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MARKET PERSPECTIVES
REVIEW & OUTLOOK

SECOND QUARTER 2024

SECOND QUARTER 2024 REVIEW & OUTLOOK

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SECOND QUARTER 2024 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

11 July 2024

PORTFOLIO THEMES

- Stronger than expected corporate earnings growth, easing inflation, and improving sentiment should support markets.
- While growth has led thus far in this market cycle, we remain watchful for a potential lasting shift to more cyclical categories, which typically lead in a better-than-expected economic environment.
- Offensive value categories, such as Energy, likely perform well while also providing diversification benefits.

MARKET OUTLOOK

- **A Resilient New Bull Market:** Young bull markets are stunningly hard to derail. Those that reach one year old almost always reach two.
- **Improved Sentiment:** While sentiment has perked amid improving economic conditions, we are still far from euphoria—providing ample room for upside surprise and big gains.
- **Politics is a Tailwind in 2024:** Since 1925, US equities ended positive in 83.3% of presidential election years. Globally, political uncertainty likely fades throughout the year further reducing investor anxiety.

Halfway through 2024, global equities are delivering the solid returns we forecasted. The MSCI ACWI Index's 2.9% Q2 return brings the first half's tally to 11.3%, led by Tech and Tech-like Communication Services equities.[i] Emerging Markets (EM) also added to its year-to-date performance, with the MSCI EM Index up 5.0% during the quarter.[ii] In our view, global equities' returns thus far amounts to a typical start for historically positive election years.

Headlines disagree. They see many equity markets already beating their long-term average annualised return and argue it is overdone. But as we have written before, average returns aren't normal. In bull markets, equities routinely skew to the extremes. Better still, 15 of 16 US election years with positive first halves saw second-half gains—7 of 8 when first-half returns surpassed 10%.[iii] We doubt this time differs.

i Source: FactSet, as of 01/07/2024. MSCI ACWI Index return with net dividends, 29/03/2024 – 28/06/2024 and 31/12/2023 – 29/06/2024. "Typical client equity portfolios" refers to our Global Total Return strategy with no client-mandated customisations.

ii Source: FactSet, as of 01/07/2024. MSCI Emerging Markets Index return with net dividends, 29/03/2024 – 28/06/2024.

iii Source: Global Financial Data, Inc., as of 26/06/2024. S&P 500 total return in election years with positive first halves, 1925 – 2023.

Before we go further, please note we favour no party nor any politician, assessing developments solely for potential market impacts. Today, the analysis of how former President Trump will match up with a new Democratic nominee is in full swing. We will show some of the potential scenarios in the full Review, but whether the Democratic candidate is Vice President Harris or another surprise nominee following the Democratic National Convention, the race very likely hinges on campaigning, grassroots efforts and turnout in six states. As this unfolds, uncertainty will fade.[iv]

Eventually we will have a winner, which usually warms sentiment regardless of personality or outcome. Investors, distracted by emotion and bias, forget this. But equities are party-blind and politically agnostic, focusing most on the likelihood of major legislative change. Hence, higher risk may loom in 2025 depending on the government structure the election delivers, but a strong 2024 finish should come first.

Meanwhile, economic drivers are still broadly positive. Inflation is receding—faster in Europe than in the US—while rising wages restore purchasing power and fuel consumer spending. After two years of cutting back to survive a recession that never came, corporations are gradually switching to offence. With flush balance sheets, renewed earnings growth, large gross margins and low default rates, many global companies appear ready and able to ramp up investment.

Strong household spending and rebounding investment render stunningly normal GDP growth, defying interest rate-obsessed doubters. The United States has led, but growth is resuming or accelerating across Europe, Canada and Australia. Japan is an outlier, but a growing world should still lift its multinationals.

The US's economic strength helped lift sentiment this year. Investors have shaken off early bull market pessimism and are warming toward optimism. Yet we are far from peak-inducing euphoria. Professional investors get attention for raising their forecasts, but they are simply chasing the rising market—lifting their year-end targets to wherever equities already rose. That implies meager expectations from here. Add in the lack of IPOs and the financial news world's overall fearful tilt, and there is ample room for moods to brighten.

Yes, headlines remain fearful. Some acknowledge US economic strength but warn it won't last unless the Fed cuts, though history shows that the Fed's timing is often poor. Most market coverage claims Tech giants mask the broader market's flaws. Never mind that breadth is increasing and this bull market thrives in places with little to no Tech. The rally is real, broad and global, benefitting our offensive positioning.

Post-election fears abound in the UK and France. In Britain, the Labour party's 4 July landslide win fueled speculation of a leftward economic policy shift. But the party's platform and new Prime Minister Keir Starmer are known quantities, in our opinion. As a result, associated policy speculation is likely already incorporated into share prices, creating big positive surprise power as investors realise Starmer's policies largely extend the outgoing Conservatives'.

As for France, after the National Rally's (NR's) strong showing in the first round, pundits warned the nationalist party could win a majority and force through windfall taxes and high public spending. Yet the 7 July runoff proved those warnings premature. Instead, the electoral pact between the leftist Nouveau Front Populaire (NFP) bloc and President Emmanuel Macron's centrist Ensemble Party carried the day. The NPF won 181 of the National Assembly's 577 seats, whilst Ensemble took 163 seats. Meanwhile, the NR won just 143. In our view, this contest largely extends the status quo. No party had a majority in France's legislature before the vote, and none has one now. Budget legislation and other key measures will continue requiring compromise. With political gridlock persisting, we think markets are likely to benefit from falling uncertainty.

iv We updated our commentary following President Biden's withdrawal from the US presidential race.

In EM, June saw the conclusion of Indian and Mexican elections, lowering political uncertainty and capping a busy 2024 of scheduled elections six months into the year. As expected, Prime Minister Narendra Modi won reelection in India. However, his Hindu nationalist Bharatiya Janata Party (BJP) and broader National Democratic Alliance (NDA) coalition won by far narrower margins than polls projected.

Indian equities initially dove on the BJP/NDA's underwhelming margin of victory—apparently on concern the narrower-than-expected edge eroded hopes for PM Modi to enact further pro-business reforms. But we think these hopes and the election disappointment were overrated. PM Modi wasn't campaigning on significant economic reforms, which were largely achieved in his prior two terms, so investors' emphasis on the vote seemed misplaced to us.

In Mexico, former Mexico City Mayor Claudia Sheinbaum won the presidency in a 2 June landslide, taking 61% of the vote, the highest percentage in Mexican history. While polls predicted this, limiting surprise, her left-wing Morena party (and allied Green and Labor parties) outperformed expectations in the Senate and Chamber of Deputies (Mexico's lower house)—reaching the verge of a supermajority able to amend the Constitution, which the prior Morena government lacked. The suddenly increased likelihood of radical legislation seemingly contributed to market volatility.

Elsewhere, South Africa formed a unity government—officially, the Government of National Unity (GNU)—nearly a month after 29 May elections, returning the African National Congress's (ANC's) Cyril Ramaphosa to the presidency. Markets seemingly welcomed the ANC's power-sharing arrangement with nine other parties. The main source of relief was the business-friendly Democratic Alliance's (DA's) inclusion. The second-largest coalition member by vote share, many see the DA as likely to curtail extreme legislation. But the simple structure of a multiparty coalition likely delivered gridlock, which would accomplish that anyway. There is an upside and downside to this gridlock in EM nations generally and South Africa specifically. While radical reforms (nationalisation, land expropriation, monetary policy intervention) are less likely with such a broad coalition, South Africa faces a host of ongoing challenges reducing its international competitiveness.

Equities still have a big wall of worry to climb. We do see risks on the horizon, perhaps for 2025, and we will detail those more in the coming quarters. Volatility and a correction are always possible. Yet corrections are fleeting. A call for patience and discipline, not action. The market's high long-term returns are the reward for enduring such swings.

GLOBAL UPDATE AND MARKET OUTLOOK

6 August 2024

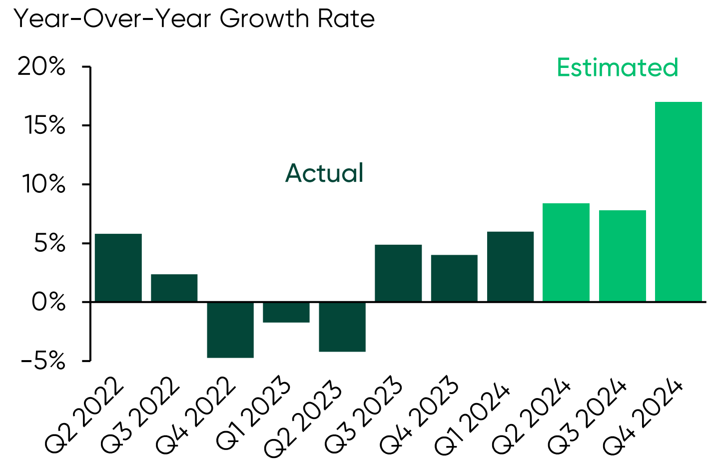
MARKET RECAP

At 2024's midpoint, equities are up and seem primed for more. As we said in January, young bull markets are resilient. Those reaching one year—as this one did last October—almost always see a second. With dour sentiment masking improved fundamentals, we expected 2024 to prove this again in a good-to-great year.

CORPORATIONS PIVOT TO GROWTH

In 2023, equities rose partly on relief as the widely anticipated, pre-priced recession never came. Now equities are seemingly pricing the return to growth. For two years, corporations retrenched via layoffs, inventory drawdowns and cut or postponed investments. We experienced a recession's reset without the recession itself. Now the typical recovery is forming. Earnings rose a third straight quarter in Q1, with 8 of 11 sectors in the S&P 500 advancing. (Exhibit 1) Same with revenues (4.3% y/y), as 8 of 11 sectors rose—highlighting solid demand.[iv]

EXHIBIT 1: THE RETURN OF EARNINGS GROWTH



Source: FactSet, as of 09/07/2024. S&P 500 earnings growth and projections, Q2 2022 – Q4 2024.

Profits aplenty motivate and fuel expansion, putting cash stockpiles—investment fuel—at an all-time high of $7.93 trillion.[v] Today's world-leading Tech firms are also the biggest investors, pumping billions into AI investment in addition to reap bumper profits. Mergers, too, are ramping up as firms seek opportunity. This bull market seems to be built on solid ground.

US PRESIDENTIAL FOURTH YEARS ARE OVERWHELMINGLY POSITIVE

Politics strengthen its foundation. Election years raise gridlock, lowering legislative risk. Congress is too busy on the campaign trail to pass economically significant legislation, as is typical in election years. Hence equities climbed in 83.3% of them, averaging 11.4% gains. And that is no ceiling. Since 1928, 13 topped it—some wildly. (Exhibit 2; see next page)

A strong first half doesn't imply weakness ahead. Yes, election years are ordinarily back-end loaded, averaging 2.8% in the first half and 9.2% in the second.[vi] 2024 may seem different, given the strong start. But as mentioned in the Executive Summary, 15 of 16 election years with positive first halves featured second-half gains, including 7 of 8 when first-half returns topped 10%.[vii]

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iv Source: FactSet, as of 09/07/2024. S&P 500 earnings growth and projections, Q2 2022 – Q4 2024.

v Source: Federal Reserve, as of 10/07/2024.

vi Source: Global Financial Data, Inc., as of 26/06/2024.

vii Source: Global Financial Data, Inc., as of 26/06/2024. S&P 500 total return in election years with positive first halves, 1925 – 2023.

EXHIBIT 2: THE PRESIDENTIAL TERM ANOMALY

Party	President	First Year		Second Year		Third Year		Fourth Year	
R	Coolidge	1925	29.5%	1926	11.1%	1927	37.1%	1928	43.3%
R	Hoover	1929	-8.9%	1930	-25.3%	1931	-43.9%	1932	-8.9%
D	FDR -- 1st	1933	52.9%	1934	-2.3%	1935	47.2%	1936	32.8%
D	FDR -- 2nd	1937	-35.3%	1938	33.2%	1939	-0.9%	1940	-10.1%
D	FDR -- 3rd	1941	-11.8%	1942	21.1%	1943	25.8%	1944	19.7%
D	FDR / Truman	1945	36.5%	1946	-8.2%	1947	5.2%	1948	5.1%
D	Truman	1949	18.1%	1950	30.6%	1951	24.6%	1952	18.5%
R	Ike -- 1st	1953	-1.1%	1954	52.4%	1955	31.4%	1956	6.6%
R	Ike -- 2nd	1957	-10.9%	1958	43.3%	1959	11.9%	1960	0.5%
D	Kennedy / Johnson	1961	26.8%	1962	-8.8%	1963	22.7%	1964	16.4%
D	Johnson	1965	12.4%	1966	-10.1%	1967	23.9%	1968	11.0%
R	Nixon	1969	-8.5%	1970	4.0%	1971	14.3%	1972	18.9%
R	Nixon / Ford	1973	-14.8%	1974	-26.5%	1975	37.3%	1976	23.7%
D	Carter	1977	-7.4%	1978	6.4%	1979	18.4%	1980	32.3%
R	Reagan -- 1st	1981	-5.1%	1982	21.5%	1983	22.5%	1984	6.2%
R	Reagan -- 2nd	1985	31.6%	1986	18.6%	1987	5.2%	1988	16.6%
R	Bush	1989	31.7%	1990	-3.1%	1991	30.5%	1992	7.6%
D	Clinton -- 1st	1993	10.1%	1994	1.3%	1995	37.6%	1996	23.0%
D	Clinton -- 2nd	1997	33.4%	1998	28.6%	1999	21.0%	2000	-9.1%
R	Bush, G.W.-- 1st	2001	-11.9%	2002	-22.1%	2003	28.7%	2004	10.9%
R	Bush, G.W.-- 2nd	2005	4.9%	2006	15.8%	2007	5.5%	2008	-37.0%
D	Obama -- 1st	2009	26.5%	2010	15.1%	2011	2.1%	2012	16.0%
D	Obama -- 2nd	2013	32.4%	2014	13.7%	2015	1.4%	2016	12.0%
R	Trump	2017	21.8%	2018	-4.4%	2019	31.5%	2020	18.4%
D	Biden	2021	28.7%	2022	-18.1%	2023	26.3%	2024	
Frequency of Positive Returns			60.0%		60.0%		92.0%		83.3%
Average Return for Republicans			4.9%		7.1%		17.7%		8.9%
Average Return for Democrats			17.2%		7.9%		19.6%		14.0%
Average Return for All Periods			11.3%		7.5%		18.7%		11.4%

Source: Global Financial Data, Inc., as of 10/01/2024. S&P 500 total returns.

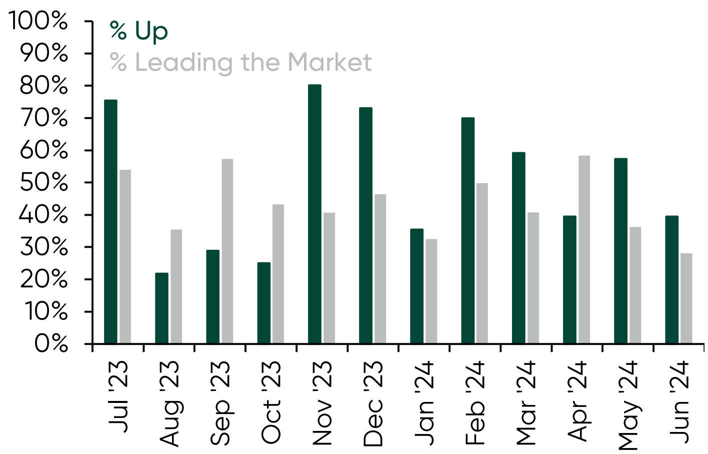
Some warn that rising uncertainty following Biden's dropout upends this. But equities cut through the campaign noise. Eventually, we will have a winner. That coming clarity sets the stage for a strong finish—even after a double-digit first half.

IS A ROTATION TO VALUE IMMINENT?

A value leadership shift remains possible. While value-oriented Energy, Financials and Industrials—not to mention Utilities (as we will discuss in detail)—had spurts of outperformance, they weren't consistent. This is fine—and normal. Shifts are typically gradual, more a dimmer than an on-off switch. Regardless, positioning isn't all about style. In most equity strategies, we emphasise offensive firms, including value equities in Energy and Industrials and growth in Tech and Communication Services.

These value bursts speak to better-than-appreciated breadth. Headlines say America's Tech-oriented "Magnificent 7" have driven this bull market, covering broad weakness elsewhere. We believe this is false. Tech and Tech-like industries in Communication Services lead, but they haven't been the sole beneficiaries of this year's returns. Many Tech-sparse overseas markets hit all-time highs this year.[viii] Exhibit 3 updates a chart from last quarter, showing the percentages of equities rising and beating the market. While the tally varies monthly, it shows big tech isn't alone in the rally.

EXHIBIT 3: UNDERAPPRECIATED BREADTH



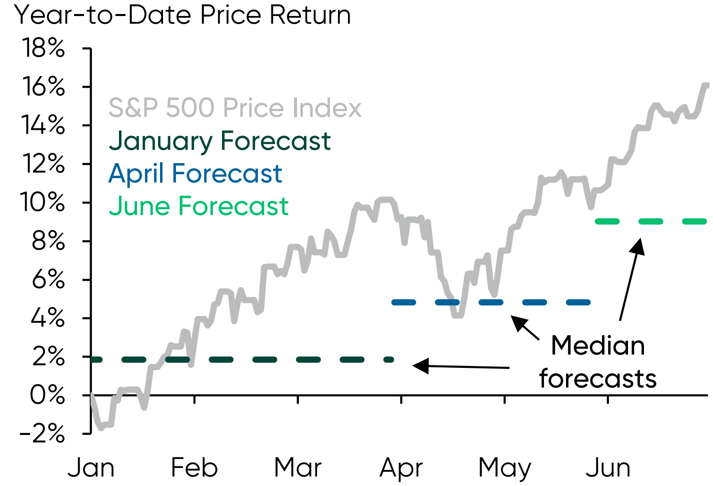
Source: FactSet, as of 10/07/2024. Percentage of MSCI ACWI constituents up or leading the market on a month-by-month fbasis.

SENTIMENT STILL ISN'T EUPHORIC

As equities climb the wall of worry, sentiment is improving. Pessimism has gone. Some scepticism lingers, but optimism is growing. Euphoria seems distant, indicating this bull market has room to run.

Professional forecasts help illustrate this. In January, the median projected a dismal 1.8% return.[ix] As equities defied this, forecasts inched higher. By April, the median was 4.8%. Forecasters then hiked their outlooks again, but by June's end the median forecast was a 9% full-year gain.[x] (Exhibit 4) Up notably from 1.8%, but implying a second-half decline!

EXHIBIT 4: REVISE, REVISE BUT EQUITIES STILL SURPRISE



Source: FactSet and Fisher Investments Research, as of 26/06/2024. Forecasts are implied price return based on actual yearend 2023 index level and median professional forecast for yearend 2024 level. S&P 500 price return through 03/07/2024.

Sentiment's gradual rise shows on several fronts, including initial public offerings (IPOs). They are off to their best start since 2021, indicating nascent enthusiasm. But this isn't a surge in poor companies with suspicious business plans and no hope of profitability.[xi] It is largely older, quality companies. Many used proceeds to pay down high-rate debt.

Earnings forecasts are also tame. Analysts project growth, but not perma-profits—Wall Street still isn't ahead of itself.

WHY WE DON'T THINK AI MAKES UTILITIES A GROWTH PLAY

As mentioned earlier, Utilities equities enjoyed an atypical burst of bull market outperformance earlier this spring, which sent analysts looking for causes. Their verdict: Utilities aren't defensive anymore. Instead, fueled by soaring electricity demand as AI proliferates, they are offensive plays destined to lead.

viii "Only fools believe stock surge is just the 'Magnificent 7' — it's not," Ken Fisher, *New York Post*, 25/02/2024

ix Source: Fisher Investments Research, as of 26/06/2024.

x Ibid.

xi "US IPOs See Best Start Since '21 as Election Shortens Window," Ryan Gould and Amy Or, *Bloomberg*, 27/06/2024.

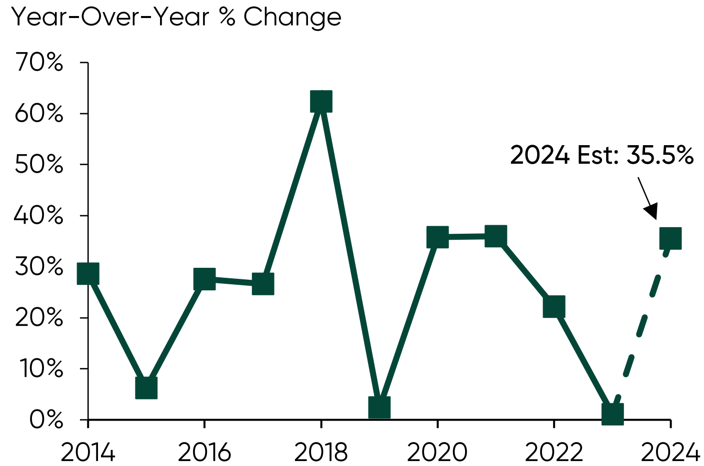
We disagreed, arguing that the burst of Utilities outperformance wasn't likely to last. They remain defensive, in our view, and AI is unlikely to change that going forward. There are three reasons why, which we will explain.

1. There is no meaningful uptick in energy demand in recent years, despite rising data-centre use.
2. Data centres' energy efficiency gains mean even a big increase in data centre usage is unlikely to translate to vastly increased electricity demand.
3. Even if electricity demand rose, it wouldn't automatically mean material increases in profits or sector outperformance for the sector, given other more powerful factor such as regulation, transmission and distribution capex, interest rates, etc.

THE FUNDAMENTAL CASE: AI DEMAND WON'T OVERPOWER UTILITIES' DEFENSIVE TRAITS

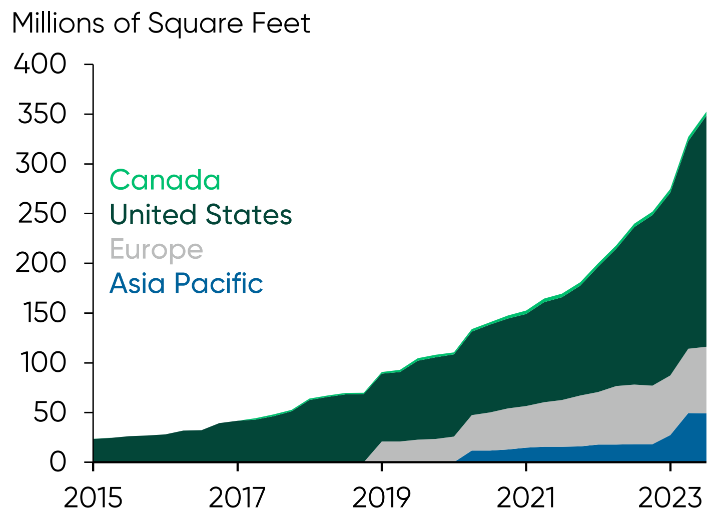
The notion AI will flip Utilities from defence to offence hinges on the rise of data centres and, as a result, electricity demand. Some estimates say data centres could rise from roughly 1% to 1.5% of global electricity consumption in 2022 to 8% by 2030, driven partly by AI.[xii] Investment in data centres rose rapidly in recent years, paused somewhat last year, but appears poised to reaccelerate. Morgan Stanley estimates global cloud capex will rise 44% y/y in 2024. Data from FactSet citing company filings suggest a similar trend, but with both a sharper slowdown and faster reacceleration to 35.5% y/y. (Exhibit 5) The result of this boom in capex spending can be observed by the overall footprint of data centres, which will grow from nearly 24 million square feet in 2015 to over 350 million. (Exhibit 6)

EXHIBIT 5: TOTAL CLOUD CAPEX IN 2024



Source: FactSet. Based on company filings. Q3 Estimates as of 31/05/2024.

EXHIBIT 6: DATA CENTRES SURGE



Source: FactSet and datacentreHawk, as of Q1 2024. 2015 – Q1 2024.*

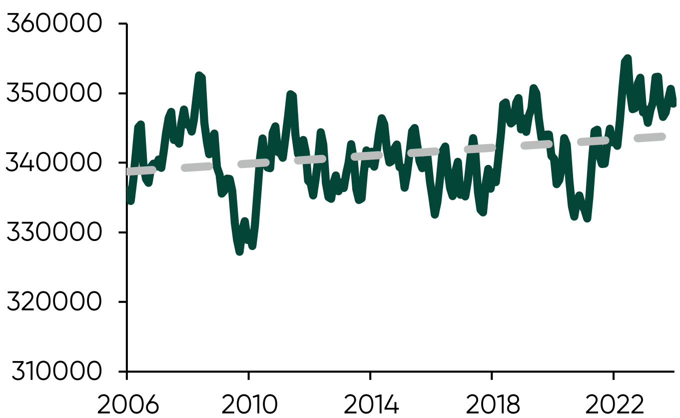
**Includes commissioned, under construction and planned projects. Some cities do not report quarterly in which case most recent quarterly data is used. Historical data not available for certain EU and Asia Pacific cities.*

xii Source: The Register and International Energy Agency, April and May 2023.

But this vast investment hasn't flipped Utilities equities from defence to offence. It hasn't driven a surge in electricity generation. Nor has data-centre consumption leapt as a share of overall electricity consumption, which actually fell -1% in 2023.[xiii] Now, that is only one year, but Exhibit 7 shows rolling 12-month US electricity generation has trended only slightly higher—not materially so. Exhibit 8 reveals data centres' share of electricity consumption is mostly flat over the last decade. Given the rise in data centre usage and construction already, we would expect to see more influence from this on generation and use if the theory held.

EXHIBIT 7: US ELECTRICITY GENERATION

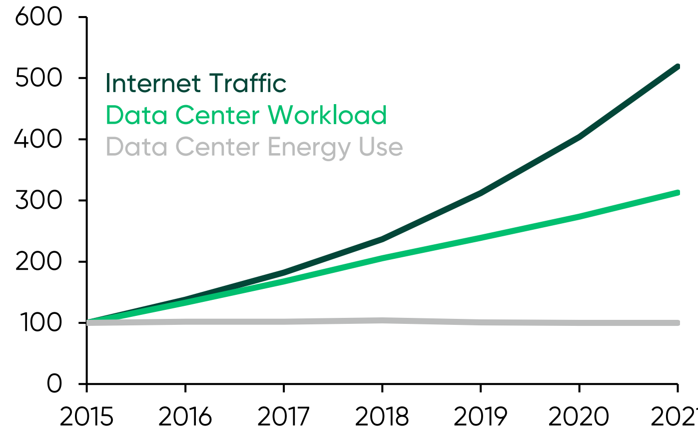
Millions of KWH (12 Mo. Moving Average)



Source: FactSet, as of 17/05/2024. 12-mo. moving avg. US electricity net generation.

EXHIBIT 8: DATA CENTRES ENERGY USE

Indexed to 100 at 2015



Source: International Energy Agency, as of March 2020. 2021 is estimated.

Forecasts for spiking consumption miss efficiency gains. Between 2010 and 2018, data centre compute instances (uses of cloud-based servers by remote users) soared 550%. But total data centre energy use rose 6%.[xiv]

Considering electricity is a cost to data centres, this shouldn't surprise: They have a material incentive to improve efficiency. As technology improves, efficiency improves with it. Hence, Central processing units, GPUs, servers, networking equipment and even cooling units use less electricity, making data centres much more energy efficient than on-site server operation. Microsoft reports its data centres are 22% – 93% more energy efficient than traditional enterprise servers.[xv] Amazon, the world's largest data-centre provider, also cites vast reductions in electricity, tied in part to more efficient cooling and facility design. IT hardware producers are seeing sharp increase in demand for liquid cooling technologies, while many HVAC producers note upticks for high-tech, efficient cooling systems stemming from data centre buildouts.

xiii Source: FactSet and Energy Institute, as of 24/06/2024.

xiv Source: "Recalibrating Global Data Center Energy-Use Estimates," Eric Masanet, Arman Shehabi, Nuoa Lei, Sarah Smith and Jonathan Koomey, *Science.org*, 28/02/2020.

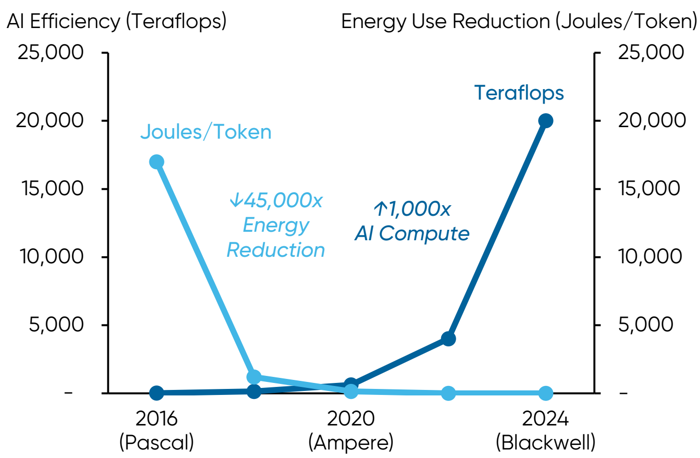
xv "The Carbon Benefits of Cloud Computing," Microsoft Corp., 2020.

One measure of this is power utility effectiveness, or PUE, which measures the ratio of electricity consumed by the computers versus the infrastructure surrounding them. According to the Uptime Institute, PUEs fell from 2.5 in 2007 to 1.55 by 2018. They have hovered around this mark since, hitting a low of 1.55 in 2022.[xvi] However, Uptime's research finds large data centres are more efficient than small, which suggests PUEs could fall even further as providers construct larger new facilities.[xvii] The largest cloud service providers have achieved PUE of 1.06 – 1.15.

CHIP, GPU EFFICIENCY

Furthermore, the chips and servers benefit from Moore's Law, which states that the number of transistors per chip doubles every year. While running up against the atomic barrier, the laws of physics haven't caught up yet due to the use of accelerators in GPUs. Hence over time, computers still become smaller, faster and more efficient. As Exhibit 9 shows, AI GPU giant Nvidia has vastly increased computing power while decreasing energy use.

EXHIBIT 9: COMPUTING SURGES WHILE ENERGY USE FALLS FAST



Source: NVIDIA Computex Presentation, June 2024. A teraflop is a unit of computing speed equivalent to one million million operations per second. Joules per token measures energy use per AI query.

UTILITIES DON'T EXPECT SPIKING EARNINGS GROWTH

We aren't alone in presuming spiking demand from data centres won't power electricity sales: Consider the Utilities themselves.

If data centres were set to send Utilities skyward, Dominion Energy should be their Nvidia. The company serves Northern Virginia, which houses five times as many data centres as the next five largest US markets combined. Most of Amazon's AWS facilities are there.

So if data centres were to boost a utility's revenue or EPS, it logically should be Dominion. Yet in a recent investor presentation, the company forecast 6% long-term compound annual earnings growth through 2029. Other regulated US utilities serving major data centre markets do not cite material acceleration in EPS or rate base growth as a result of data centre investments. Beyond Dominion, aggregate sell-side analyst forecasts put total demand growth at 2.7% through 2030. That is an uptick from 1.6% since 1973, but not an enormous one.[xviii]

Regardless, even if demand grows more strongly than the consensus expects—as some Utilities like Nextera or Duke suggest—Utilities sector sales and relative performance have diverged broadly since 2008. The dataset is somewhat limited, but this strongly suggests other factors—regulation, interest rates and market conditions—drive results much more than changes in demand. This year's brief burst of outperformance suggests similarly: It began during broad market weakness tied to fear over Middle Eastern war spreading and continued when rate cut probabilities ticked up.

Sales don't correlate automatically to rising shares, in our view, because of the industry's high costs and low margins. Furthermore, the industry is fairly inelastic—firms can't easily add materially to production, and it takes significant investment to bring it online.

xvi "Global PUEs—Are They Going Anywhere?" Daniel Bizo, Uptime Institute, 04/12/2023.

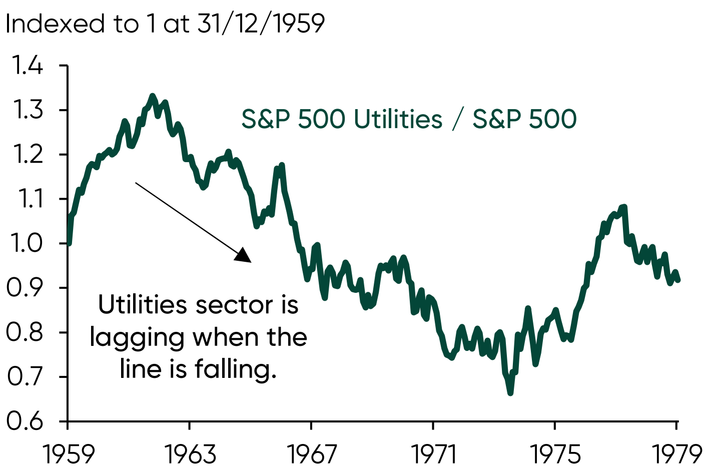
xvii Source: "Large Data Centers Are Mostly More Efficient, Analysis Confirms, "Jacqueline Davis, Uptime Institute, 07/02/2024.

xviii Source: BofA Global Research, US Energy Information Administration, as of 22/05/2024.

Yet data from the Edison Electric Institute and S&P Global suggest Utilities capex will be relatively flat through 2025—which wouldn't be true if generation were set to spike. Utilities would have to plow heavy cash into expanding capacity if that were true. Nor are there material signs that Utilities are allocating a significantly greater share of capex to generation. Generation's share of utility capex has hovered around 25% since 2016.[xix] The share that is rising in recent years is distribution—the network that takes electricity to the end user. This is in keeping with the idea that the US power grid needs investment to modernise it for increased renewable use.

Some coverage cites the air conditioning boom in the 1960s and 70s as an apt parallel, likening data centres' needs to the rapid expansion in electricity use as suburbia sprawled then. But this proves our point, not theirs: Utilities mostly underperformed then. Despite bursts of leadership during the early 1960s bull market and mid-1970s energy crisis, it lagged cumulatively in those two decades. (Exhibit 10) Historical analyses cite high construction costs as a primary earnings headwind.

EXHIBIT 10: BOOMING ELECTRICITY DIDN'T MAKE UTILITIES BOOM



Source: Global Financial Data, Inc., as of 17/05/2024. S&P 500 and Utilities sector total return index levels, monthly, 31/12/1959 – 31/12/1979. Indexed to 1 at 31/12/1959.

UTILITIES LIKELY REMAIN DEFENSIVE

While some individual Utilities could see a boost at the margin from data-centre demand, we are sceptical it affects or alters the industry's defensive nature. Recent years' expansion in data centres hasn't delivered booming electricity consumption. And data centres' improved efficiency should let them continue growing without vastly increasing electricity demand. Lastly, there is little available evidence rising Utility sales are automatically bullish for their relative returns.

A LOOK BACK AT THIS YOUNG BULL MARKET

"BULL MARKETS ARE BORN ON PESSIMISM, GROW ON SCEPTICISM, MATURE ON OPTIMISM AND DIE ON EUPHORIA."

– SIR JOHN TEMPLETON

We use this quote often to describe how bull markets form and grow. As this one nears its second year, tracking its sentiment progress helps show how we approach markets.

When this bull market began in October 2022, pessimism abounded. Fears from Ukraine war to inflation to Fed hikes reigned supreme. Nobody could say definitively a new bull market was underway then. But bull markets always follow bear markets. To paraphrase Sir John, they feed on despair, which lowers expectations and enables positive surprise. Hence, the recovery's stage was set. As our Q4 2022 Review shared:

Given global markets' dismal 2022 performance, investors are fatigued and discouraged. Most economists anticipate recession and many expect more rate hikes, weighing on economic growth and equity markets. However, we believe this broad pessimism entering 2023 provides the perfect backdrop for an emerging bull market—delivering a year of recovery.

xix Source: Edison Electric Institute, as of July 2023.

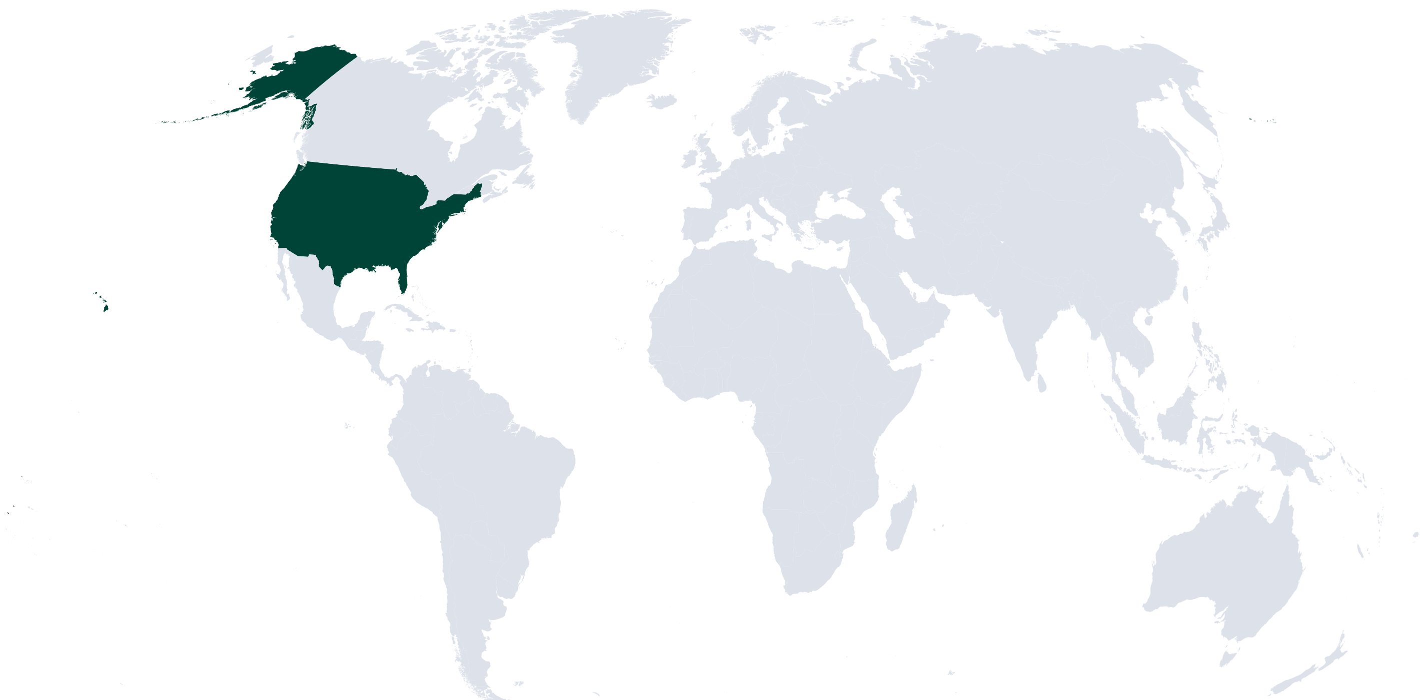
To take advantage, we emphasised high-quality growth in most equity strategies. That positioning—which helped returns—is unusual for a young bull market, when value usually leads historically. But history is merely a framework for assessing probable outcomes. It isn't destiny. Our review of the backdrop suggested the unusual—large growth leading early—was likely. There hadn't been a recession to crush economically sensitive value equities, and growth fell hardest in the downturn. What falls the most, usually bounces the most, especially when sentiment toward the category sours excessively. So rather than move to smaller, value positions, we targeted growth-oriented bounce candidates. It worked.

2023 wasn't worry free. March's regional bank scare and a late-summer correction rattled investors' nerves. But bull markets never rise uninterrupted. Short-term volatility is the price for equities' long-term returns. By yearend, global equities erased the correction and hit new highs.

WHAT TO MAKE OF 2025?

Things look good for 2024. But next year could bring risks. What could make 2025 poor? Past Reviews detailed how 2022's bear market resembled 1966's while 2023's recovery echoed 1967's. With 2024 sharing similarities with 1968, we must acknowledge 1969 was a bear market year. But history never repeats exactly, and each timeframe must be understood within its own context. It is still too early to gauge 2025, but we will begin addressing these issues in upcoming Reviews—particularly Q4's, which will share our 2025 forecast.

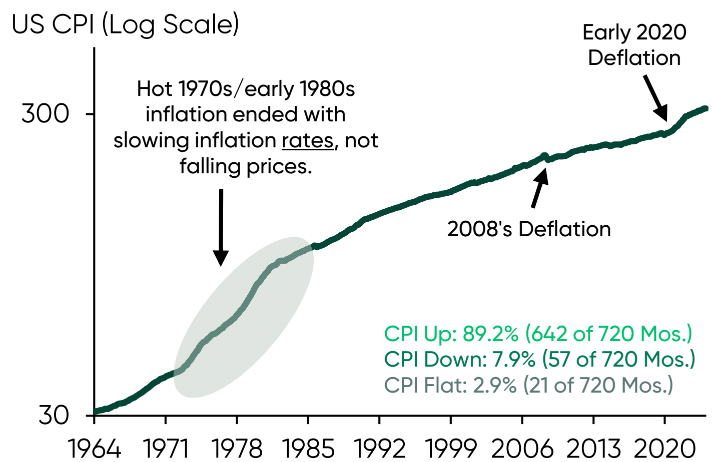
UNITED STATES **COMMENTARY**



Consumer surveys show respondents remain pessimistic about the economy. One key reason? Prices. While inflation slowed from June 2022's 9.0% y/y to 3.0% in June 2024, broad consumer prices' still rose 19.2% cumulatively since 2020's end.[xx] This greatly impacts sentiment.

The consumer price index (CPI) almost surely won't see 2020 levels again. Exhibit 11 shows the last 60 years, using a logarithmic scale to strip out compounding's impact. As shown, deflation is rare.

EXHIBIT 11: THE US DOESN'T DO DEFLATION WELL



Source: FactSet, as of 11/07/2024. US Consumer Price Index (log scale) and frequency of positive, negative and flat month-over-month CPI readings.

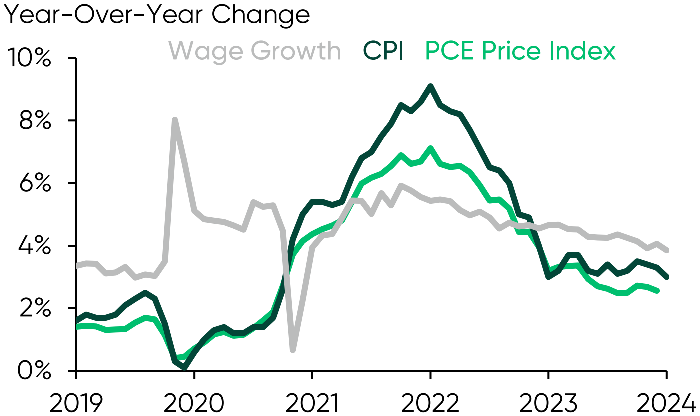
xx Source: FactSet, as of 05/07/2024. Based on US Consumer Price Index (headline).

Deflation didn't end the 1970s' inflation nightmare. Moreover, reversing recent rises would take a -16.5% plunge—unseen since the 1920s. In the last 60 years, the largest bouts of deflation were 2008 and 2020's brief lockdown dip. Prices fell -3.5% and -1.3%, respectively.[xxi] Perhaps some prices return to pre-2021 levels. But economywide? Highly unlikely. Nor would it necessarily be desirable considering the recessions driving past deflations.

Inflation has the biggest impact for folks at the bottom 40% of the income spectrum—those on fixed incomes or with low/no wages. Inflation is a regressive tax. We don't downplay the burden on higher earners, which stung—but likely less so, and temporarily. Most workers' wages rise after inflation and catch up—this is how folks overcame the 1970s' hot inflation *without* falling prices. It is happening now, helping normalise economic growth and activity. (Exhibit 12) Headlines occasionally claim consumers whittled down savings and ramped up debt to survive rising prices. Perhaps, in some cases but overall, wage growth can support spending.

EXHIBIT 12: WAGE GROWTH OUTPACING INFLATION

Year-Over-Year Change



Source: FactSet, as of 11/07/2024. Average hourly earnings of private employees and CPI, June 2019 – June 2024. Personal consumption expenditures price index, June 2019 – May 2024.

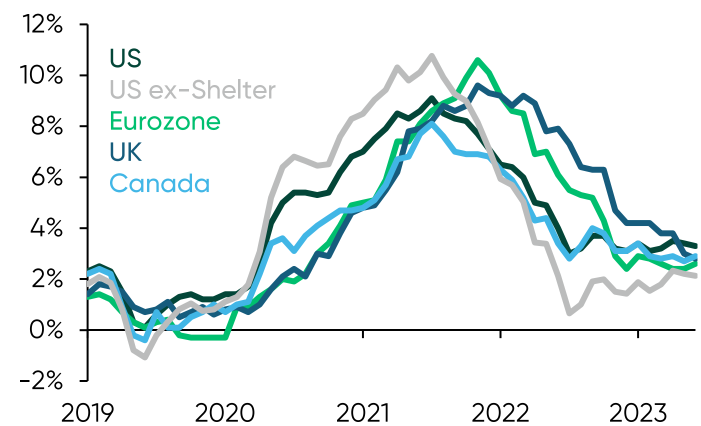
PRICES COOLING GLOBALLY—FASTER THAN IN THE US?

With inflation normalising as economic growth continues, wages should outpace inflation globally. Outside of the US, inflation is slowing faster than in the US. (Exhibit 13) Some of this is illusory, a function of how various price indexes account for shelter costs.

US CPI attempts to tally housing costs via owners' equivalent rent (OER), which aims to estimate what homeowners would pay if they rented their homes. No one actually pays this, and its inclusion is debatable, considering owned property is more of an investment than an outright expense. Furthermore, few homeowners in America see big shifts in their ownership cost since most mortgages are fixed rate and 39% of US homes are owned outright, a record high.[xxii] As Exhibit 13 also shows, excluding shelter, US CPI has slowed all the way to 1.8% y/y. Regardless, the 2021/2022 inflation burst was a global trend. So is its cooling.

EXHIBIT 13: INFLATION IS SLOWING GLOBALLY

Year-Over-Year Percentage Change



Source: FactSet, as of 05/07/2024. Eurozone Harmonised CPI, US CPI and CPI less shelter, December 2019 – May 2024. UK and Canadian CPI, December 2019 – May 2024.

xxi Ibid.

xxii Source: US Census Bureau, as of 05/07/2024. 2022 American Community Survey, percentage of owner-occupied housing units without a mortgage.

FORGET FED FIXATION

Inevitably, inflation discussions drift to central banks. Many argue global growth and equities need rate cuts. They dissect every speech, press release and decision to predict the next move. They see "divergence" between the Fed and others as risky. Ignore it. This bull market, born amid hikes, proves the Fed doesn't dictate market direction.

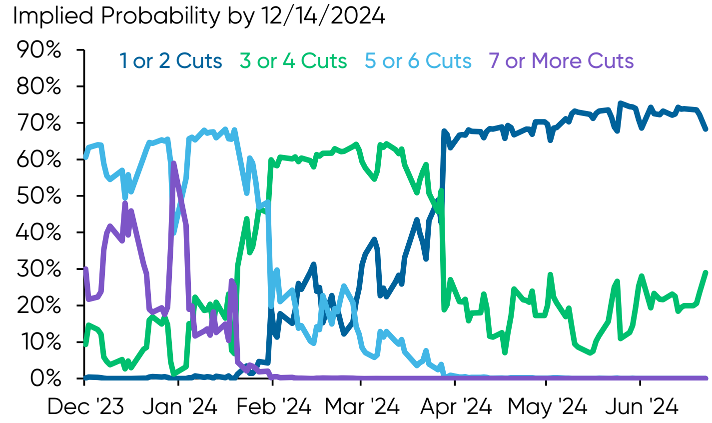
If cuts were vital, we would expect this year's swings in rate expectations to stoke volatility—perhaps even negative returns. Entering 2024, official projections showed 11 Fed officials expected to cut 3 or more times. Now none see more than two. The number expecting zero doubled from two to four.

Exhibit 14 shows the evolution in fed-funds futures traders' expected number of rate cuts by yearend. The year began with traders placing the highest probability on five to six cuts. Soon more than *seven* stole the lead. Now? Traders give those basically zero chance, with one or two cuts predicted.

Despite this large shift in expectations, equities soared amid relative calm. The lesson: Forecasting the Fed is impossible and unnecessary. Monetary policy doesn't dictate equities' direction.

Additionally, central bankers usually *react* to events—they don't have special insight, so they often play catchup to the economy or markets. Hence, with rate cuts: Be careful what you wish for. Historically, the Fed cuts feverishly when the economy is staring down a recession. Now, as we wrote last quarter, it could be fine if the Fed starts to cut rates on the belief that its current policy is unnecessarily restrictive given weakening inflation. But the idea that rate cuts are super bullish or strong enough to offset weaker macroeconomic conditions, if they come, is wrongheaded.

EXHIBIT 14: IMPLIED NUMBER OF RATE CUTS BY DECEMBER'S FED MEETING



Source: CME FedWatch, as of 08/07/2024. 13/12/2023 – 05/07/2024.

INFLATION'S UNSEEN IMPACT ON US DEBT

Relatedly, many think spiking US federal debt is an acute problem after 2021 and 2022's hot inflation, considering interest rates rose. But this is reversed.

While most people lose to inflation, the government wins. Debt and interest payments are made in current, non-inflation-adjusted dollars. While the absolute level of federal debt (excluding government holdings, which are both government assets and liabilities) is up 27.8% from 2020's end through June 2024, the cumulative 19.2% CPI inflation burst since then mutes the rise.[xxiii] Exclude this, and "real" debt is only up a total of 8.6% or 2.4% annualised. That isn't a spike. Furthermore, from 2020's end through Q1 2024 (the latest data available), real GDP has climbed a cumulative 9.8%.[xxiv] The economy has outgrown debt.

Inflation, simply, makes the debt cheaper. It boosts tax revenue, too. The majority of the government's personal tax take comes from higher earners, whose incomes rise at a lag to inflation. The result is a stealth tax hike over time. Bad for them, good for the government.

xxiii Source: US Bureau of the Fiscal Service and Bureau of Labor Statistics, as of 23/07/2024.
xxiv ....Source: FactSet, as of 23/07/2024.

Finally, interest rates' rise didn't affect all of America's debt at once. It would only matter when refinanced. Many bonds and notes issued before 2022 still carry very low yields. If interest rates fall over time, the government will likely see only a very small influence from higher rates—especially because, again, it is highly unlikely prices and wages deflate substantially.

The combination of inflation's impact in making debt repayment cheaper, boosting government revenue and not affecting all the government's debt at once is why high-rate debt issued in the 1960s and 1970s—still on the books—became easier to service in time. As rates fell, the revenue and inflation impacts never reversed, but bonds were refinanced at lower rates.

We aren't counseling the government to recklessly spend. But as we often note, the government's debt isn't a crisis. The emotions over it run hot, but there is no sign trouble is imminent or even brewing.

A BUSY YEAR IN POLITICS

All eyes have been on the US election given President Biden's historic decision to forego his candidacy and the attempt on Trump's life. It may seem chaotic now. But US election year second halves typically boom as investors gain clarity on the candidates, their platforms, the presidential winner and resulting government structure. This time should be no different.

SHOCKING DEVELOPMENTS IN THE US PRESIDENTIAL CONTEST

Late June and July brought several historic moments in a short period, stirring volatility in the election.

The race heated up after 27 June's debate, when President Biden's poor showing sparked chatter over the Democratic Party replacing him. Calls for him to step aside trickled in over the days and weeks thereafter. At first, he steadfastly rejected them.

President Biden's poll ratings fell after the debate—but not hugely—from 44.9% pre-debate to a low of 43.8% on 3 July.[xxv] Yet Trump's support only rose from 46.6% to 46.7%. This suggests voters' initial reaction was to shift support from Biden to third parties, like RFK Jr.

Then came the next historic moment: The 13 July assassination attempt on former President Trump. In the wake of that horrible event, both Trump's and Biden's poll numbers rose, with Trump's hitting 47.3%.[xxvi] Biden's rebounded too, nearing pre-debate levels at 44.8%.[xxvii]

But another historic moment struck a week later: After contracting COVID and enduring more calls to exit the race, President Biden announced he would acquiesce. On 21 July, he announced he wouldn't seek the nomination, endorsing Vice President Kamala Harris instead.

THE STATE OF THE RACE

President Biden's decision may seem to inject uncertainty into the race anew. But given all the highly publicised talk over the last month, this doesn't seem likely. Markets anticipate events by pre-pricing widespread discussion and forecasts. When a bevy of Democratic donors, editorials in left-leaning outlets like *The New York Times* and, eventually, actual sitting politicians called for his exit, markets weighed it carefully. Hence, equities rose the Monday following President Biden's weekend decision.[xxviii]

Now, his decision does mean we approach mid-August's Democratic National Convention with no anointed candidate. While he endorsed Harris—and many prominent Democrats followed suit—his stepping aside releases the nearly 4,000 delegates bound to him through the primary process, making this technically the first open convention on the Democratic side since 1968 (another parallel to the time period we have so often thought an analogue to the present).

xxv Source: RealClearPolling, as of 10/07/2024.

xxvi .... Ibid.

xxvii .... Ibid.

xxviii Source: FactSet, as of 22/07/2024. Statement based on S&P 500 Index, which rose 1.1% on Monday, 23/07/2024.

But even this uncertainty should fall very soon, as there are no clear primary challengers to Harris. She has a lot of support, rallied fundraising and has access to Biden's existing funds. Even if someone does challenge her, we will know the winner in mere weeks. Some continue talking up a "blitz primary" of sorts. But it isn't clear how that would or could work from a rules or infrastructure standpoint.

Hence, for markets—our focus—uncertainty should fall in the coming months. Expect nonstop discussion of the election's market impact. Headlines will dwell on candidates' personalities and fitness. Ignore it. Markets are party-blind, always. What matters: Eventually, we will get a winner. No matter which side wins, sentiment tends to coalesce around the victor, rallying equities. This is a big reason typical election years are back-end loaded. With plenty of uncertainty to fall, this year's second half should be quite strong.

THE PATH NARROWS

Polls did widen ahead of President Biden's stepping aside. The impact of his departure is unclear, but there are months until the election. Trump is a very well-known candidate who evokes strong emotions on both sides. So we could easily see the race re-tighten as we enter the fall. Regardless, don't expect a landslide that will shift government heavily in either direction.

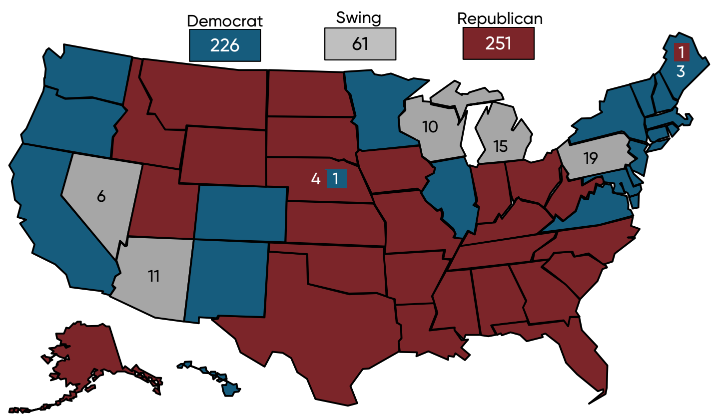
Now, we do think Trump presently has the edge in the Electoral College. As we showed last quarter and in 2016, Trump can lose the popular vote by around 3 percentage points (ppts) and still win. Most states aren't in play, including the biggest. Democrats dominate California, Illinois, Massachusetts, Maryland and Washington in lopsided fashion.

Meanwhile, Trump will win GOP strongholds including populous Texas and Florida. But the GOP isn't likely to win these states by as large a margin as the Democrats should their deep blue states. And the population edge isn't nearly as big. Hence, the Democrats have a popular vote advantage.

But the Electoral College is different. The best site for Electoral College outcomes is the new, little-known *270toWin.com*. This is a great resource. It may not be the only site to review, but it has some unique, data-rich features and very current polling. It also allows you, for example, to play around with hypothetical state-by-state results.

And it shows state projections in map form. On 1 July, it showed Biden's baseline was 226 electoral votes versus 235 for Trump. This left six toss-ups: Nevada, Arizona, Wisconsin, Michigan, Georgia and Pennsylvania. That shifted after the assassination attempt. By 17 July, the site considered Georgia Trump's, bringing his baseline to 251 electoral votes—just 19 shy of the needed 270. (Exhibit 15)

EXHIBIT 15: BASELINE ELECTORAL MAP AS OF 17 JULY



Source: 270toWin, as of 17/07/2024. Nebraska and Maine allow for split electoral college votes, hence the divided allocation.

Yes, Trump was leading in all six swing states before 21 July. But several were within the margin of error. And painting Georgia red may prove hasty—the large minority vote could easily swing it back, for example. Biden's exit, which isn't reflected in nearly enough state polls to build scenarios yet, could sway things. So look at both the scenarios existing on 1 July and now.

If you still consider Georgia a swing state, in line with the 1 July model, there are 12 combinations that would deliver Trump the win versus 9 for Harris (or the eventual Democratic candidate). Exhibit 16 shows you these combinations to cross 270. If you consider Georgia red, there are five paths through the swing states for Trump. The Democratic nominee has just three. (Exhibit 17)

As Exhibits 16 and 17 showed, Pennsylvania is critical for both candidates—especially the Democratic nominee. Even if you still count Georgia a swing state, there are only three scenarios where Harris or another can reach 270 without Pennsylvania. All involve winning Georgia and/or Arizona. If you count Georgia a red state, Pennsylvania is must-win. There are 11 counties that chiefly matter. The five around Philadelphia (north and west suburbs), the five around Scranton and Erie County in the state's northwest corner.

EXHIBIT 16: BIDEN AND TRUMP PATHS TO 270 — 1 JULY MODEL

Likely/Solid Blue 226 Plus ...	Total Electoral Votes
PA GA MI	276
PA GA AZ	272
PA MI AZ	271
PA GA WI	271
PA MI WI	270
GA MI AZ WI	278
GA MI AZ NV	274
GA MI WI NV	273
PA AZ WI NV	272
Likely/Solid Red 235 Plus ...	**Total Electoral Votes**
PA GA	270
PA MI AZ	280
GA MI AZ	277
PA MI WI	279
GA MI WI	276
PA AZ WI	275
GA AZ WI	272
MI AZ WI	271
PA MI NV	275
GA MI NV	272
PA AZ NV	271
PA WI NV	270

Source: 270toWin, as of 01/07/2024.

EXHIBIT 17: BIDEN AND TRUMP PATHS TO 270 —17 JULY MODEL

Likely/Solid Blue 226 Plus ...	Total Electoral Votes
PA MI AZ	271
PA MI WI	270
PA AZ WI NV	272
Likely/Solid Red 251 Plus ...	**Total Electoral Votes**
PA	270
MI AZ	277
MI WI	276
AZ WI	272
MI NV	272

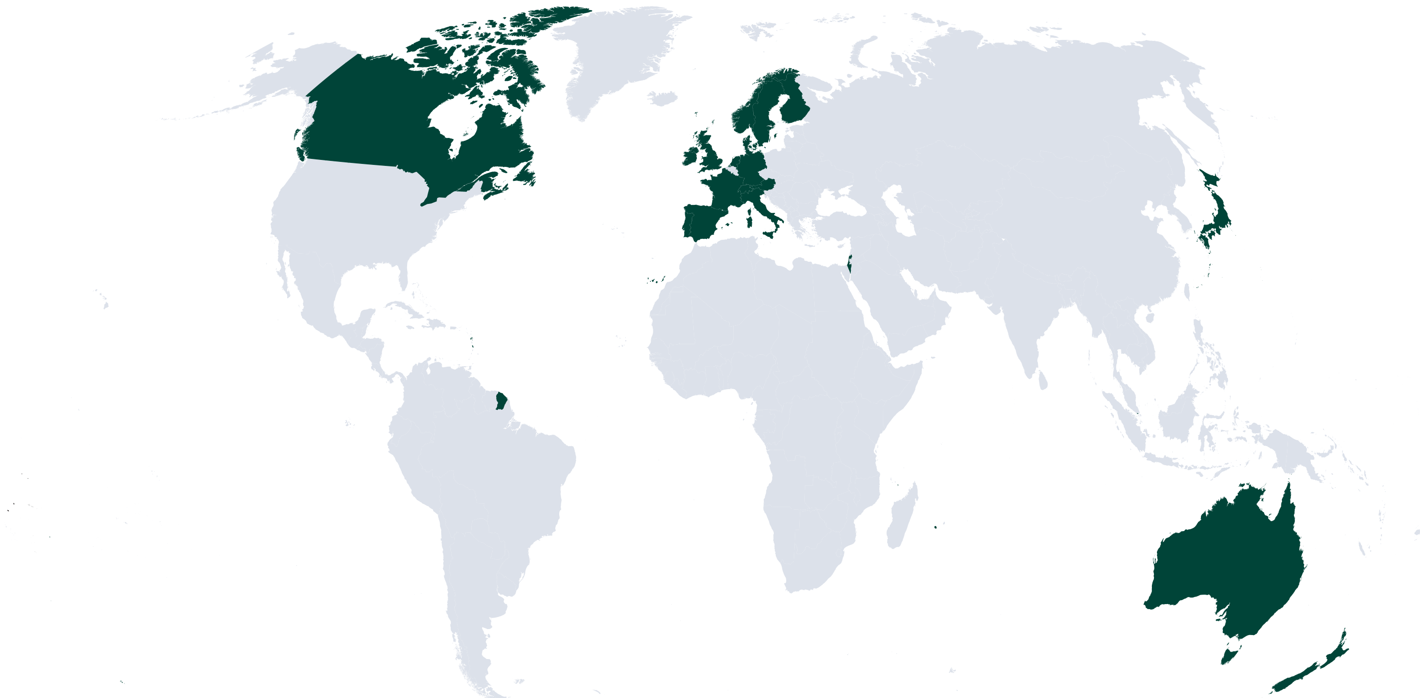
Source: 270toWin, as of 17/07/2024.

Expect both candidates to concentrate campaigning there. Campaigners will likely focus on mobilising turnout around Philadelphia, a key stronghold, where Harris will need suburban votes. Trump has a better chance of rallying the outlying areas, where he can tout his administration's economic progress.

Pennsylvania, like all swing states, should come down to campaigning and grassroots efforts. The Democrats have fuller campaign coffers and a more robust ground game, but they may have to spread their resources. Whoever the official nominee is, the lower name recognition could put them on defence in states long presumed blue, including Minnesota, New Jersey, New Hampshire, Maine and Virginia. They have the money to blitz airwaves with ads. But their get-out-the-vote machinery in these states is thinner. This takes time and resources to construct. Building it could divert resources from elsewhere.

As this year progresses, uncertainty over these factors will fall—bullish, in our view. Crucially, though, the control of government is less about 2024 than beyond. And even there, the White House is only one branch of government. House and Senate control are key for markets, as this will determine whether we get bullish gridlock. This is key to weighing the election's market implications in 2025 and beyond, but it is too early to assess now. The election's structure favours relatively little change, but control could still swing.

GLOBAL DEVELOPED EX-US **COMMENTARY**



Q2's busy international political calendar elevated uncertainty elsewhere in the developed world, too. Finland, Portugal, Belgium and most recently, the UK and France, all held major national elections. But markets took it all in stride.

Now this flurry of activity is in the rearview, with only Austria presently slated to vote later this year. Investors have clarity, and in most cases, they are gradually realising the outcome wasn't so bad as feared. This bullish force is just getting started in Britain and France.

LABOUR'S LANDSLIDE

As expected, Labour trounced the Conservatives in Britain's 4 July election. Keir Starmer is now prime minister (PM), fanning fears of draconian tax hikes, stifling regulation and other political headwinds.

This is normal when Labour wins. Echoing the US, investors tend to view the Conservatives as good for markets and Labour as anti-business. Hence, people tend to fear Labour. This gets priced in the run-up to the election, then usually proves false, pushing UK equities up the wall of worry. Hence, in the 12 months after a Labour-led government took power since 1923, the FTSE All-Share's median return is 12.5%, outpacing Conservative government's 7.8%.[xxix] It happened when Tony Blair's Labour won huge in 1997 and likely happens now.

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xxixSource: Global Financial Data, Inc., as of 03/07/2024. FTSE All-Share Index median total return 12 months after UK elections, December 1923 – December 2020.

Labour's win was a foregone conclusion. Polls signaled it in 2022, three prime ministers ago. Yet the fears are far older. Today, investors acknowledge Labour's manifesto mostly extends the status quo from 14 years of Conservative rule. But they warn Labour will go off script with a wealth tax, big inheritance or capital gains tax hikes, North Sea oil production bans and more. These fears reigned under Starmer's predecessor as Labour leader, Jeremy Corbyn. And under his predecessor, Ed Miliband. That is a 14-year run. If markets are at all efficient, they priced these items long ago.

Hence, positive surprise potential seems high as markets realise Labour's government isn't necessarily worrisome for the economy, and the likelihood of moderation is higher than perceived. While Labour added 209 seats versus 2019's election, bringing its total to 411, its vote share rose by less than 2 percentage points (2 ppts).[xxx] Voters didn't embrace the centre-left. They abandoned the Tories (121 seats) for the centrist Liberal Democrats (72 seats, up from 11 in 2019) and the grassroots Reform UK.[xxxi] Combined, the Tories and Reform won about 38% of the vote, topping Labour.[xxxii] Starmer, like any politician, wants to be re-elected. He will also know he is on a short leash with the public. That is an incentive not to rock the boat.

Labour also has internal divides, much like the ousted Tories. Those divisions kept the Tories from completing much of 2019's manifesto. We can see similar internal gridlock erupting from disputes between Labour's centrists and grassroots left. Even if Labour does more than its manifesto suggests, the Tories hiked corporate taxes, adopted Energy price controls and windfall profits taxes, and stealthily raised income taxes by not indexing the tax bands to inflation. But UK equities participated in the three global bull markets spanning the Conservatives' government.

Expect similar now. The US and UK usually move together, and politics don't tear them apart. As Ken showed in his *Telegraph* column, there are two big examples when US and UK politics swung hard in opposite directions. Both times, markets moved together.

In the US, the Great Depression began under a Republican government, but FDR's 1932 election brought 20 years of Democratic government. Meanwhile, Britain's Conservatives replaced a Labour government in 1935 and ruled for a decade. But US and UK equities cycled together, moving from bear market to bull and back again.

Likewise, in 1997, Labour's landslide ended a long stretch of Tory rule just as Congress flipped Republican. George W. Bush became president in 2000. But both governments lasted through most of the 2000s, until Barack Obama won in 2008 and the Conservatives won in 2010. Here, too, the two moved together, through the Tech boom, the dot-com bust, the mid-2000s bull market, the global financial crisis and the long bull market that followed.

FRENCH VOTERS CHOOSE GRIDLOCK

France's saga begins with the European Parliament's early-June election, which is national electorates' only direct vote for their EU representation. Right-leaning parties gained at the centre left's expense. This temporarily fueled fears that the centre-right European People's Party could abandon its coalition with two big centrist parties and join the more populist right-leaning parties instead. This looked far-fetched, considering those groups lacked a combined majority. Now the populist right has splintered, rendering it even less likely, helping uncertainty fall.

However, this election shook some national governments. Particularly France, where President Emmanuel Macron's Ensemble Party lost to the populist National Rally (NR). In response, Macron called a snap French legislative election for 30 June and 7 July, stoking fears the NR could win a majority and force through windfall taxes and high public spending.

xxx Source: House of Commons and BBC, as of 08/07/2024.

xxxi .... Source: House of Commons, as of 08/07/2024.

xxxii .... Source: BBC, as of 08/07/2024.

French markets fell in the run-up as uncertainty jumped. But they rallied after the first round diminished the likelihood of an NR majority. While they won the most votes, Ensemble and the left-green alliance (New Popular Front, or NPF) agreed to pull third-place candidates and support each other against the NR. This raised the likelihood of a hung parliament, which France got in the second round. NPF and its allies took 181 seats in the 577-seat National Assembly, followed by Ensemble and its allies with 163—and just 143 for the NR.

Here, too, markets pre-priced the fear, then rallied on falling uncertainty. More clarity should come, as NPF's "win" caused fresh jitters. Headlines warn Macron could concede higher spending or unwind pension reforms to pass legislation—old fears. As gridlock emerges, reality should beat expectations.

THE GLOBAL ECONOMY REMAINS STABLE

Halfway into 2024, developed economies have defied lingering downturn expectations and proven resilient. Yes, there are some soft patches. But overall, economic reality has held up better than many feared, a key part of the fundamental backdrop underpinning the global bull market.

The developed world featured pockets of strength and weakness in the first half of the year. In Western Europe, headlines cheered the ending of the UK's "technical recession" (widely defined as two or more consecutive quarterly GDP contractions) after Q1 GDP grew. However, many of those same publications fretted the eurozone's "two-speed" economy, as Southern Europe's growth outpaced the "core" of Germany and France. Now, whether these are actually recessions or just contractions remain to be seen—the Euro Area Business Cycle Dating Committee is the eurozone's official recession arbiter, and they haven't declared one. They may do so later, though this declaration would be well after the fact. However, recession or no, contraction was never as deep as feared, and now growth seems underway anew.

In the Pacific, coverage of Japan's Q1 GDP contraction focused on the weak yen and its supposed negative economic impact in buoying import costs. Meanwhile, in Australia, experts wondered if growth could hold up amid the Reserve Bank of Australia's (RBA's) higher interest rates and allegedly "stubborn" inflation.

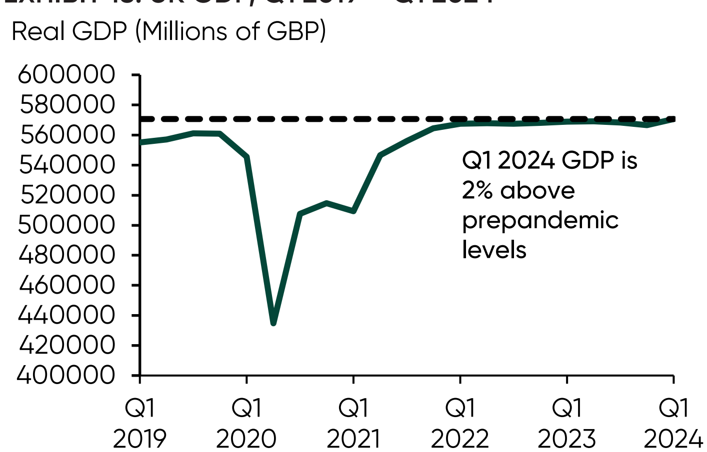
Now, developed nations' economic conditions are by no means robust uniformly. Though some have rebounded, a few economies continue to struggle. But in our view, that is all old news to markets, which recognised some solid underlying trends that persisted into Q2.

WESTERN EUROPE

After Q1 UK GDP registered its quickest quarterly growth since late 2021, Q2 data released thus far were more varied. Monthly GDP was flat in April before expanding 0.4% m/m in May.[xxxiii] In both cases, the weather played a big role. April was one of the wettest months on record, which weighed on economic activity—e.g., retail trade (excluding motor vehicles and motorcycles) fell -2.3%.[xxxiv] However, the following month ended up being the warmest May on record, boosting the construction, retail and accommodation industries—and contributing to higher output.[xxxv]

Taking a longer perspective, the three-month period to May showed 0.9% growth from the prior—extending the resumption of UK economic growth. (Exhibit 18)

EXHIBIT 18: UK GDP, Q1 2019 – Q1 2024



Source: Office for National Statistics, as of 23/07/2024.

xxxiii Source: Office for National Statistics, as of 23/07/2024.

xxxiv Ibid.

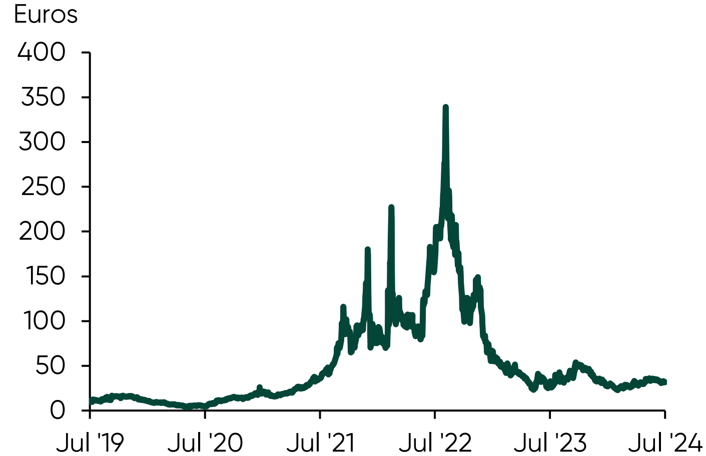
xxxv Ibid.

On the Continent, the first estimate of eurozone Q2 2024 GDP showed +0.3% q/q expansion, above expectations and matching Q1's q/q growth rate. Among the eurozone's four largest economies, Germany contracted but France, Italy and Spain continued expanding. Many headlines bemoan Germany's weakness, but given the eurozone is a currency bloc of 20 diverse countries, it is quite normal to see a mix of relatively stronger and weaker national economies. Q2's preliminary GDP report isn't predictive of what will happen next, but we think it demonstrates how moderately positive results can exceed still-too-low expectations for the eurozone.

The focus of many continues to linger on weak German and French manufacturing following July's purchasing managers' index (PMI) reports. However, each country's services PMIs—which represent a larger portion of the French and German economies—remain expansionary. Notably, France's economy grew +0.3% q/q in Q2 despite its manufacturing PMI reflecting contraction throughout the quarter—illustrating how growth in services can offset weakness in manufacturing. Further, the eurozone is much larger than just Germany and France, with countries such as Spain and Ireland registering strong growth this year so far.

In our view, eurozone's economic reality has turned out better than many forecast—evidenced by the Continent's energy situation. Not long ago, many worried Western sanctions on Russian oil and gas would lead to energy supply shortfalls in Europe—and those fears contributed to a spike in European natural gas prices in early 2022. (Exhibit 19) But those dire scenarios didn't come to pass as businesses, households and governments adjusted—and the fall in prices reflects that adaptation. Moreover, this is another influence on Northern Europe's heavy industry-driven tepid growth, which is more energy intensive.

EXHIBIT 19: EUROPEAN NATURAL GAS PRICES, 2019 – 2024



Source: FactSet, as of 23/07/2024. Dutch TTF natural gas prices, 23/07/2019 – 23/07/2024.

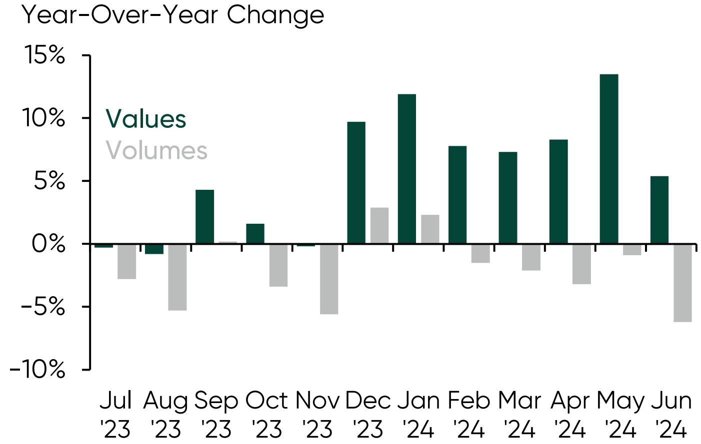
JAPAN

In Japan, the weak yen and its impact on consumers dominated conversation—which we will discuss in more detail below. A weak currency makes imports more expensive, problematic for Japanese households since the country imports most of its fuel. This has been a lingering headwind weighing on domestic demand.

That said, a weak currency can benefit exporters, as they can either undercut competitors on price and reap volume gains or keep their prices constant. The latter appears to be the case based on latest export data. (Exhibit 20, see next page)

Japanese multinationals can take advantage of relatively stronger external demand and use profits from this currency translation to offset some of their expenses. Note: This isn't an economic plus—it is a plus for corporations' bottom line. For it to benefit Japan's economy, volumes and reinvestment of those profits into new projects are the key. This is one of many reasons the market isn't synonymous with the economy and vice versa.

EXHIBIT 20: JAPANESE EXPORTS, VALUES VS. VOLUMES



Source: Ministry of Finance, as of 23/07/2024.

The weak yen isn't new or surprising to markets—it is a legacy of Japan's long-running bizarre monetary policy, stemming from one prong in the late former Prime Minister Shinzo Abe's economic revitalisation programme. A weak yen is a headache for households and domestic-oriented businesses, but big multinationals can manage these conditions and use it to their benefit, in our view.

AUSTRALIA

Many view Australian economic developments, from changes to the unemployment rate to the latest inflation reading, through their potential impact on the Reserve Bank of Australia's (RBA's) monetary policy. That is understandable, especially since floating-rate mortgages and loans dominate in Australia—meaning more households and businesses would feel the effect of higher rates than in other nations such as the US, where most rates are fixed.

While economic growth isn't robust—e.g., Q1 GDP rose 0.1% q/q—household spending (0.4%) has held up despite RBA's cash rate target at its highest in over a decade.[xxxvi] Energy spending was up 4.9% q/q—reflection of higher prices—but so was recreation and culture (0.6%), a sign of resilient discretionary consumption.[xxxvii] Moreover, per the RBA, businesses have cash buffers larger than prepandemic averages and nonperforming business loans remain low—signs that firms are profitable and have the capacity to fund spending and investment without having to refinance at higher rates.[xxxviii] In our view, the economic hit from higher interest rates hasn't been as severe as many feared.

The global downturn so many expected *still* hasn't arrived. And even some of the soft patches are seeing improvement—improvement pessimists cast as illusory. Many hype central bank rate cuts as needed, but like hikes, they don't have any predetermined impact.

And just as higher rates didn't cause big problems, we don't think lower rates will automatically fuel growth. Yes, lower rates could help some areas like real estate and have a disparate impact on more rate-sensitive nations. But the impact is likely at the margin—and says nothing about whether central banks get the timing right. In our view, growth likely persists at least through yearend. Given investors' fixation on rate cuts and dismissal of resilient economic conditions, that should be sufficient to keep markets climbing.

US DOLLAR STRENGTH CONCERNS

Monetary policy divergence does influence foreign exchange rates. Hence, partly due to the US's relatively higher rates, the dollar is quite strong.

Headlines fret over this, but currency moves are normal. All currencies trade in pairs, strengthening and weakening cyclically. Unlike equities, which largely move up and to the right, most major currencies remain flat over longer time periods. (Exhibit 21, see next page)

xxxvi Source: Australian Bureau of Statistics, as of 27/07/2024.

xxxvii Ibid.

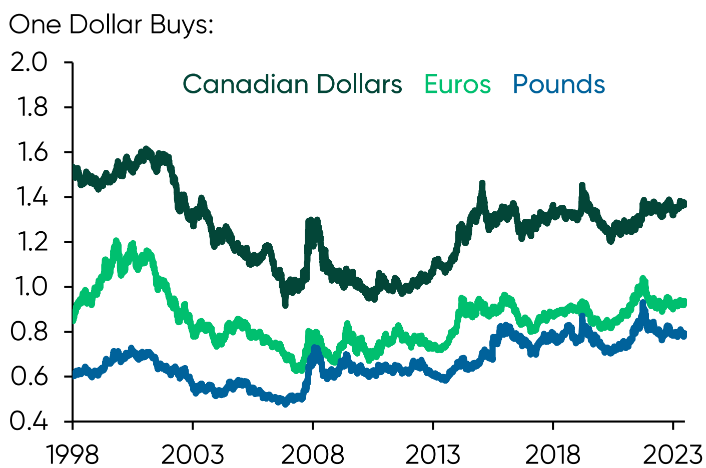
xxxviii "Australian Businesses Dipping Into Savings, but Arrears Still Low," Alice Uribe, *The Wall Street Journal*, 08/07/2024.

The dollar will weaken eventually. But that isn't a key concern: The economy and equities have done fine with strengthening and weakening currencies, despite the fact pundits seem to hate them both.

We aren't saying currency swings have no impact. They do. As Aaron Anderson wrote in his 2009 book, *Own the World*, currency swings affect overseas investment returns. The portfolio gets an overseas equity's return *plus or minus* currency movement.

You can see this in Japan. Year to date, the MSCI Japan is up 21.5% in yen.[xxxix] But overseas investors generally see a large detraction from the yen's extreme weakness. Hence, the same index is up just 6.5% in US dollars, 9.7% in euros and 7.4% in pounds.[xl] Conversely, if you look at the MSCI Kokusai Index (the MSCI World excluding Japan), Japanese investors get a boost from currency strength elsewhere against the yen. Such swings are real. But because major, liquid currencies ebb and flow in pairs, we believe it all tends to even out in time.

EXHIBIT 21: A LONG VIEW OF THE DOLLAR VERSUS THE EURO, POUND AND CANADIAN DOLLAR

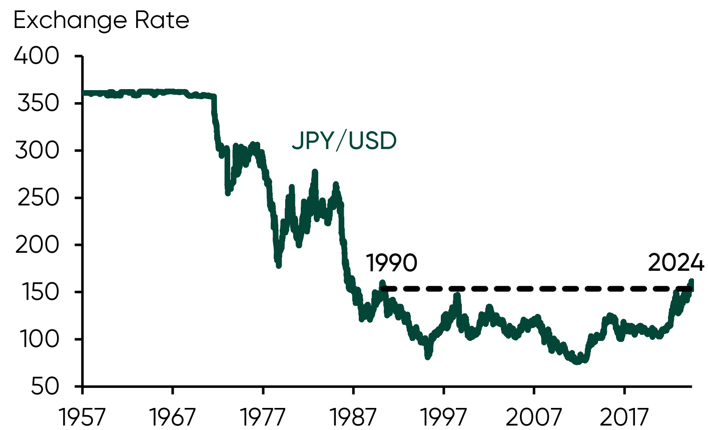


Source: FactSet, as of 08/07/2024. US dollar versus the euro, Canadian dollar and British pound, 31/12/1998 – 30/06/2024.

THE CAUSES AND IMPLICATIONS OF JAPANESE YEN WEAKNESS

The Japanese yen is the most notable example of the relative strength of the US dollar given the yen is the weakest it has been versus the dollar in over three decades. (Exhibit 22) This is causing consternation in Japan, particularly with Bank of Japan (BoJ) currency interventions attempting to stem the tide. But, contrary to what you might expect given many pundits' fixation with yen exchange rates, this hasn't caused Japanese equities to diverge sharply from the world.

EXHIBIT 22: YEN WEAKEST AGAINST THE DOLLAR SINCE 1990



Source: FactSet, as of 25/07/2024. Japanese yen to US dollar, 31/01/1957 – 25/07/2024.

xxxix Source: FactSet, as of 08/07/2024. MSCI Japan Index, 31/12/2023 – 30/06/2024. Presented in yen. Currency fluctuations between the dollar and yen may result in higher or lower investment returns.

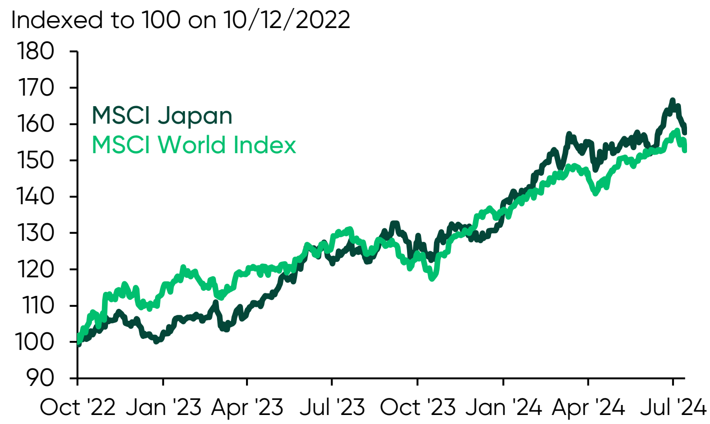
xl Ibid.

Japanese intervention is likely feckless, but that hasn't stopped them from trying. Reports estimate the BoJ has intervened to the tune of ¥6 trillion ($37.9 billion) in mid-July and close to ¥10 trillion in late-April.[xli] But this pales in significance next to around $19 billion in average *daily* USD-JPY trading volume year to date.[xlii] Now, the Finance Ministry and BoJ have stated they are aiming to combat "excessive" yen movements and aren't necessarily defending a particular level (although the two suspected interventions both occurred around 160 yen/dollar, casting that assertion into doubt).[xliii] But they have also said they are concerned about the weak yen's effect on import costs and household consumption.[xliv]

However, for all their intervention, the results are difficult to decipher from normal currency swings. Why? Interest rate (nominal and real) differentials drive flows, in our view, swamping intervention efforts. All else equal, currencies chase higher yields. The fed-funds target rate's upper range is 5.5%, the ECB's policy rate is 4.25% and the Bank of England's is 5.25%. Yet the BoJ's overnight target rate is just 0.1%. While some speculate BoJ hikes and cuts elsewhere may come soon, the gap is extremely wide today. A BoJ hike alone, like 19 March's, is likely too small to sway the forex market much—even if it is combined with potential overseas cuts starting. Currency interventions may interrupt this dynamic temporarily, but they are unlikely to overcome rate fundamentals.

Pundits have long presumed the yen's direction is critical to the country's equity markets' moves. Yet this year suggests otherwise. Despite the extreme yen weakness, Japanese equities are mostly moving in tandem with the world. Since daily price data begin in 1984, the MSCI Japan and MSCI Kokusai (World Ex. Japan) Indexes have a 0.54 correlation.[xlv] Moreover, the correlation has become progressively stronger. Since 2000, the correlation has been 0.61. And since 2020, 0.65. So it is this year, too. Equities in Japan and outside it have mostly paralleled one another in 2024. The *degree* differs. The *direction* largely doesn't. (Exhibit 23) This comes with Japan's wildly diverging inflation rate path, monetary policy—and currency—with everyone else's the last few years.

EXHIBIT 23: JAPANESE EQUITIES MOVING WITH GLOBAL BULL MARKET



Source: FactSet, as of 25/07/2024. MSCI Japan returns with gross dividends in yen and MSCI World returns with net dividends in dollars, 12/10/2022 – 27/07/2024.

xli "Japan Keeps Up Yen Warnings; 6 Trillion Yen, 2-Day Intervention Suspected," Leika Kihara, *Reuters*, 16/07/2024. "Is Japan Government Intervening in the Foreign Exchange Market for a Second Time? The Outflow of Funds From the Central Bank Accounts Has Exceeded 35 Billion US Dollars for Two Consecutive Days." Staff, *Futubull*, 16/07/2024.

xlii "Latest US Dollar to Japanese Yen Rate and Live USD/JPY Data," Staff, Pound Sterling Live, 25/07/2024.

xliii "Explainer: What Are Japan's Tactics Based on Latest Suspected Intervention?" Staff, Reuters, 17/07/2024.

xliv "Bank of Japan Issues Stronger Warning Over Yen's Impact on Policy," Leika Kihara and Satoshi Sugiyama, Reuters, 08/05/2024.

xlv Source: FactSet, as of 25/07/2024. MSCI Japan and MSCI World Ex. Japan price returns in local currencies, weekly, 30/12/1983 – 19/07/2024.

Some also see yen weakness as a sign of overall Japanese malaise. And it does act like a tax on imports—particularly energy—which weighs on domestic demand. We think this has contributed to Japan's GDP slide from its Q2 2023 highwater mark. Household consumption has contracted every quarter since then—also in contrast with most other major developed market countries.

But mostly, yen weakness shows BoJ monetary policy remains bizarre, even if it is becoming marginally less so. Ending negative overnight rates in March was a start, but continuing to artificially depress long rates through ongoing quantitative easing and yield curve control drives the interest rate wedge wider versus the rest of the world, especially as other central banks have stopped or reversed their extraordinary measures. The main result—a weaker yen—hasn't been stimulus, undercutting the stated intent of BoJ policy.

None of this is new, though. Japan's households and corporations have a wealth of experience coping with yen depreciation. This is partly why Japan's net international investment position—external financial assets less liabilities—is the largest in the world. Japanese investors have bought a lot of foreign assets seeking better (yen-denominated) returns. Meanwhile, many Japanese multinationals source materials and components overseas and, in turn, sell into markets abroad, hedging their currency exposure where it makes sense along the way. This is also why when the yen is strong, we often say it isn't the trouble for Japan's big exporters many claim.

What the yen does skew: currency-adjusted returns. For non-Japan-domiciled investors, the yen has detracted from Japanese equities' performance since the MSCI World Index's October 12, 2022 trough. The MSCI Japan Index, which is up 57.6% locally, drops to 51.0% in dollars, compared to the MSCI World Index's 52.7%.[xlvi] But don't overrate currency effects, which tend to even out over the long term.

xlvi Source: FactSet, as of 25/07/2024. MSCI Japan returns with gross dividends in yen and dollars and MSCI World returns with net dividends in dollars, 12/10/2022 – 27/07/2024.

EMERGING MARKETS **COMMENTARY**

US dollar concerns are varied and prevalent in both Global Developed, as highlighted above, and in Emerging Markets.

DE-DOLLARISATION, THE BRICS CURRENCY AND FALSE FEARS

You can't discuss the dollar without someone mentioning de-dollarisation—the faulty fear the world will abandon the US dollar's primary role in global commerce and central banks' chief currency reserves. Many argue this "exorbitant privilege" permits the US to borrow massively at low rates. Should the world move on, the story goes, disaster would ensue.

We disagree. Yes, oil, gold and other items are universally priced in US dollars. When a country wants to buy oil or gold, most of the time, they sell their currency, buy dollars and exchange them for oil. The recipient can then either hold dollars or sell them and buy their own currency. This, plus America's huge and open economy, is why the dollar is involved in 88% of foreign exchange transactions (note: this figure is out of 200%, as all currency transactions have two sides).[xlvii] But the US gets nothing from this—no tax, no brokerage fee.

As for reserve assets, central banks often build buffers of foreign currencies, gold and other assets for use in crises or if their currencies plummet, as in 1997 – 1998's Asian Contagion.

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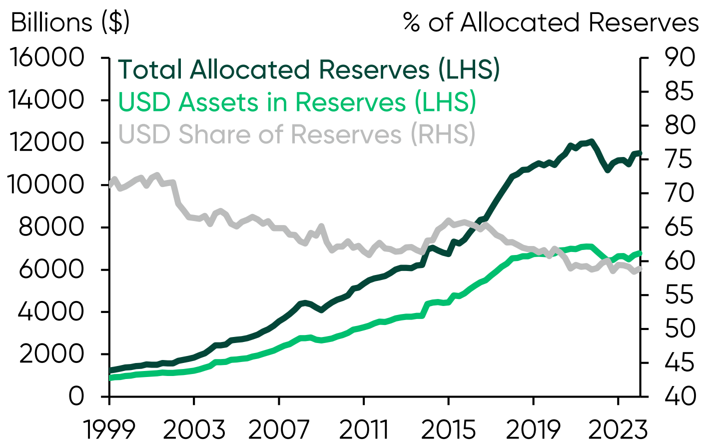
xlvii "The Impact of International Fragmentation and the Role of the US Dollar," Alexandre Tombini, *Bank for International Settlements*, 28/10/2023.

The dollar has long been the most popular, at 58.9% of "allocated" (officially reported at the currency level) reserves in Q1.[xlviii] This is down from nearly 73% in the early 2000s, which some cite as evidence of de-dollarisation. But the dollar is a slightly smaller piece of a vastly larger pie. The declining share came as total holdings of dollar assets rose from just under $1.1 trillion to nearly $6.8 trillion. If countries hold six times as many dollars in reserves, it is hard to see how de-dollarisation fears make sense.

EXHIBIT 24: MORE DOLLARS HELD IN RESERVE DESPITE FALLING SHARE



Source: IMF, as of 09/07/2024.

Then, too, what is the alternative? Gold is impractical, given its scarcity. Plenty of people talk of a shared currency among the BRICS (Brazil, Russia, India, China and South Africa). Nonsense. BRIC was a term coined by Jim O'Neill in 2001 to describe those four nations' geopolitical emergence, with the fifth added later. Many used it to market investment products. But there is little connective tissue among the five. India and China are rivals in South Asia with competing economies, cultures, political systems and disputed borders. Brazil has endemic inflation, as does South Africa. Russia is … Russia. A common currency requires similar political systems and a shared central bank—and, arguably, centralised government debt. The eurozone showed the problems without these, and those nations have much more political and cultural similarity. The idea China would surrender monetary autonomy when they don't even allow capital to freely cross their border is bizarre.

As O'Neill said last year, "… [E]ver since the Brazilian and Russian foreign ministers proposed the idea of creating a formal BRIC political grouping in 2009, I have questioned the organisation's purpose, beyond serving as a symbolic gesture."[xlix]

Besides, having the primary reserve currency doesn't lower borrowing costs. France has a higher debt load as a share of GDP, similar inflation, slower economic growth… and lower interest rates.[l] Japan has much more debt relative to GDP, with much lower yields.[li] Neither the yen nor euro is the primary reserve asset. US debt isn't affordable because the dollar is central to reserves. The US dollar is central to reserves because our debt is affordable, the market is deep and liquid, and the full faith and credit of a government with stable institutions backs the assets.

xlviii Source: IMF, as of 09/07/2024. Currency composition of official foreign exchange reserves, Q1 2024.

xlix "Does an Expanded BRICS Mean Anything," Jim O'Neill, Project Syndicate, 25/08/2023.

l Source: FactSet, as of 09/07/2024.

li Ibid.

EM ECONOMIC DATA IS BETTER THAN INVESTORS APPRECIATE

East Asian GDP reports released in Q2 were better than expected. China's GDP rose 5.3% y/y in Q1, ticking up from Q4's 5.2% and topping the 4.7% consensus.[lii] Infrastructure investment underpinned the acceleration, speeding from 6.0% y/y in Q4 to 6.5% last quarter. Fixed investment in factories and equipment also sped from 4.2% to 4.5%. Taken together, this seems like China's government plan to stimulate growth via heavy industry—the old channel left behind in recent years—is bearing at least some fruit. However, real estate remained weak, with property investment falling -9.5% y/y in Q1.

China continued rolling out property support, battling lingering concerns—and lifting sentiment. The People's Bank of China (PBoC) unveiled a 300 billion yuan ($42 billion) loan programme to fund state purchases of unsold housing units. The funds are intended to be lent through banks to local state-owned enterprises, who then make the units available for social/affordable housing. The PBoC estimates its loans could underpin 500 billion yuan of such buying. That seems small compared to the estimated 30 trillion yuan of unsold inventory—raising doubts about their effectiveness. But alongside a host of other measures—like big cities' lowering down payments and mortgage rates for first-time buyers—policymakers are taking multiple steps to address this headwind, helping assuage sentiment.

Separately, China began issuing 1 trillion yuan ($139 billion) in special long-term treasury bonds in Q2, consisting of 300 billion yuan in 20-year maturities, 600 billion in 30-year debt and 100 billion for 50-year tenors. In only the fourth special sovereign debt sale—after 1998's state bank recapitalisation, 2007's sovereign wealth fund initialisation and 2020's pandemic response—the funds will be used for strategic investment in "major national strategies and building security capacity in key areas" to support growth.

Besides these special bonds, local governments will be allowed to issue 3.9 trillion ($542 billion) in new special debt. Moreover, China's biggest banks have begun selling around 440 billion yuan ($62 billion) in special "total-loss absorbing capacity" (TLAC) bonds to raise capital. In our view, this looks like something of a reversal from earlier policies aimed at cooling local debt sales and represents the government directing notable financial resources to both backstop banks and give local governments latitude.

South Korean GDP's 3.4% y/y Q1 growth cruised past consensus estimates for 2.4%, accelerating for the third straight quarter.[liii] Growth was led primarily by exports' 7.0% y/y gain, but notably, intangible fixed asset investments' 2.6% advance continued to contribute as well. Relatedly, Taiwanese GDP also beat and accelerated, up 6.5% y/y, up from 4.9% the prior quarter and beating consensus expectations for 5.9%.[liv] Echoing Korea's growth, this was driven by rising exports, up 10.2% year-over-year. In concert, these two nations' trade data are evidence the boom in Tech equities over the last year-plus isn't unfounded. It supports the notion there is real demand that they anticipated, particularly for the hardware that powers AI, as the technology drives an overhaul in computing.

Eastern European GDP also accelerated in Q1—and beat expectations—mirroring the recovery in broader eurozone growth. Czech GDP accelerated to 0.4% y/y, ahead of the 0.3% consensus estimate and Q4's 0.2%—which came after three straight quarterly contractions.[lv] Hungary's Q1 GDP jumped 1.1% y/y from a flat reading in Q4—and also follows contractions in 2023's first three quarters.[lvi] Latin American GDP reports also signaled ongoing growth. Mexican GDP rose 0.2% q/q, accelerating from Q4's 0.1% and beating expectations for an unchanged quarterly rate.

lii Source: FactSet, as of 02/05/2024.

liii Source: FactSet, as of 02/05/2024.

liv Source: FactSet and National Statistics, Republic of China (Taiwan), as of 30/04/2024.

lv Source: FactSet and Czech Statistical Office, as of 30/04/2024.

lvi Source: FactSet and Hungarian Central Statistical Office, as of 30/04/2024.

Finally, in India, EM's second-largest economy grew rapidly. Indian GDP rose 7.8% y/y, beating the 6.7% consensus. But a sharp drop in government subsidies bolstered growth. Gross value added—which removes the effect—rose 6.3% y/y, slowing from Q4's 6.8%. Consumer spending, about 60% of GDP, stayed steady at 4.0% y/y. Although these slower underlying growth rates are fine and add to global demand, in our view, they show the problems with taking headline GDP at face value. We don't think the reality quite matches current enthusiasm toward India.

A BUSY YEAR IN POLITICS: EM VERSION

Like Developed Markets, 2024 has been an active year in politics for EM. In our view, the benefit of clarity that elections provide are generally positive in both EM and the Developed World. However, gridlock—which is typically positive for Developed Markets—can hinder EM countries if positive reform is needed. Below is a summary and our views of several major EM elections this year.

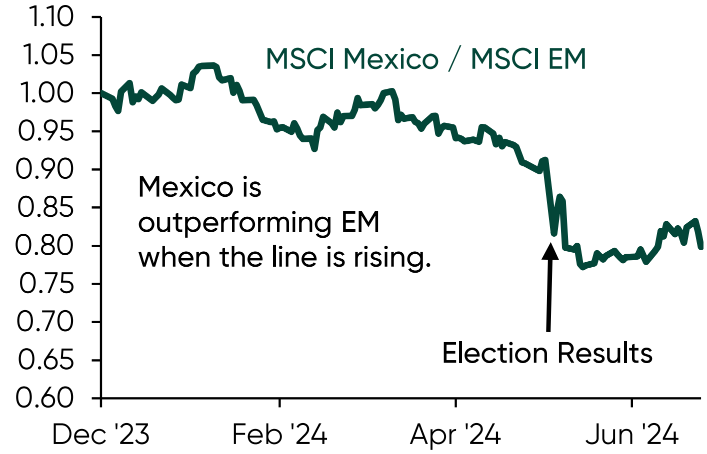
MEXICO'S VOTE STIRS ANGST

Mexico's 2 June election preoccupied investors throughout Q2. Markets sank in the run-up to the contest, pricing in the fear of leftist President Andres Manuel Lopez Obrador's (aka AMLO's) hand-picked successor, Claudia Sheinbaum, winning with a supermajority for their Morena party in the legislature. This came close to happening. Sheinbaum won in a landslide, while Morena took a super majority in the lower house of Congress and fell three seats short of one in the Senate.

Mexican equities are flattish since then, but with high volatility along the way. (Exhibit 25) This is likely because there will be a one-month stretch in September where AMLO will preside over the new legislature before Sheinbaum's inauguration. AMLO has hinted he will pursue constitutional amendments including undoing prior governments' liberalisation of the energy sector during this window, spooking markets. His gambit seems to be that he can pass contentious measures on the way out, then Sheinbaum can play up market-friendly rhetoric once in office.

EXHIBIT 25: RELATIVE RETURNS SURROUNDING MEXICO'S ELECTION

Indexed to 1 at 12/31/2023



Source: FactSet, as of 25/07/2024. MSCI Mexico and MSCI Emerging Markets (EM) returns in USD with net dividends, 31/12/2023 – 27/07/2024. Indexed to 1 at 31/12/2023.

Radical legislation isn't a foregone conclusion. AMLO may need just four opposition votes to push a constitutional amendment through the legislature, but those votes won't come easily. Additionally, completing amendments requires support from a majority of states. AMLO may simply spend the next few months floating trial balloons in the press to gauge the public's potential reaction, which heightens volatility but helps markets pre-price change.

Regardless, investors will eventually get clarity. The feared changes aren't new, sapping their surprise power when and if they come to fruition. Meanwhile, Sheinbaum has also nodded to more investor-friendly measures, including boosting private investment in energy production and supporting the nearshoring of global manufacturing. The latter may even necessitate the former.

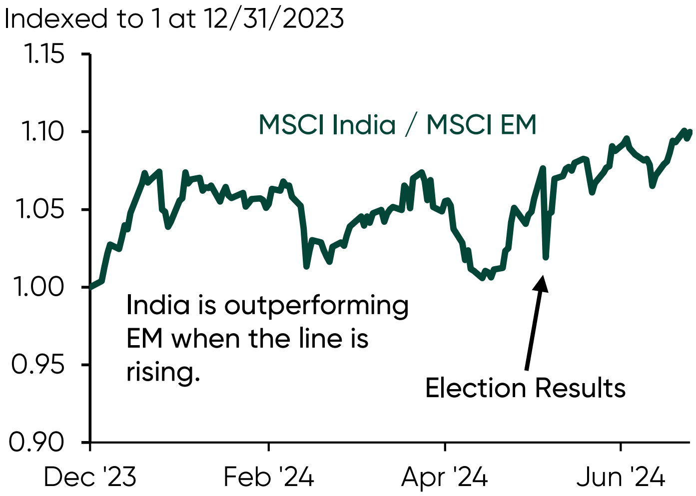
Ultimately, all this volatile policymaking over a key national economic asset (the Energy industry) is a near-term negative and is worth monitoring, as it stokes uncertainty. But we should get clarity on the matter soon.

INDIA LONG VOTE LEAVES MODI SHORT OF OUTRIGHT MAJORITY

India's elections also stoked volatility, but the falling-uncertainty rally is now well underway. Markets rallied in the run-up to the vote, in part because Prime Minister Narendra Modi's alliance looked poised to win a landslide third term. Hopes for structural reforms were high. So when PM Modi's alliance lost seats and his Bharatiya Janata party (BJP) lost its outright majority, disappointment set in, and Indian markets fell.

Yet the reaction proved overblown. Indian equities erased the initial decline within a week and have rallied since. (Exhibit 26)

EXHIBIT 26: RELATIVE RETURNS SURROUNDING INDIA'S ELECTION



Source: FactSet, as of 25/07/2024. MSCI India and MSCI Emerging Markets (EM) returns in USD with net dividends, 31/12/2023 – 27/07/2024. Indexed to 1 at 31/12/2023.

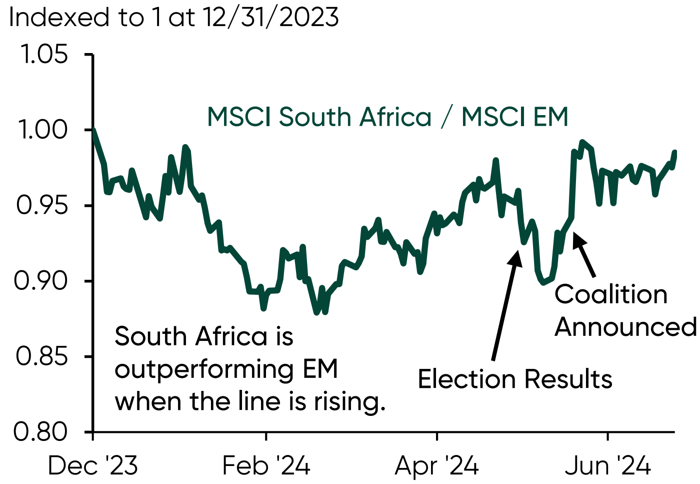
We aren't surprised. For one, PM Modi's broader alliance still has a majority. Two, reform hopes were always far-fetched. Even if the BJP had extended its outright majority, Modi picked all the low-hanging reform fruit in his first two terms. The BJP's platform for this election was notably light on structural reforms. It nodded to increasing investment and infrastructure spending while maintaining fiscal prudence. A coalition with its allies probably doesn't jeopardise this, although the economic and market impacts are likely quite limited. Moreover, extending the current coalition continues a status quo markets are familiar and fine with.

SOUTH AFRICA

South Africa's election, held in late May, also roiled markets initially. The African National Congress (ANC) lost the outright majority it had held since 1994, raising the likelihood of a coalition government—and gridlock. While gridlock is a positive in advanced economies with freer markets and strong institutions, in developing countries, it often blocks necessary reforms. In South Africa's case, gridlock would potentially block legislation to address a litany of structural problems, including eroding property rights, corruption, problems in the energy grid and fiscal concerns. Hence, as the high likelihood of gridlock became evident, markets registered their disappointment.

However, in mid-June, things turned around with a last-minute coalition deal. The new legislature opted to support incumbent President Cyril Ramaphosa, and the ANC formed a coalition with the Democratic Alliance (DA), widely considered the most market-friendly coalition combination, and several tiny parties. The DA is a centrist, pro-business party that supports economic reforms, and while the new government has nodded to higher social spending (part of the ANC's platform), it also has emphasised measures to increase employment and electricity access and stabilise public finances. This boosted investors' hopes for improvement to infrastructure, economic growth and other long-running sore spots, boosting markets as the coalition came together. (Exhibit 27, see next page)

EXHIBIT 27: RELATIVE RETURNS SURROUNDING SOUTH AFRICA'S ELECTION



Source: FactSet, as of 25/07/2024. MSCI South Africa and MSCI Emerging Markets (EM) returns in USD with net dividends, 31/12/2023 – 27/07/2024. Indexed to 1 at 31/12/2023.

Over the medium to longer term, though, the initial optimism may prove hasty. Political divisions between the ANC and DA have already erupted, and the coalition may not have much staying power. Even if it lasts, the ideological differences between the two parties may breed more gridlock than investors currently expect. This could make strengthening the countries' institutions and addressing its structural issues difficult. While markets likely appreciate the falling uncertainty and extension of a status quo they have long been familiar with, the likelihood that reform drives sustained outperformance looks low.

IN SUMMARY

Worrying over EM politics shows sentiment is still sceptical, but with elections in the rearview, we think falling political uncertainty itself is a tailwind. Improving economic fundamentals also show reality likely continues beating expectations with recent indications pointing to widening global growth.

INDEX DESCRIPTIONS

MSCI ALL COUNTRY WORLD

MSCI All Country World Index is a free float-adjusted market cap-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 47 country indices comprising 23 developed and 24 emerging market country indices. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

MSCI WORLD

The MSCI World Index is a free float-adjusted, market cap-weighted index designed to measure the equity market performance of developed markets. The MSCI World Index consists of 23 developed market country indexes. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

MSCI EMERGING MARKETS

MSCI Emerging Markets Index is a free float-adjusted market cap-weighted index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of 24 emerging market country indices. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

S&P 500

The S&P 500 Index measures performance of 500 primarily large cap US stocks and includes a representative sample of leading companies in leading industries as determined by Standard and Poor's. Returns are presented inclusive of dividends.

MSCI JAPAN

The MSCI Japan Index is a free float-adjusted market cap-weighted index that is designed to measure equity market performance of the Japanese market. With 203 constituents, the index covers approximately 85% of the free float-adjusted market capitalisation in Japan. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

MSCI KOKUSAI

The MSCI Kokusai Index (also known as the MSCI World ex Japan Index) is a free float-adjusted market cap-weighted index that is designed to measure equity market performance of Developed Markets excluding Japan. The MSCI Kokusai Index consists of 22 developed country indexes. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

MSCI MEXICO

The MSCI Mexico Index is designed to measure the performance of the large and mid-cap segments of the Mexican market. With 24 constituents, the index covers approximately 85% of the free float-adjusted market capitalisation in Mexico. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

MSCI INDIA

The MSCI India Index is designed to measure the performance of the large and mid-cap segments of the Indian market. With 146 constituents, the index covers approximately 85% of the Indian equity universe. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

MSCI SOUTH AFRICA

The MSCI South Africa Index is designed to measure the performance of the large and mid-cap segments of the South African market. With 32 constituents, the index covers approximately 85% of the free float-adjusted market capitalisation in South Africa. Unless otherwise specified, returns shown include dividends after deducting estimated withholding taxes. MSCI calculates estimated withholding taxes using the maximum rate of the constituent company's country of incorporation applicable to non-resident institutional investors that do not benefit from double-taxation treaties.

Should you have any questions about any of the information provided above, please contact FIE by mail at Level 18, One Canada Square, Canary Wharf, London, E14 5AX or by telephone at +44 (0)207 299 6848.