

MARKET PERSPECTIVES BY ALGERNON PERCY

LAST QUARTER RECAP

2.4%

The US stock market advances 2.4% (and more like 10% in sterling / euro terms as the dollar appreciates strongly against other currencies).

1998

Wall Street closes its second successive year up more than +20% for the first time since 1998.

10%

Approximate return on the US stock market for sterling- or euro-based investors.

France/Greece

France's borrowing cost exceeds Greece's for the first time.

1990

The yield spread between UK gilts and German bunds reaches its widest since 1990.

47.5%

Turkey cuts interest rates from 50% to 47.5%.

NVIDIA

Dow and Intel are replaced by NVIDIA and Sherwin Williams in the Dow Jones Industrial Average.

"It is time for the people to run the government, not the other way round."

JIMMY CARTER, ACCEPTANCE SPEECH AT THE DEMOCRATIC NATIONAL CONVENTION, 1976

THE OUTLOOK FOR INTEREST RATES

BOND YIELDS HAVE RISEN MARKEDLY.

Given that the economic and political prospects in the UK and the US have diverged so markedly in the last three months, it is perhaps surprising that 10-year gilt and US treasury yields have ended the year at almost identical levels – 4.56% and 4.57% respectively. Moreover, they have moved on a broadly similar path over the last three months (though treasury yields started the fourth quarter lower, at just 3.79%). It's rare that bonds should perform so badly at a time when central banks have been cutting overnight interest rates. The problem is that inflation has been edging up again (to 2.7% in the UK, and 2.6% in the US) and neither the incoming right-wing government in the US nor Labour in the UK show any signs of getting on top of their budget deficits – let alone reducing national debt. Accordingly, real yields look more attractive than they have done for many years. Unfortunately, politicians both sides of the pond are doing a good job showing why a much higher risk premium is warranted.

THE US DOLLAR HAS BEEN VERY STRONG.

Another notable feature of the last quarter has been the weakness of the pound against the US dollar: it has moved from \$1.34 on 30 September to \$1.25 on 31st December – a fall of 7%. It is tempting to attribute this as a sign of falling confidence in the UK government following Rachel Reeves' October budget, which was received poorly in just about all quarters, including financial markets. However, sterling has been stable against other major currencies – in fact, it is fractionally up versus the yen, Swiss franc and euro. So, the real story has been significant US dollar strength following Mr. Trump's election to the presidency. That is somewhat ironic given that one of Trump's stated aims is to bring down the value of the dollar relative to rival currencies which he believes are kept artificially low in order to fuel trade surpluses with the US – thinking of China in particular. There is a further contradiction in that his stated trade policy of imposing tariffs on imports is likely to increase the value of the dollar; no doubt the threat of this happening is already having an impact on the currency. The dollar is also doing well on the back of present economic fundamentals: the US economy continues to outperform other countries which, together with somewhat sticky inflation, means that the US Federal Reserve has been toning down its expectation of interest rate cuts in 2025.

CHINESE AND JAPANESE BOND MARKETS ARE GOING IN OPPOSITE DIRECTIONS.

Japan also has seen rising bond yields, with the 10-year closing at 1.09%. Whilst this sounds low, it is actually the highest level it has been at since 2011, and the trend is firmly upwards as Japan seems at long last to be leaving behind the era of deflation. However, China is another story altogether: bond yields in Shanghai have been trending down for years, and they've collapsed in the last quarter, ending at just 1.71%. This is a symptom of the apparent 'Japanification' of China as deflation in the property market has led to a wider economic malaise. Convergence of the Chinese and Japanese 10-year bond yield must surely be on the cards at some point in 2025 – the two countries' 30-year yields crossed over in November 2024 at 2.25%. Our bond funds remain short Japanese duration (though we are positive on the value of the yen), and we do not have exposure to Chinese debt given its extremely limited fundamental value at these levels.

GILTS ARE NOT DISCOUNTING THE LIKELY PACE OF INTEREST RATE CUTS.

We are, however, happy to retain gilt and treasury duration at these levels. Gilts especially look well underpinned given the high real yields available and the fact that a moribund economy will likely shift the Bank of England's focus away from inflation to the need for stimulus. At present the markets only discount 2 ½ quarter-point base rate cuts in the UK, versus 5 equivalent cuts in the Eurozone. This leaves scope for gilts to outperform.

JAPANESE VERSUS CHINESE 30-YEAR BOND YIELDS



Source: Bloomberg

THE OUTLOOK FOR EQUITIES

US EXCEPTIONALISM CONTINUES.

Whilst bonds in the US and the UK have been moving broadly in tandem, the same cannot be said of share prices. A Republican ‘clean sweep’ in the November elections led Wall St. to welcome with alacrity low taxes and deregulation – with the ‘magnificent seven’ (MAG7) leading the charge as elements of Silicon Valley, notably Elon Musk of Tesla, appeared to buy into the ‘MAGA’ philosophy. By contrast, in the UK the October budget seriously dented sentiment in the business community, with domestic sectors such as housebuilding bearing the brunt of price falls. So, once again, the story of Q4 2024 has been the outperformance of the US, led by mega-cap technology.

VALUATIONS IN THE US ARE EXTENDED...

Valuations do now look extended in New York relative to the rest of the world on a number of metrics, and the US now accounts for 66% of the world index – its highest ever weighting. However, this needs to be considered in the context of the consistently superior earnings growth which has been delivered over several years by the US stock market relative to other regions. Couple that with a much a more business- friendly government than in Europe or the UK, together with a long history of innovation, entrepreneurial management and the deepest capital market in the world and it would be a brave call to shun the US solely on valuation grounds. Moreover, as active managers we are not compelled to buy into the headline valuation of the market as a whole, but can pick and choose those sectors and stocks where we see greater long term upside for lower valuation risk. Areas we still like include financial services (e.g. American Express, Visa, Interactive Brokers) and industrials like GE Vernova, Hitachi and Siemens, which are benefitting from strong demand for more (and cleaner) power – driven in part by the huge increase in power consumption created by the growth of AI data centres around the world. Our portfolios do also have plenty of exposure to technology stocks, including some of the MAG7 (Microsoft, Alphabet and Amazon) – just not the 34% that an S&P 500 index fund has to those seven stocks. We prefer to have broader exposure encompassing companies which are currently less fashionable but nonetheless are performing well in generating free cash flow growth (e.g. IBM, Qualcomm, Intuit).

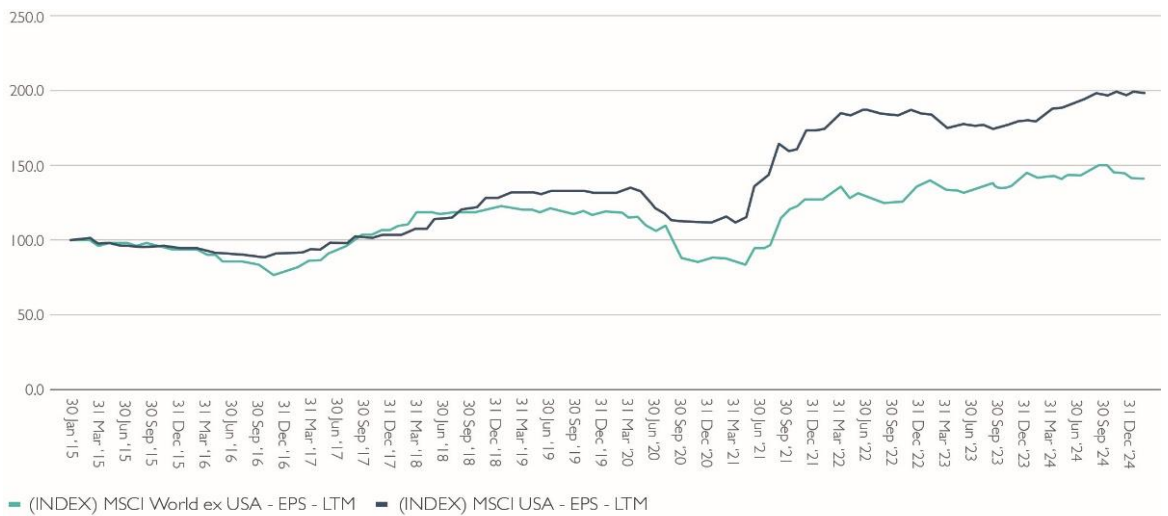
...AND WILL BE VULNERABLE IF BOND YIELDS RISE FURTHER.

A lot will depend on whether the incoming administration in Washington will live up to expectations, some of which for the moment seem to be contradictory (e.g. tariffs might push up inflation, the dollar and bond yields – none of which the new President wants – and cracking down too heavily on immigration would not be helpful to the economy either). Also, how effective Mr. Musk’s Department of Government Efficiency (DOGE) will be, and whether Mr. Trump challenges the independence of the Federal Reserve (as he has threatened to do) could have a material impact on interest rates and therefore asset prices: a positive surprise from DOGE would be well regarded by markets in the short term but could prove deflationary in the longer term; a negative surprise on Fed independence would be bad news for all sorts of reasons.

RUSSIA’S IMPORTANCE IS DIMINISHING AS THE US’S ECONOMIC INFLUENCE RISES.

Another important variable is the oil price. The Republican mantra, “Drill, baby, drill”, if it is followed through, would be positive for inflation and the economy, as would any resolution of hostilities in Ukraine or the Middle East. It is encouraging that the price of oil has hardly moved in response to the announcement at the end of December that Russia would no longer be able to supply gas to Eastern Europe through Ukraine. Even though Russia has yet to be militarily defeated, its capacity to hold the world to ransom economically is very much diminished since 2022. There could not be a greater contrast between Putin’s Russia and the United States of America.

US TRAILING EARNINGS VERSUS NON-US TRAILING EARNINGS



Source: Waverton / Factset / MSCI.

STERLING ADJUSTED

	3 MONTHS (%)	6 MONTHS (%)	9 MONTHS (%)	1 YEAR (%)
ICE BofA UK Gilt Index	-3.6	-1.2	-2.3	-4.1
ICE BofA Global Broad Market Index (Hedged)	-1.7	2.6	2.4	2.0
MSCI United Kingdom All Cap Index	-0.6	1.6	5.1	9.0
MSCI United Kingdom Index	-0.2	1.5	5.2	9.5
MSCI AC World Index	6.0	6.5	9.6	19.6
MSCI AC World (ex UK) Index	6.3	6.7	9.7	19.9
MSCI AC World (ex US) Index	-1.0	0.8	1.8	7.4
S&P Composite Index	9.7	9.5	14.1	27.3
MSCI Europe (ex UK) Index	-4.2	-4.2	-4.6	1.9
MSCI Japan	3.2	2.9	-1.1	10.2
MSCI AC Asia Pacific ex Japan Index	-1.6	2.5	9.1	12.1
MSCI Emerging Markets	-1.5	1.0	6.2	9.4
Growth Index	4.0	5.3	7.5	14.8
Balanced Index	2.8	4.7	6.3	12.1
Cautious Index	1.6	3.9	5.1	9.4
Defensive Index	0.6	3.3	4.1	7.2
Return on Cash £ (1 month deposit rate)	1.2	2.5	3.8	5.1
Inflation - UK CPI	0.7	0.7	1.6	2.2
Gold Price (£2087.19)	5.9	12.8	19.0	29.0
£ vs US\$	-6.6	-0.9	-0.9	-1.8
£ vs Euro	0.6	2.5	3.4	4.8
£ vs Yen	2.6	-3.2	3.0	9.5

US DOLLAR ADJUSTED	3 MONTHS (%)	6 MONTHS (%)	9 MONTHS (%)	1 YEAR (%)
ICE BofA US Treasury Index	-3.3	1.4	1.5	0.5
ICE BofA Global Broad Market Index (Hedged)	-1.6	2.8	2.7	2.4
MSCI United Kingdom All Cap Index	-7.2	0.7	4.2	7.1
MSCI United Kingdom Index	-6.8	0.6	4.3	7.5
MSCI AC World Index	-1.0	5.6	8.6	17.5
MSCI AC World (ex UK) Index	-0.8	5.7	8.8	17.8
MSCI AC World (ex US) Index	-7.6	-0.1	1.0	5.5
S&P Composite Index	2.4	8.4	13.1	25.0
MSCI Europe (ex UK) Index	-10.6	-5.1	-5.4	0.1
MSCI Japan	-3.6	1.9	-2.0	8.3
MSCI AC Asia Pacific ex Japan Index	-8.2	1.5	8.2	10.2
MSCI Emerging Markets	-8.0	0.0	5.3	7.5
Growth Index	-1.4	4.8	7.1	13.7
Balanced Index	-1.6	4.4	6.3	11.6
Cautious Index	-1.9	4.0	5.4	9.4
Defensive Index	-2.1	3.6	4.7	7.6
Return on Cash \$ (1 month deposit rate)	1.2	2.6	4.0	5.3
Inflation - US CPI	0.6	1.1	1.3	2.5
Gold Price (\$2614)	-1.1	11.7	18.0	26.8
US\$ vs £	7.1	0.9	0.9	1.8
US\$ vs Euro	7.8	3.5	4.3	6.7
US\$ vs Yen	9.9	-2.3	3.8	11.5

* All MSCI benchmarks are net of tax.
Source: Factset, RIMES

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