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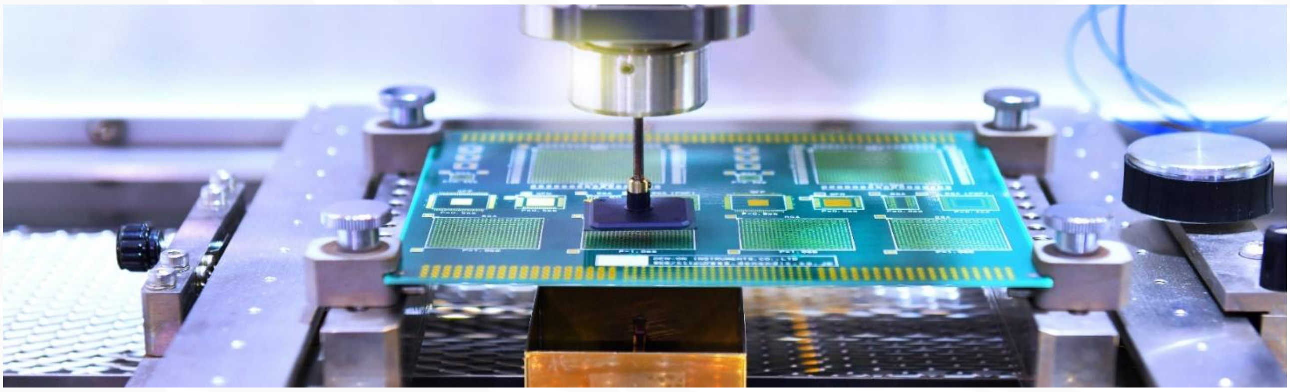
B Capital Commentary and Outlook Update 3Q2024



A Big Question. Is your portfolio ready for the global economic shift?

As we enter the second half of 2024, the investment landscape is undergoing a profound transformation. The era of high inflation and aggressive rate hikes appears to be winding down, replaced by a delicate balancing act as central banks navigate a "soft landing". This shift presents both opportunities and challenges for your portfolio.

You may be wondering: How can I position my investments to thrive in this evolving environment? Should I be adjusting my allocations to international markets? What about the ongoing AI boom – is it too late to participate, or are there still opportunities?

These are exactly the questions we'll address in our 2024 Mid-Year Investment Outlook. We've analysed insights from leading global investment banks and economic institutions to provide you with a comprehensive view of what lies ahead. Our goal is to help you make informed decisions about your portfolio as we navigate this pivotal moment in the global economy. Further research resources are available on our website '**Outlook**' pages should you wish to download more information.

Let's dive into the key themes that will shape the investment landscape for the remainder of 2024 and beyond:

Macroeconomic Outlook: Soft Landing Taking Hold Globally

The good news is that recession fears are fading across major economies. In the U.S., we expect GDP growth of around 2.5% in the second quarter, surpassing the Federal Reserve's long-term estimates. Europe is also showing resilience, with the IMF projecting growth of 0.8% for advanced economies and a more robust 2.9% for emerging European markets in 2024. Meanwhile, China's economy is forecast to expand by 4.6% as it continues its post-pandemic recovery and as we suggested, India continues to lead the GDP pack with growth near 7% this year, moderating slightly in 2025.

What does this mean for portfolio allocations? A soft landing scenario could provide a supportive backdrop for risk assets, potentially benefiting your equity holdings across various regions. More on equities valuations and regional allocations later.

Interest Rates and Cash: The Turning Point

The long-awaited pivot in monetary policy is finally on the horizon. We predicted that rate cuts would begin with the European Central Bank in June, followed by the Bank of England in August and the Federal Reserve in September. The ECB's deposit rate stands at 3.75% and markets are betting on about 40 basis points of cuts over the rest of the year, or between one and two moves, and also see a total of four cuts in the next 18 months. This gradual easing cycle could have significant implications for fixed-income investments and overall portfolio strategy. Since the end of 2023 we have counselled that shorter dated fixed income is extended to 4-5 years to lock in the higher yield environment and this will prove a wise choice for bond holders as yields start to drop towards the end of 2024. The allure of cash deposits will fade as we head into 2025 and the bond markets will shine again.

Inflation: The Slow March Downward

While inflation is expected to continue moderating, it's important to note that the pace of decline is slowing. In the U.S., we forecast CPI to reach 2.9% by year-end, with the Fed's preferred measure hitting its 2% target only by mid-2025. Europe faces a similar trajectory, possibly seeing inflationary falling a bit faster but with bumpy readings month by month. This 'higher for longer' but eventual decline suggests that inflation protection should remain a consideration in any investment approach, and by this we mean maintaining equity allocations and a smaller position in commodities or precious metals.

Equities: Maintaining Our U.S. Conviction

While many analysts initially predicted earnings growth below 8% for U.S. equities in 2024, we've maintained a more bullish stance. Our forecast of 10% growth is now being adopted as the rough consensus figure, underscoring the resilience and dynamism of the U.S. economy. Despite seemingly elevated valuations, with the S&P 500's forward P/E ratio at approximately 20x, we believe this premium is justified given the strong earnings outlook and the transformative potential of AI.

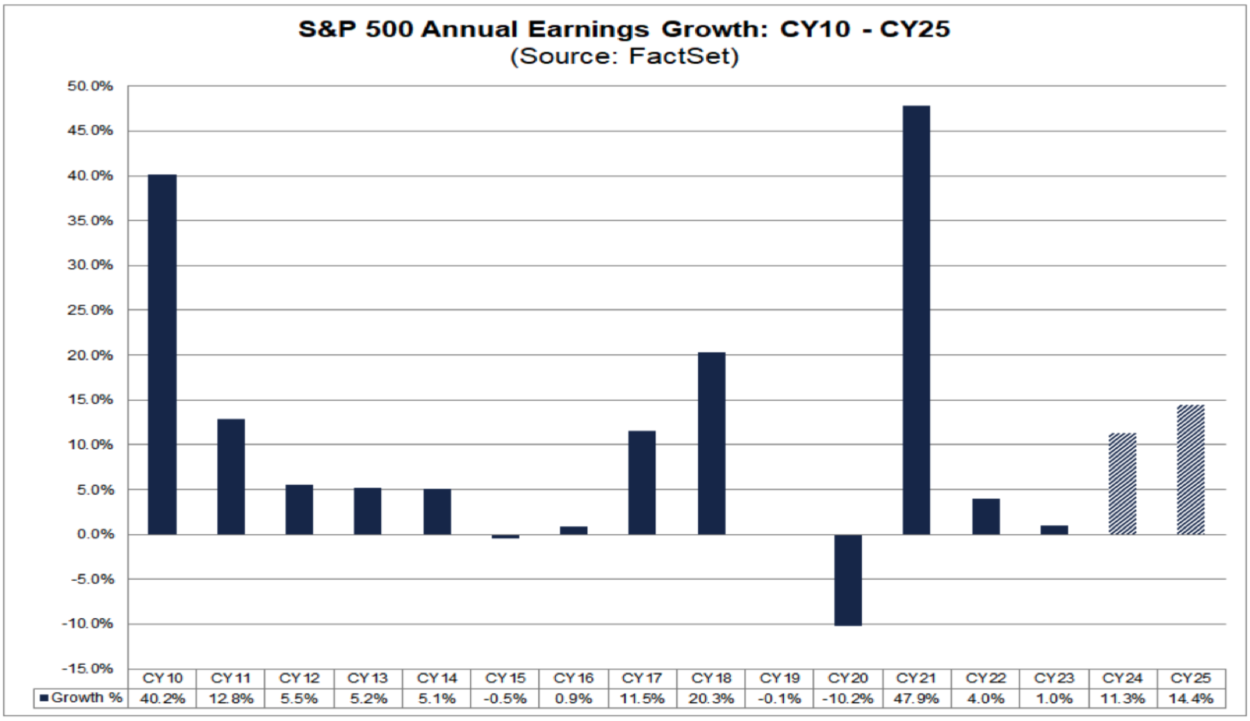


Fig 1 - S&P Earnings Growth, Historic & Projections 2024 - 2025
***Source - Factset**

Although some investment banks are highlighting the discount applied to European equities as an attractive opportunity, we take a more cautious view. The slower growth rate in Europe, combined with disjointed economic policies and ongoing political uncertainty, leads us to maintain our preference for U.S. equities. Our longstanding overweight to U.S. equities has provided risk-adjusted outperformance for several years, and we see this trend continuing.

We're particularly bullish about the contribution of AI to earnings, which we believe will support the Nasdaq and tech-exposed indexes such as the S&P 500. Our own "Big Tech" (Dirty Dozen?) strategy, which we recommend as a satellite portfolio, has delivered exceptional returns, up +32% year-to-date following a +72% gain in 2023. We still recommend this as a valid complementary strategy to follow.

Our international exposure is carefully calibrated through a combination of MSCI All World, MSCI World, MSCI EM, and S&P 500/Nasdaq 100 allocations. This approach has delivered strong returns at the mid-year point of 2024, balancing global diversification with our conviction in U.S. market leadership.

The AI Revolution: Driving Growth

The artificial intelligence boom continues to captivate investors, and - with the risk of sounding repetitive - we believe it will be a significant driver of earnings growth, particularly in the U.S. tech sector. Our "Big Tech" strategy focuses on companies at the forefront of AI innovation and has delivered outstanding results.

Our Market Outlook letters in 2023 and this year have highlighted the AI revolution in its nascent period and we are convinced of the unstoppable trend here. More coverage on this can be found in our specific thematic recommendations about the opportunity in this field, and above all we think it's not too late.

Key Risks to Watch

While our overall outlook is constructive, it's important to be aware of potential risks:

1. Geopolitical tensions and elections, particularly the U.S. presidential race. Israel/Palestine and Russia/Ukraine to remain contained.
2. A potential resurgence in inflation, if supply chains become damaged, such as closure of trade passages due to geopolitics.
3. Localised corrections in AI-related stocks, which is more of a 'when' rather than an 'if', and in our view an entry point for investors.
4. Stress in certain credit market segments, specifically challenged real estate sectors and China's patchy recovery.
5. Ongoing economic challenges in China causing a drag to global growth if mismanaged.

Summary

As we head into the second half of 2024, we remain optimistic that the global economy is in reasonable shape and will achieve growth at the rate we predicted at the start of the year. Equity allocations are therefore valid and are contributing successfully to portfolio returns, coupled with decent fixed income yields. We expect pockets of volatility to emerge in the more expensive sectors but overall growth will show through. Markets will not move in a straight line for sure, so it will be no surprise if there is a minor drawdown or simply a lull at some point, possibly in the late summer when growth drivers are often absent and trading volumes dissipate. This will not deter us from the long-term view we hold and the ultimate benefit of our positioning in our portfolios for capital growth.

Lorne Baring
Managing Director