

GLOBAL OUTLOOK
July 2023

This document should be used as a guide only. It is based on our current view of markets and is subject to change.

INTRODUCTION

This document shows the charts that we think are particularly useful to help us determine where we are in the economic cycle and what the outlook is for markets.

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SUMMARY OF OUR VIEWS

Macroeconomic background

There remains an apparent disconnect between a stock market that wants to move higher and the range of historically reliable indicators suggesting a recession is likely in the US.

Some of this is normal in the sense that during monetary policy tightening cycles the stock market often does well in absolute terms and relative to fixed income. This is in part because the tightening cycle is driven by a desire to slow demand to help in the battle against inflation. While demand appears robust investor confidence in the earnings outlook remains high.

That appears to be the situation today too. The Federal Reserve is likely to continue to tighten policy because there is so far little evidence that the economy is slowing in response to the rate increases of the last 18 months.

One difference in this cycle is that the fiscal spending initiated in the first two years of the Biden Administration is having a meaningful impact. As highlighted by our equity team, new construction spending on manufacturing facilities has more than doubled since the end of 2021, a direct result of the fiscal packages such as the Inflation Reduction Act, Infrastructure Investment and Jobs Act and the CHIPS and Science Act.

That could be one reason why it is taking longer than many expected to have clearer evidence of slowing demand. For the Federal Reserve though there is a clear desire to have that evidence which suggests a postponement of the likely slowdown ahead rather than avoiding it.

We continue to see bonds as attractive. If we look at current nominal bond yields on both sides of the Atlantic and compare them to current market expectations for inflation over the next decade, there are positive real yields on offer in gilts and Treasuries.

We continue to have more exposure to government bonds than normal in our fixed income portfolios as we have a lower allocation to credit than we have ever done (back to 2009).

We note in this publication that the forward earnings yield on the S&P500, the Baa corporate bond yield and the 3-month Treasury bill are all at very similar levels. This has been unusual in recent decades. Our suspicion is that both the earnings yield and the corporate bond yield will increase if we do finally get signs of a slowdown in the second half of 2023.

Robust fiscal spending is supporting the US economy but the Federal Reserve will raise rates again this month as it continues to attempt to slow demand.

Risk warning: The above should be used as a guide only. It is based on our current view of markets and is subject to change. As at 10.07.23

SUMMARY OF OUR VIEWS (continued)

Equities (underweight)

Global equities returned +3.3% in the second quarter. They are up 7.8% so far this year (all in sterling terms).

Sterling strength, courtesy of expectations that the Bank of England will be raising rates more than other central banks this year, has moderated equity returns to a UK investor. In dollar terms the World Index is up 14% this year.

The world market continues to be led by the largest US companies but there was some broadening of market leadership in June, coinciding with a pick-up in investor sentiment.

There continues to be support for equities from ongoing economic growth in the US, in particular, and greater than expected resilience in full year earnings estimates. Outside the tech-heavy Nasdaq index in the US, stock valuations are not demanding.

Geographically, we continue to find more investment opportunities in Japan than the UK and remain shy of Asia Pacific and Emerging Markets. North America makes up 64% of the index, with disproportionate exposure to the world's largest technology stocks – so being underweight the US is a mathematical consequence of prudent portfolio management rather than a decision to avoid the region. Our recommended portfolio has over 50% in the US.

We continue to focus on companies where we have greater confidence in their ability to deliver Free Cash Flow growth over the next few years, irrespective of the broader macro environment, and where valuations are undemanding. We remain disciplined in our approach and long-term in our perspective.

Fixed income (overweight)

The overall gilt total return index returned -6.0% in the second quarter. It has returned -3.8% this year.

We now see some value in gilts for the first time in many years. Within the Sterling Bond Fund we have exposure to both long duration gilts and long duration US Treasuries.

Short dated sterling credit is also attractive with yields of 5-6% on offer for an investment grade portfolio of bonds maturing within the next 18 months.

Alternatives (neutral)

We believe Alternatives have an important role to play in diversified portfolios.

Absolute Return strategies can give exposure to an uncorrelated stream of returns giving diversification benefits. This sector has struggled in recent years, but well-run funds have attractive volatility dampening characteristics.

Real Assets such as property (both physical and intellectual), infrastructure (including transportation), commodities (such as gold) and other investments underpinned by physical assets offer a combination of income and capital return that is attractive. Many of the assets that produce income have inflation linked cashflows.

Cash (neutral)

Even though savings rates have risen, cash still loses purchasing power quickly in the current period of high inflation.

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Part 2
RECESSION, INFLATION, POLICY RESPONSE
AND GOVERNMENT BONDS

US AND UK RATE EXPECTATIONS DIVERGE...

The top chart shows current expectations for the US Federal Reserve policy rate. The market is no longer "fighting the Fed" by pricing in rate cuts this year. The first cut is now not expected until Q2 2024.

This is rational given the ongoing headline strength of the economy, the ongoing concerns about the level of service industry inflation in particular, and the consistent messaging from the majority of monetary policymakers that another hike is likely later this month.

The bottom chart shows current expectations for the Bank of England's Base rate.

In recent weeks the market has materially changed expectations for how aggressive the Bank of England will have to get.

It now sees four or five more hikes from the current base rate of 5.0%. If the base rate does get to 6.5% that will be painful for the UK economy.

The only good news is that in our view it unlikely that both these charts will be an accurate reflection of what happens from here. If the Fed can stop hiking after one more increase it will be because US inflation and growth are moderating.

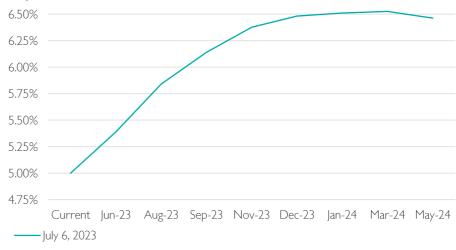
Given the size of the US economy, Fed success will have a moderating influence on global growth and the global inflationary impulse. That would be of benefit to the Bank of England and suggests that the BoE will not have to raise rates as much as the market currently anticipates.

Implied US Fed Funds rate %





Implied UK Base Rate %



Source: Bloomberg, Waverton. Data as at 06.07.23

... A DIVERGENCE THAT HAS NOT BEEN SEEN SINCE 2008

The top chart shows the Bank of England Base Rate and the Federal Reserve's Fed Funds rate since the Bank of England became operationally independent in June 1997. It also includes market expectations for both rates into the summer of 2024.

Since the Global Financial Crisis the two rates have been similar except for the period when the Fed attempted to raise rates before Covid hit.

The bottom chart shows the Base Rate minus the Fed Funds rate. If current market expectations are correct, the Base rate will be more divergent from the Fed Funds rate than it has been since 2008.

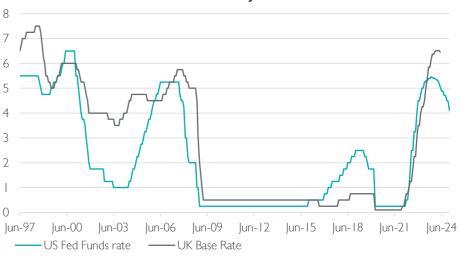
It is certainly possible that we go back to the period roughly corresponding to the first decade of the Bank of England's independence. After all, many commentators assert that the Bank has mishandled policy in recent years and has contributed to the inflation problem in the UK. And it is certainly true that the UK's inflation problem is worse than the problem in the US and the euro area. Those with that view likely think it rational for UK interest rates to be materially higher than those in the US.

But we suspect that the Bank needs help to reduce UK inflation. The UK is an open economy. Raising interest rates here is very negative for large sections of the UK economy but we are sceptical that raising the Base rate significantly from here will do much to reduce aggregate inflation.

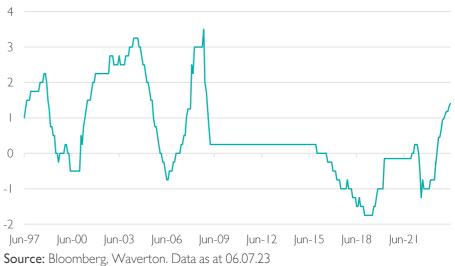
The UK needs to see the US economy slowing and the inflationary impulse there slowing too. When that happens, we expect to see UK inflation slow too.

We are sceptical that the Base Rate and the Fed Funds rate will diverge in 2024 as much as the market currently expects.

UK Base rate and US Fed Funds rate, June 1997 – current, %



UK Base rate minus US Fed Funds rate, June 1997 – current, %



STOCKS TEND TO DO WELL DURING TIGHTENING CYCLES

Despite the market no longer "fighting the Fed", the US stock market continues to trend upward. Earlier in the year this was explained by the market expectation that the Fed would "pivot" and cut interest rates later this year. Now the explanation for the ongoing strength in the market is that earnings continue to hold up well, including a widespread expectation that the Q2 reporting season will confirm that narrative.

During Fed tightening cycles the stock market does tend to do well.

The top chart shows the US stock market total return relative to the total return from investing in bonds. The grey bars are tightening cycles, defined as being from the first interest rate hike to the last in each such cycle.

The bottom chart just shows the total return from investing in the US equity market and those same tightening cycles.

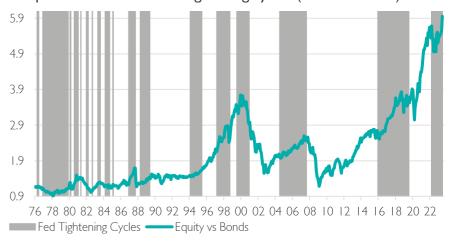
What we have seen in the last 18 months is "normal". We suspect the recent narrative that despite the rate hikes the stock market is supported by ongoing earnings strength is also "normal" for this stage of the cycle.

But look at what happens to the green lines in each chart after tightening cycles end. Generally, equities underperform bonds and decline in absolute terms too.

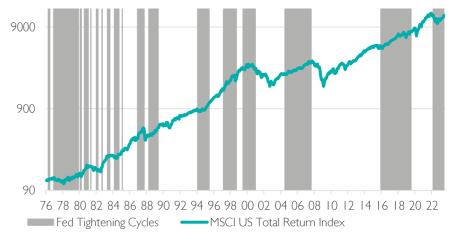
This is because tightening cycles end when the Fed has achieved a slowdown in the economy, which makes bonds more attractive and suggests a weaker outlook for earnings.

Perhaps in the second half of 2023 and into 2024 we may see something similar occurring?

US equities vs bonds & Fed Tightening cycles (1976 - current)



US equities and Fed Tightening cycles (1976 – current)



Source: Bloomberg, Waverton. Data as at 30.06.23

THERE IS SIGNIFICANT RISK OF A RECESSION IN THE US (PART ONE)

This chart is an indicator of recession probability in the next 12 months from the New York Federal Reserve with a history going back to 1960. The probability is based on the spread between 10-year and 3-month Treasury rates. The grey bars on the chart are recessions.

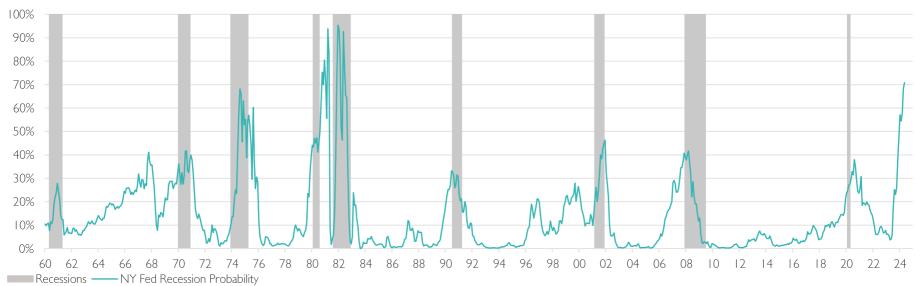
3-month Treasury bill rates have been generally above 10-year bond yields since 26 October 2022. Not surprisingly the probability of a recession has therefore picked up and as at the end of May it is 71%.

Since 1970 a recession has occurred each time this indicator got to 30% so it is now well above where it needs to be to signal a high risk of recession.

The US yield curve has been one of the most reliable indicators of future recession.

It will be surprising if the US does not now have a recession in 2023.

New York Federal Reserve Recession Probability Indicator 1960 - current



Source: Bloomberg, Waverton. Data as at 31.05.23

THERE IS SIGNIFICANT RISK OF A RECESSION IN THE US (PART TWO)

Along with the shape of the yield curve, another reliable cyclical indicator is what is happening to collections of indicators that tend to move ahead of cyclical turning points (the Leading Indicators).

The Index of Leading Indicators is made up of 10 series including share prices, the yield curve and a range of indicators covering housing, new orders and leading indicators of the labour market such as jobless claims.

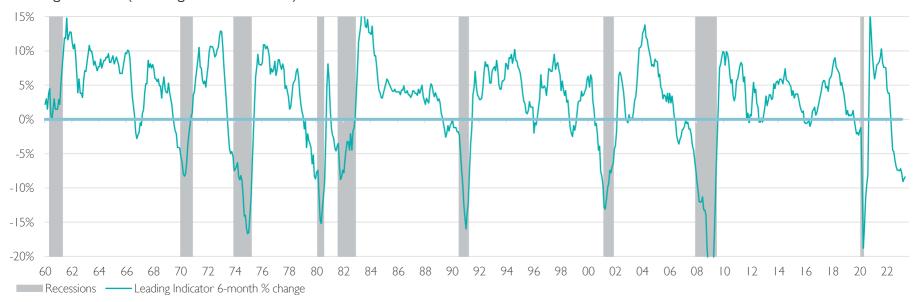
The chart shows the change over six months in the Leading Index since 1960. The grey bars are recessions.

As the chart shows, there has been a recession after every occasion when the Leading Indicators are lower than they were six months ago.

As at the end of May the change in the index over the last six months is -8.4%.

As you can see, since 1970 the US has either already been in recession, or a recession has started within three months of the change in the index being -7.0% or worse.

Leading indicator (% change over 6-months) and Recessions



Source: Bloomberg, Waverton. Data as at 31.05.23

THERE IS SIGNIFICANT RISK OF A RECESSION IN THE US (PART THREE)

The National Federation of Independent Business (NFIB) was founded in 1943 and is an association of small businesses. It has conducted a survey of its members since December 1973 which is a closely watched indicator of sentiment in an extremely important part of the US economy.

The survey asks ten questions around how optimistic the members are about various elements of their businesses such as whether they are hiring, how easy is their access to credit and what they think of general economic conditions.

One of the questions, "is now a good time to expand" your business, is graphed below.

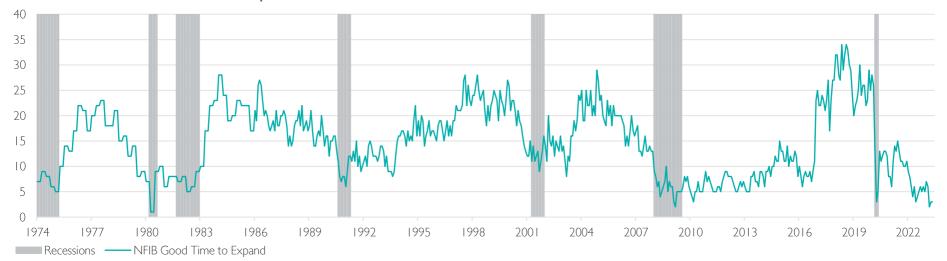
The reading in March was at its lowest level since the 1980 recession and only marginally better in April amd May.

Our conclusion from this chart is that, like the others we have shown, the risk of a recession at this point is material.

Approximately 47% of US workers are employed by small businesses (defined as employing 500 or fewer workers).

Very few of these businesses are publicly traded so this survey offers an insight into the health of an important indicator of the overall health of the US economy.

NFIB Small Business Good Time to Expand Index and Recessions 1974 - current



Source: Bloomberg, Waverton. Data as at 31.05.23

US PROFITS AS % OF GDP ARE IN DOWNTREND

This chart shows pre-tax profits of corporate America relative to GDP through Q1 2023, the most recent data available. This profit series shows aggregate profits across the whole economy and shows them in US dollars, not as earnings per share. Consequently, this series is not susceptible to financial engineering via such things as share buybacks to boost earnings per share. It is a proxy for profit margins and confirms S&P data showing historically high levels of margins.

In every recession except 1982, profits were falling as a % of GDP before it. We may be able to add this chart to the case for a recession in 2023.

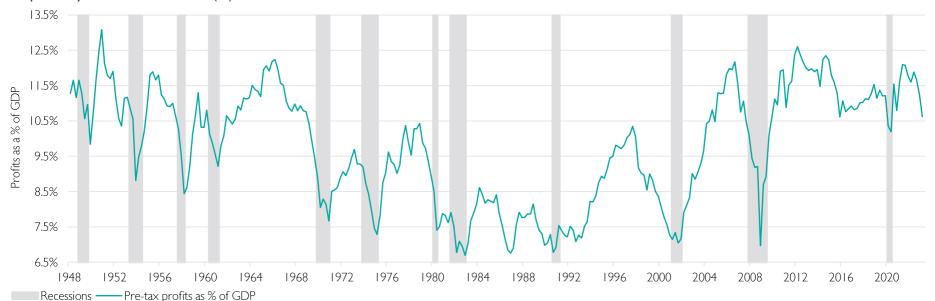
Q1 2023 profits were 10.5% of GDP, down from 11.3% in Q4 2022.

Profits as % of GDP are down from the 12.1% reported for Q2 and Q3 2021 which was likely the cyclical peak.

We expect weakness in profits as we go into H2 2023 and so expect to see this ratio declining further in the quarters ahead.

If that happens, we will certainly be able to add this to the list of indicators suggesting a recession is ahead.

US profit cycles and recessions (%)



Source: MSCI. Factset, Waverton, Data as at 31.03.23

THE US CONSUMER HAS BEEN RESILIENT UP TO NOW

The US consumer has benefitted from an ongoing robust labour market. There are almost twice as many job vacancies as there are people registered as unemployed.

The consumer has also benefitted from the decline in gasoline (petrol) prices since they peaked in June 2022. Gasoline prices have a significant impact on consumer expectations for inflation and they are a constraint on discretionary spending when they are high given the importance of the motor vehicle to the vast majority of US consumers and to the logistics industry. The move down to the current \$3.60 a gallon from a peak close to \$5.00 is shown in the top chart.

Betting against the US consumer has been, along with fighting the Fed, a disastrous trade for the last 40 years. But we have reached a point in this cycle, thanks to levels of inflation not seen for 40 years, where we need to see a curbing of consumer demand to get the Fed to stop tightening policy.

The housing market is weakening in the face of the interest rate rises already seen which have taken the 30-year mortgage rate to its highest levels for 22 years (bottom chart). The change in rates will dampen housing demand.

House prices nationally are still -4.9% on a year ago at the end of June and we would expect that to fall further in coming months. It peaked at 21% in April 2022.

That will be another headwind for consumer confidence and thus spending.



GOVERNMENT BONDS STILL LOOK INTERESTING AT THESE LEVELS

The top chart shows how the yield on 10-year gilts and 10-year US Treasuries has evolved over the last year.

UK yields have moved above US yields since March, partly because the market fears more rate hikes from the UK but is increasingly convinced the Fed will only raise rates one more time in the US.

The bottom chart shows those same yields after deducting the current 10-year inflation swap rate in each market. The swap rate is one indication of market expectations for inflation over the life of the bond.

Inflation swaps are priced on RPI in the UK so we have deducted 1.2% from the swap rate to get an implied indication of expectations of CPI inflation (1.2% is about the long-term "wedge" between RPI and CPI inflation).

As the chart shows, both markets continue to offer, on this measure, a positive real yield.

The inflation linked bond market is saying something similar in the US where the Treasury Inflation Protected Securities market is giving a positive real yield. The January 2033 TIPS yields 1.8%.

The UK linker market is less attractive (the November 2032 linker yields +0.8%).

Given the challenging economic outlook and the positive real yields on offer, we think there is still value in the government bond market today. Recent days are a reminder that government bonds remain an important component in a diversified portfolio.

US and UK 10-year bond yields (%)



US and UK implied real 10-year bond yields (%)



Source: Bloomberg, Waverton. Data as at 06.07.23

STERLING STRONG AGAINST THE FURO

Sterling has strengthened against the euro in recent weeks as the expectations for the extent the Bank of England will have to raise interest rates has moved higher.

We continue to think that the exchange rate versus the euro is a better measure of the market view of UK specific risks is the sterling/dollar rate.

The chart shows the number of euros per pound since I July 2016. The average exchange rate since then is shown as the grey line and we show a range 6% either side of that average.

We use 6% as that was the range sterling was allowed to trade against its DM2.90 central rate when it was in the Exchange Rate Mechanism (ERM). Famously sterling was forced out of the ERM in September 1992 when it was unable to hold within that range.

We note that over the period shown (over 1,800 trading days), sterling has only been out of a 6% trading range for five days.

For now it is slightly above average. If anything the issue in coming weeks may be that sterling strength continues. This will have some marginal positive impact on the fight against inflation here.

Euros per pound (01.07.2016 – current)



Source: Bloomberg, Waverton. Data as at 09.06.23

INFLATION REMAINS PERSISTENT AROUND THE WORLD...

This chart shows reported inflation in the US and UK since 1980 and the euro area since data started in 1997. We are at levels not seen for 40 years although there is evidence that the rate of inflation is now slowing.

The peak for US inflation was in June 2022 at 9.1%. It is now 4.0%. The euro area looks like it peaked in October 2022 at 10.6% (now 5.5%) and the UK may have peaked in October 2022 when RPI was 14.2%, and CPI 11.1%. The UK is struggling to reduce inflation as quickly as it appears to be reducing in the US. RPI is now 11.1% and CPI is 8.7%.

US core inflation (excluding food and energy) hopefully peaked at 6.6% in September. 2022 It was 5.3% in May.

Despite the recent improvements, there remain concerns about the

inflationary impulse across the developed world. The detail of recent inflation reports shows a slower reduction in price increases and Service inflation in the US in particular is a concern.

If inflation goes back to surprising to the upside there is a lot more to go in terms of rate hikes given how extraordinarily low they remain compared to headline inflation (and to history).

However, as the next charts show, the market is still somewhat sanguine about future inflation, which is understandable if there is a recession in the major economies this year. Although it is unusual for the stock market to be rallying strongly into a recession.

Inflation (% change year-on-year)



Source: Bloomberg, Waverton. Data as at 30.06.23

...BUT EXPECTATIONS FOR FUTURE INFLATION ARE MORE IMPORTANT

The top chart shows the 2-year inflation swap rate which is one reflection of the market's view on future inflation. One can buy or sell the swap. If you think inflation will average more than the current price, you buy the swap and vice versa. The payoffs are roughly linear. If you buy at 2% and the outcome is 2.2%, you make about 10%.

The moves in rate markets and inflation swaps are clearly interlinked. The market remains sanguine about inflation over the next two years as the expectation that rates will stay higher for longer is expected to ease the inflationary impulse.

But if future inflation actually takes longer to return to target that will be an issue for investors as it will almost certainly see a reversal upward in rate expectations.

The bottom chart shows longer term inflation indicators. Here the picture remains encouraging.

The green line is the 10-year US inflation swap and the black line is the inflation rate calculated from the spread between five year nominal and inflation linked bonds five years forward.

They are not suggesting any alarm about long-run inflation being out of range for those measures over the last 14 years.



Long-term US inflation expectations



Source: Bloomberg, Waverton. Data as at 30.06.23

THE BROAD COMMODITY COMPLEX IS WEAK

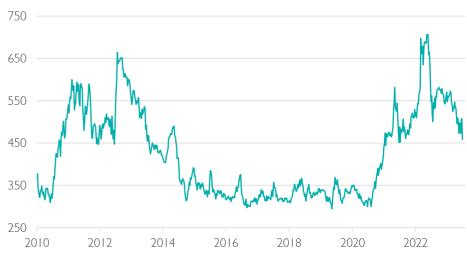
The broad commodity complex has responded to the narrative about a coming slowdown or even recession. Despite the support that grain prices should have from fears of supply disruption from Ukraine, the bread basket of Europe, and Russia, grain prices fell last summer before rebounding a little and then losing momentum again (see top chart).

The Industrial Metals index (bottom chart) also fell last summer, then rallied a little before also falling back recently.

The change of policy toward Covid in the People's Republic of China is one of the potential positives for the global growth outlook.

So far the bottom chart on this page is one of several suggesting that the PRC economy has not recovered as much as had been hoped earlier in the year.

S&P GSCI Grains Index



S&P GSCI Industrial Metals Index



Source: Waverton, Bloomberg. Data as at 30.06.23

DOLLAR HIT IN IMMEDIATE AFTERMATH OF BANK PROBLEMS

The top chart shows a trade weighted dollar index. Having been very strong from June 2021 to mid October 2022 it weakened until the beginning of February and has been range bound since.

The fluctuations in expectations for Federal Reserve policy have moved the currency around. With those expectations having moved back to about where they were pre the early March banking problems, the dollar has some support from the more hawkish monetary policy now expected.

The bottom chart shows that an index of emerging market currencies. This index is weighted by the weighting of each country in the MSCI Emerging Market equity index, so China is the biggest component.

It has not moved much in recent weeks having rallied early in the year on the expectation of Chinese economic recovery.

For now there are no clear signals from the currency markets.



MSCI Emerging Market Currency Index



Source: Waverton, Bloomberg, MSCI. Data as at 30.06.23

GOLD CLOSE TO RECORD HIGH

On the month-end basis shown below, gold is close to its all-time high in dollar terms hit at the end of April. It is \$70 below the level hit then.

In sterling terms it is £85 below its all-time high set at the end of March.

With all the uncertainty highlighted on previous pages of this presentation, we are of the view that gold has a role to play in diversified portfolios.

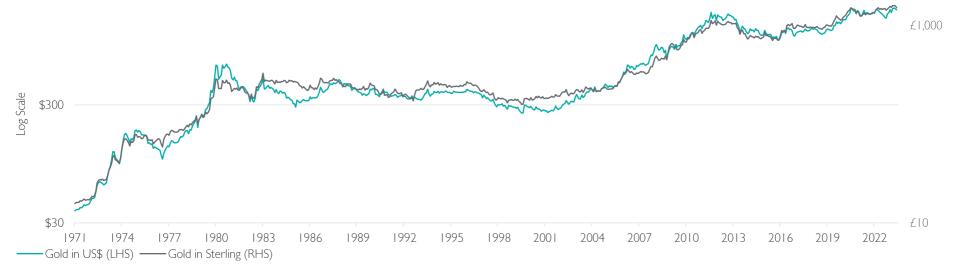
Gold benefitted from the exceptional monetary policy in evidence from 2008 to arguably 2021. With zero or even negative nominal interest rates the opportunity cost of owning gold had never been lower.

Although it is interest rates that seem to be driving the gold price at present, we are aware that the market is sanguine about the inflation outlook today.

We think gold offers a good hedge against that complacency.

So at the moment, gold could be a winner from both declining interest rates and higher inflation which are likely the two alternate scenarios going forward from here.

Gold price per troy ounce in US dollars and in sterling 1971 - current



Source: Bloomberg, Waverton. Data as at 30.06.23

COMMODITY PRICES STILL LOW VERSUS EQUITIES

Commodities are not an asset class per se as they do not generate cash flow. This makes them next to impossible to value. But when the ratio of commodities to financial assets is at extremes that is saying something worth being aware of.

This chart shows the ratio of a commodity index to the Dow Jones Industrial Average. It hit an all-time low in April 2020 and the commodity complex has been outperforming since then (the commodity index is up 159% while the Dow is up 42% and the ratio has improved by 82%).

But note that since last summer the stock market has done better than the commodity complex leaving this ratio at levels in 2017 and before that 1969 and 1931.

Structurally, there is probably a long way to go for the commodity complex as it bounces from this historical extreme.

We see this as a proxy for Real Assets and their attraction relative to Financial Assets.

We think Real Assets more broadly will do well in coming years.

Ratio of S&P GS Commodity Index to Dow Jones Industrial Average (daily)



Source: Goehring & Rozencwajg Associates, Waverton, Bloomberg. Data as at 05.07.23

HIGHER INFLATION HAS CHANGED THE BOND/EQUITY RELATIONSHIP

This chart shows the relationship between inflation and the correlation in the returns you get from investing in bonds and equities. It shows that when the average core inflation rate over 3 years gets to 2.5% or higher the correlation between the return you receive from investing in bonds and equities becomes significantly positive. We reached that point last year. This has potentially enormous implications for portfolio construction.

For most of the last 23 years, and particularly since 2008, the relationship between bond and equity returns has been consistently negative. That has meant that in the assorted equity market falls since 2008 the bond market has acted as a stabiliser in a balanced portfolio.

Indeed, from September 2008 to December 2021, a global 60% equity, 40% bond portfolio compounded at 8.9% per annum. However, in 2022, such a portfolio returned -8.0%.

The blue dot in the chart is the rolling 3-year correlation as of June. The graph shows a neat path up and to the right as core inflation has risen in recent months. The correlation turned positive in August 2022 for the first time in recent years. The correlation is now 51%, down a little from the 53% reached in April and May. The last three months have seen the highest positive correlation since 1997.

If inflation has peaked in the US it should start to move back toward a negative correlation, perhaps though not until 2024.

US equity / bond correlation and core inflation



Source: Minack Advisors, Bloomberg, Waverton. Data as at 30.06.23

Part 3 EQUITIES AND CREDIT

2023 FARNINGS GROWTH ESTIMATE +0.1% GLOBALLY AND 1.3% FOR THE US

As we get ready for the Q2 earnings season expectations remain modest **Earnings per share calendar year growth rate** in the US and globally.

It remains our view that there is downside risk to these numbers if indeed we see a downturn in the US in coming months.

It is also the case that expectations for future quarters have stabilised and there is confidence in a full rebound in 2024.

The rest of the world remains in aggregate below its historical average PE.

Several markets, including the UK, are trading at meaningful discounts to their own historical averages suggesting that the market is already sceptical about earnings estimates, outside the US at least.

				GROWTH RATE		
region	PE NTM	RELATIVE	2022	2023	2024	2025
World	16.3		+1.7%	(0.4%)	+11.1%	+10.5%
US	19.5	119%	+3.7%	+0.5%	+11.9%	+12.2%
Europe ex UK	13.3	81%	+1.7%	+7.5%	+8.1%	+8.5%
UK	10.3	63%	+19.6%	(3.2%)	+2.9%	+5.6%
Japan	14.9	91%	(3.3%)	(2.3%)	+7.7%	+8.1%
Asia Pac ex Japan	13.4	82%	(11.6%)	(4.4%)	+21.5%	+15.4%
Latin America	8.9	54%	+16.4%	(17.7%)	+7.1%	+3.7%
Emerging markets	12.2	75%	+13.1%	+4.0%	+8.2%	+8.5%
World ex USA	12.9	79%	(0.8%)	(1.2%)	+10.2%	+8.7%

Source: MSCI. Factset, Waverton, Data as at 30.06.23

STOCK MARKET VALUATION RELATIVELY ATTRACTIVE

The PE ratio for the US market (solid green line) is 19.5 times. It is again above its 20-year average of 15.7 times (the green dotted line). The World outside the US now trades at 12.9 times earnings, a slight discount to its 20-year average of 13.1.

There is uncertainty about the EPS these valuations are predicated on but particularly outside the US there is a reasonable amount of that uncertainty priced in.

MSCI US and MSCI Global ex US price—earnings ratio based on next 12 months earnings



Source: MSCI, Factset, Waverton. Data as at 30.06.23

NARROW US MARKET LEADERSHIP A FEATURE IN 2023

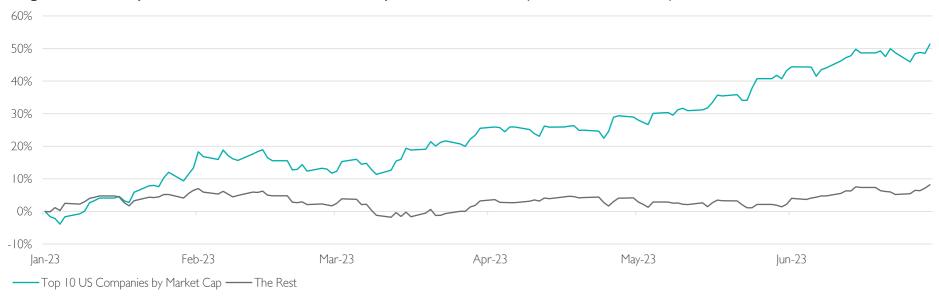
This chart shows the cumulative performance of the largest 10 US companies by market capitalisation and the cumulative performance of the rest of the market so far in 2023. Those 10 companies are Apple, Microsoft, Amazon, NVIDIA, Tesla, Alphabet, Meta, Berkshire Hathaway, United Health and Exxon Mobil.

The top 7 of the top 10 are technology heavy and many are seen as beneficiaries of the leap in adoption of Artificial Intelligence that has

excited the market this year.

Although there has been some broadening of market leadership in recent weeks (for example 58% of US stocks are above their 200-day moving average, up from 38% at the end of May), the largest 7 companies are still the market bellwethers. It would be healthier if leadership did broaden in coming weeks.

Largest 10 US Companies and rest of market, cumulative performance in 2023 (based on US\$ indices)



Source: MSCI, Factset, Waverton. Data as at 30.06.23

US INVESTOR SENTIMENT GETTING MORE BULLISH

One of the things that was supportive for the stock market in the early months of 2023 was that investor sentiment by various measures was muted.

This chart is one such measure, the weekly survey of its members done by the American Association of Individual Investors. The chart shows the % of respondents who are bullish among those that express a view (so it is Bulls as a % of Bulls plus Bears).

This could not be a simpler sentiment measure but it is worth knowing about. The two horizontal lines are showing one standard deviation

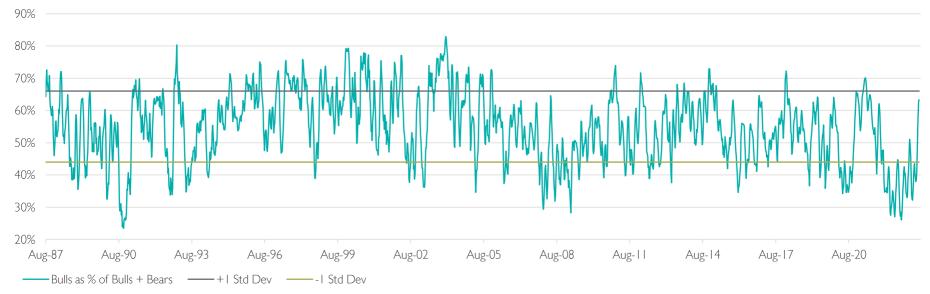
above (blue line) the average level and one standard deviation below (orange line).

If you buy the market when the green line is below the orange line your average return in the next year is +15%.

If you buy the market when the green line is above the blue line your average 12-month return is +6%.

It is notable that sentiment has picked up in recent weeks. Not quite to the level that might cause concern but close to it.

American Association of Individual Investors survey, Bulls as % of Bulls plus Bears



Source: AAII, Bloomberg, Waverton. Data as at 06.07.23

CORPORATE BALANCE SHEETS YET TO SHOW REAL STRESS

The top chart is a quarterly series showing the number of US corporate bankruptcies (officially called "Chapter 11" filings). It hit its lowest level for 18 years in Q3 2021. It has slowly moved up since then but remains at historically low levels in Q1 2023.

The Bloomberg Index in the bottom chart is of economy wide US bankruptcies and takes into account the size of the bankruptcy as well as the number of them. Hence there were more big bankruptcies in 2009-10 than in 2003-04. That index is at historically very low levels although it has picked up from its lows in April 2022.

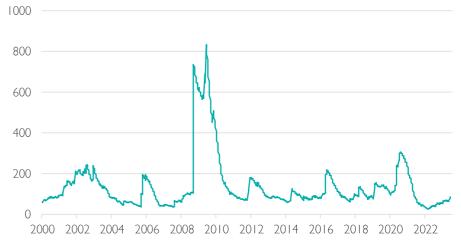
The challenge in coming months will be whether the combination of tighter monetary policy and the inflationary pressures makes it harder for corporates. We have seen an increase in corporate bond yields in recent weeks but defaults remain rare. That may well change from here.

But corporates are entering the more challenging environment with strong balance sheets.

US bankruptcy filings (2000 to 2023, quarterly)



Bloomberg US Corporate Bankruptcy Index (2000 – 2023, weekly)



Source: Bloomberg, Waverton. Data as at 30.06.23

CORPORATE BOND YIELDS, S&P500 EARNINGS YIELD & T-BILLS YIELD THE SAME

The Moody's Baa yield (a benchmark for the investment grade market) moved slightly above the earnings yield of the S&P500 Index in March and is above it again at the end of June (5.8% vs. 5.5%).

It was first above the earnings yield in October and November last year which was the first time since 2009.

The last two periods when this was the case were the run up to the Dotcom peak in 2000 and its unwind. Then this happened again during the Global Financial Crisis of 2007 - 09.

One does not need to draw apocalyptic conclusions from this but it does likely reflect that the increase in government bond yields, combined with

the traditional spread for corporates, is reflecting a more cautious outlook for the economic cycle than the equity market is at present.

The orange line is the 3-month Treasury bill rate which is currently 5.3%. It is the closest it has been to the earnings yield and the Baa yield since 2007.

We suspect both the earnings yield and the Baa yield will move upward in the second half of 2023.

This chart also suggests it is rational for investors to be more favourably disposed toward cash today than has been the case since pre the GFC.

Moody's current Baa Corporate yield, S&P500 forward earnings yield, 3-month Treasury bill yield (%)



Source: Moody's, Bloomberg Waverton. Data as at 30.06.23

CORPORATE CREDIT MARKETS NOT REALLY STRESSED

Credit spreads are about where they were at the beginning of the year.

We remain a little sceptical that credit (and equity) will be able to shrug off more obvious signs of a significant demand slowdown/recession in the months ahead.

Spreads will widen further if there is a risk of higher inflation and tighter monetary policy for longer than currently expected.

Hence our overweight to government bonds in fixed income funds.

US corporate bond spreads (%)



Source: Markit, Bloomberg Waverton. Data as at 30.06.23

PRC CURRENCY WEAKENS FURTHER BUT STILL (JUST) WITHIN RANGES

The renminbi has weakened against the dollar. The move away from the "zero Covid" approach in China was hoped to be a significant benefit to the global economy. But there are few signs that is happening. PRC imports, for example, declined 4.5% in May from a year ago and exports declined 7.5%. Inflation is very moderate (CPI +0.0%, PPI -5.4% in June) which is also inconsistent with robust demand.

The weakening of the Rmb since January needs to be watched.

The Taiwan dollar is stable, despite the scaremongering headlines about Taiwan that appear regularly.

We continue to remain sceptical about the PRC conducting a military operation against Taiwan partly as it is one of the most complex amphibious invasions imaginable. It is an 8-hour boat trip from the PRC and only 10% of the coastline is suitable for an amphibious landing; which means those boats would be under intense attack.

Meanwhile, the People's Liberation Army has not seen action overseas since 1979 when it, at best, drew with Vietnam after invading the north of the country.

On top of that, the US has long supported Taiwan with weapons. It has aircraft carriers to deploy too. The PRC, and President Xi, certainly want Taiwan but it will likely have to wait. Indeed, given its complexity, an invasion may only happen if the PRC government feels vulnerable for some reason and seeks to deflect attention from whatever those problems are.

Renminbi per US dollar



Taiwan dollars per US dollar



Source: Bloomberg, Waverton. Data as at 30.06.23

Part 3 OUR APPROACH TO INVESTING RESPONSIBLY

RESPONSIBLE STEWARDSHIP OF CLIFNTS CAPITAL

We aim to identify responsible allocators of capital ensuring business resilience and long term financial sustainability

How we incorporate ESG

- Integrated approach to the assessment of ESG factors
- Detailed fundamental analysis avoids greenwashing
- Mitigates poor data quality and inconsistent third-party ESG ratings
- Focus on engagement over an exclusion/divestment strategy
- Identify those successfully adapting to ESG opportunities/risks
- Acknowledge when ESG risks are integral to transition solutions
- Pragmatic approach focussed on high or improving ESG standards

The advantages of our investment approach

- Global: largest universe of investment opportunities
- Direct: greater transparency around ownership
- Active: flexibility to avoid areas at risk of capital loss
- Concentrated: in-depth identification / monitoring of risks
- Experienced team: library of knowledge is an advantage
- Engaged: long-term relationships create a two-way dialogue
- Strong ESG outcomes: natural result of our approach

Signatory of:













RESPONSIBLE INVESTMENT AT WAVERTON

Environmental, Social & Governance (ESG) Investment















Ethical Investment

Client-specific ethical restrictions applied at the portfolio or fund level

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Should you require anything further in respect of the information included in this presentation please address all enquiries to:

William Dinning
Waverton Investment Management Limited
16 Babmaes Street
London
SWIY 6AH

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