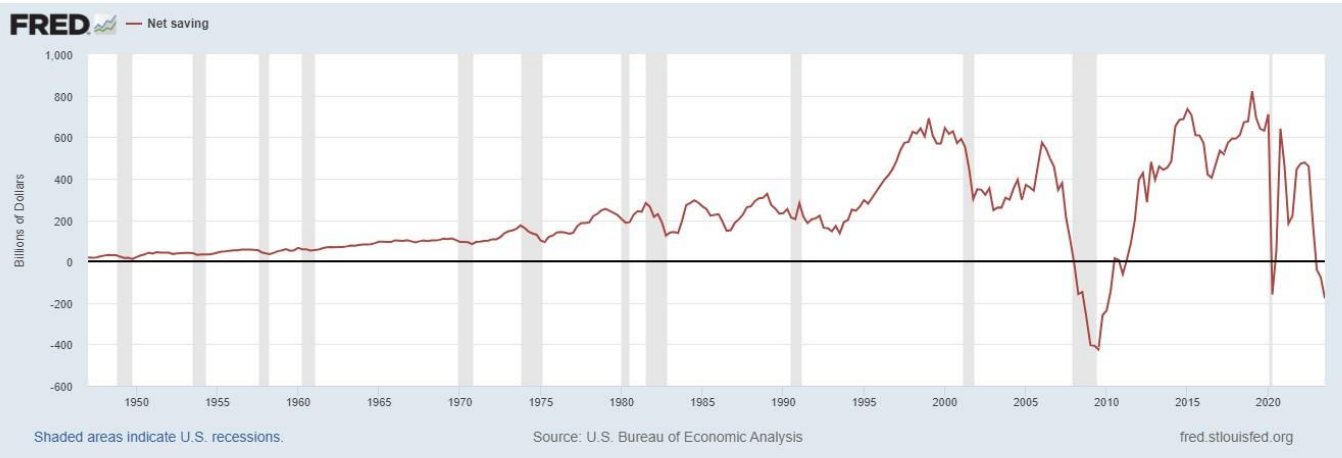
Tread cautiously!

Chart 1: The incremental Capital-Output-Ratio has been rising, and generating one unit of GDP growth now requires significant investment.



Source: Absolute Strategy Research / ASR Ltd., LSEG Datastream
Date: 28/11/2023

Chart 2: 'Saving for a rainy day' has been thrown away:



Source: fred.stlouisfed.org
Date: 30/09/2023

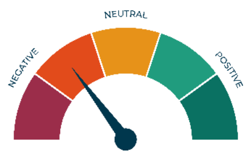
MARKET SNAPSHOT

	Index Series	FX	Last Price		Since:	31/12/2023	
					MTD	YTD	1 Year TR
EQUITIES	Bloomberg World Equity Index	USD			4.80%	22.24%	22.24%
	Bloomberg World Equity - Growth	USD			4.52%	27.14%	27.14%
	Bloomberg World Equity - Value	USD			5.21%	12.96%	12.96%
	Bloomberg UK Equity Index	USD			4.39%	13.57%	13.57%
	Bloomberg US Equity Index	USD			4.74%	26.91%	26.91%
	Bloomberg Europe ex-UK Equity Index	USD			5.21%	22.96%	22.96%
	Bloomberg Japan Equity Index	USD			4.36%	21.22%	21.22%
	Bloomberg Asia ex-Japan Equity Index	USD			3.10%	5.84%	5.84%
	Bloomberg China Equity Index	USD			-2.02%	-12.00%	-12.00%
	Bloomberg Emerging Market Equity Index	USD			3.63%	8.47%	8.47%
FIXED INCOME	Bloomberg Global Aggregate Index	USD			4.16%	5.72%	5.72%
	Bloomberg US Treasury Index	USD			3.37%	4.05%	4.05%
	Bloomberg US Corporate Bond Index	USD			4.34%	8.52%	8.52%
	Bloomberg UK Gilt Index	GBP			5.76%	3.56%	3.56%
	Bloomberg Sterling Corporate Bond Index	GBP			4.97%	9.79%	9.79%
	Bloomberg EM Hard Currency Aggregate Index	USD			4.20%	9.09%	9.09%
	Bloomberg EM Local Currency Govt Index	USD			2.54%	6.44%	6.44%
COMMODITIES	Gold Spot $/Oz	USD	$	2,075.26	2.26%	0.60%	13.77%
	LME Copper Spot ($)	USD	$	8,463.92	1.53%	1.19%	0.65%
	Oil - Brent ($)	USD	$	78.39	-0.62%	1.75%	-8.75%
	Bitcoin ($)	USD	$	45,556.51	15.10%	7.17%	171.96%
CURRENCIES	GBP-USD FX-Rate	USD	$	1.27	0.81%	0.03%	5.72%
	EUR-GBP FX-Rate	GBP	£	0.87	-0.96%	0.09%	2.22%
	USD-JPY FX-Rate	JPY	¥	141.50	4.04%	-0.33%	-7.56%
	EUR-USD FX-Rate	USD	$	1.10	1.79%	-0.08%	3.40%

Source: Bloomberg L.P., 31/12/2023

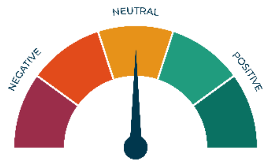
EQUITIES

Equity markets had a strong finish into year-end as the long-awaited Fed-pivot finally hit markets. We remain underweight equity markets due to the risk-reward outlook, specifically US equities which we believe are overvalued. We remain overweight Japanese equities but note the negative correlation between the Japanese equities and the Japanese Yen.



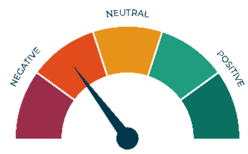
FIXED INCOME

The Fed-pivot and high real yields provided a catalyst for a continued rally in bond markets. We remain neutral, and specifically overweight the short-dated government bonds where yields look attractive, and risks limited. Credit spreads remain very tight and given the significant rise in interest rates and material refinancing risks, credit markets are not being priced accordingly and we remain underweight.



REAL ASSETS

Energy prices continue to fall as the market focus on oversupply in US Nat Gas markets alongside a global slowdown in demand. Gold continues to shine. Given the hedge it provides against monetary devaluation and event risk, alongside strong price momentum, we retain significant exposure and remain bullish on the shiny stuff.



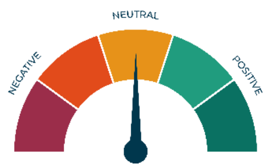
Listed Real Estate and Infrastructure markets rallied on the back of the Fed-pivot. As we mentioned previously, we continue to be wary, with specific concerns around commercial real estate markets given the differential between cap-rates and short-term government bond yields.

SPECIALIST STRATEGIES

Our specialist strategies continue to play a significant stabilising role within our portfolios. Our managed futures & trend following exposures had a difficult finish to 2023 as the swift change in sentiment and market rally generally caught positioning off-side. We retain significant conviction and a positive outlook for the specific strategies we own. Our market neutral and relative value hedge fund exposures had another good month despite low equity correlations. We retain limited exposure to private markets, both credit and equity, given our concerns regarding debt and the refinancing cycle.

CURRENCIES

We remain broadly neutral on currencies. On the margin we note that changes in interest rate expectations would support a weaker USD and likely to imbed recent trends. The US Dollar however remains the global reserve currency of choice, and in a severe market sell-off, we expect it to do well. We retain our positive view on the Japanese Yen, which we believe is undervalued with clear catalysts for a potential revaluation on the horizon.



CONTACT US

For further information on any of our services, or if you would like to arrange a meeting with an investment manager to see how we can work with you, please get in touch.

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