GLOBAL OUTLOOK

August 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

The decision to be underweight equities is a macro call predicated on the view that a slowing of demand is likely in coming months as the lagged impact of higher interest rates feeds through.

But we recognise that it is possible that central banks negotiate a soft-landing where there is enough demand taken out of the economy to slow the inflationary impulse without shrinking the economy. We reflect that in a new slide derived from the US labour market which has been very resilient in the face of tighter monetary policy in this cycle. To the extent that the one reliable indicator of a recession that is suggesting a soft landing is the change in the unemployment rate, as explained on slide 8.

Central banks have continued to raise rates with both the US Federal Reserve and the Bank of England doing so in early August. Market expectations for future Federal Reserve policy have stabilised and suggest that it is likely we are at the peak policy rate. But there is not an expectation of a cut until Q2 2024 so the so-called "pivot party" that supported markets earlier this year is no longer evident.

That has contributed to a broadening of leadership in the stock market which is healthy, and consistent with the soft landing narrative.

There has been a significant reduction in how far the market thinks the Bank of England will raise interest rates from the current 5.25%. The peak is now expected to be 5.75%, down from 6.5% a month ago.

We were sceptical that the base rate would need to go that high and so hope the new expectation is more accurate. It may be that the peak can be 5.5% if over the next couple of months we see signs of at least a slowdown in the US economy.

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.

Given our cyclical view, 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 would also highlight that for the first time since 2001, the 3-month Treasury bill, a proxy for cash, yields more than the forward earnings yield on the S&P500.

It remains the case that 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.

The one thing that would derail the current market narrative it would be an increase in the rate of inflation. We are watching developments in the energy markets closely as a significant increase in oil and petrol prices would dampen discretionary demand but would alarm policymakers who are hoping they are nearly done with rate hikes.

The Federal Reserve and Bank of England raised rates again this month. We may be at peak policy rate in the US and we are close to it in the UK.

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 03.08.23

SUMMARY OF OUR VIEWS (continued)

Equities (underweight)

Global equities returned +2.4% in July. They are up 10.4% so far this year (all in sterling terms).

Valuations outside of the leading Nasdaq listed companies look undemanding in both the US and in the rest of the world. Our equity team continues to find attractive long-term opportunities that will further broaden the industry exposure in the Global Recommended Portfolio.

We expect to see market leadership change in the second half of the year and widen from the unusually narrow drivers evident in the first half.

We note that since the end of May, S&P500 Cyclicals are up 16% versus 9% for Growth stocks and 5% for Defensive names. The stock market is behaving in a manner consistent with confidence that the US (and global) economy will avoid recession.

The earnings reporting season has also supported that narrative with aggregate earnings coming in ahead of expectations. According to FactSet data, of the 51% of S&P500 Index companies reporting, 80% have beaten estimates, above the 10-year average of 73% that do so. But the beats have been a little modest relative to normal, with an average beat of 5.9% relative to estimates, compared to a 10-year average of beats being 6.4%.

The best sector performance has come from Consumer Discretionary and Communication Services. Given the importance of the consumer sector to the outlook for the overall economy, that has contributed to the view that a soft landing Is becoming more likely.

As ever, the focus is on those companies where the team has greatest confidence in the ability to deliver Free Cash Flow growth over the next few years and where valuations are not extended.

Fixed income (overweight)

The overall gilt total return index returned +0.8% in July.

It has returned -2.7% 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

MARKET IS SUGGESTING WE ARE AT, OR CLOSE TO, PEAK POLICY RATES

The top chart shows current expectations for the US Federal Reserve policy rate and those expectations a month ago. There has not been a meaningful change in expectations.

The market thinks the Fed is done with its rate hikes. It expects a rate cut in Q2 2024. This is more in line with how Fed policymakers have been guiding expectations. Earlier this year the market had convinced itself there could be rate cuts at the end of this year, and certainly would be in Q1 2024.

The bottom chart shows current expectations for the Bank of England's base rate and those expectations a month ago.

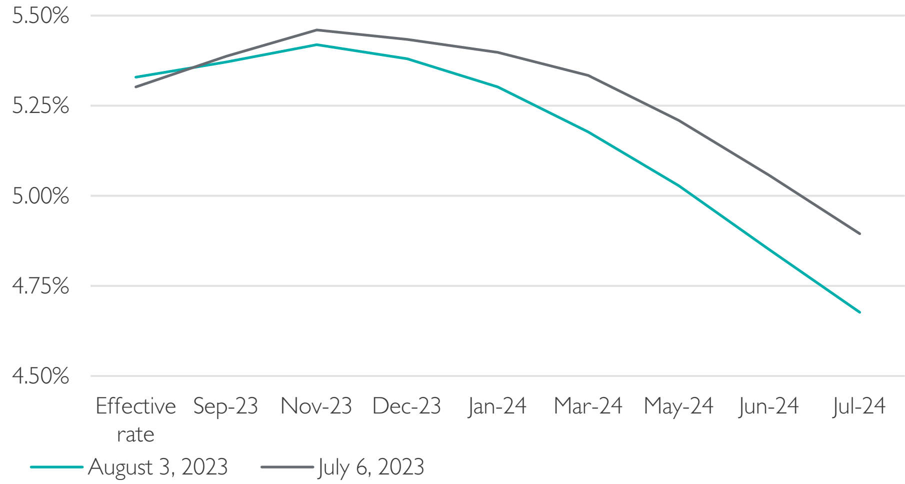
The base rate was hiked to 5.25% on August 3 by a divided monetary policy making committee. Some members voted for a hike to 5.5% and one voted for no change, leaving it at 5.0%.

The good news is that the market has stopped thinking we could get to 6.5% for the base rate, a level that would be very difficult for the UK economy.

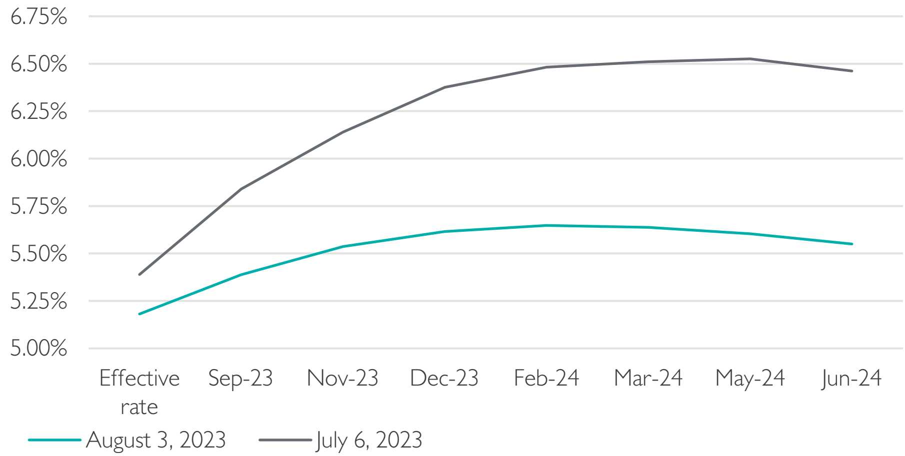
Given the size of the US economy, Fed success in reducing demand in the US will also have a moderating influence on global growth and the global inflationary impulse. That would be of benefit to the Bank of England.

If we get more signs of a slowdown in the US economy in coming months it is quite possible that the next base rate hike in September could be the last which would give relief to sectors of the UK economy and market that have suffered in the last year such as housing and REITs.

Implied US Fed Funds rate %



Implied UK Base Rate %



Source: Bloomberg, Waverton. Data as at 03.08.23

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, which the Q2 reporting season has so confirmed.

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.

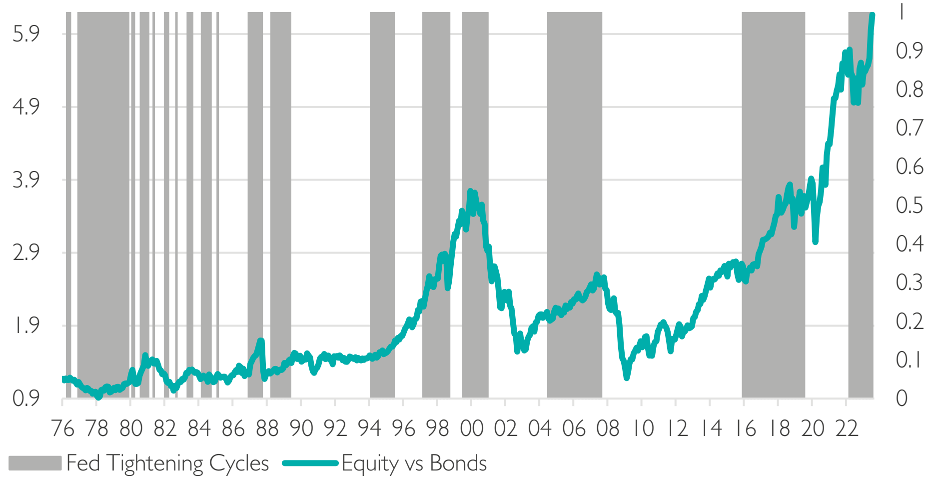
What we have seen in the last 18 months is "normal". We suspect the recent narrative that despite the rate hikes the stock market is supported by ongoing earnings strength is also "normal" for this stage of the cycle.

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.

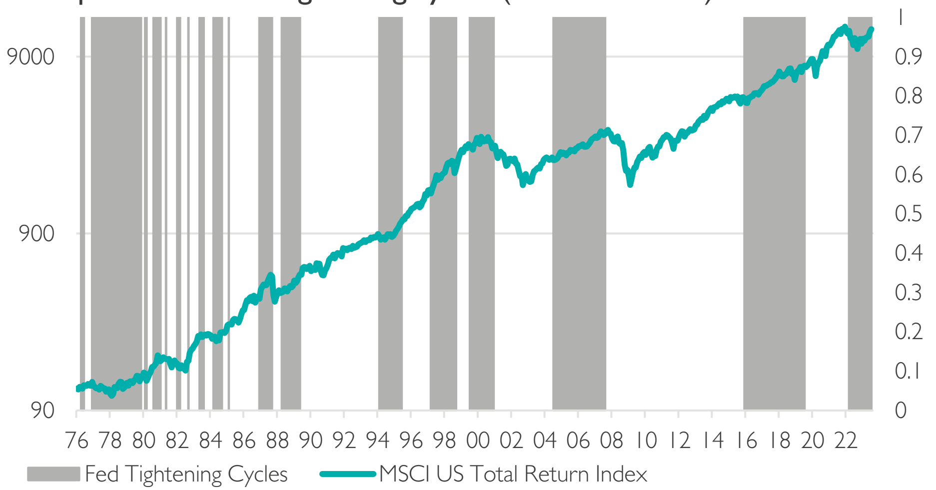
This is because tightening cycles end when the Fed has achieved a slowdown in the economy, which makes bonds more attractive and suggests a weaker outlook for earnings.

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 31.07.23

CURRENT MARKET NARRATIVE EXPECTS A "SOFT LANDING" IN THE US

The Federal Reserve and the Bank of England has each withdrawn their internal forecasts for recessions in the US and UK this year.

In the US, the market narrative has shifted in recent weeks to one where a so-called "soft landing" is deemed more likely than a recession. In a soft landing the central bank reduces inflationary pressures in the economy without shrinking the economy. Such an outcome is rare but has been done, arguably, in the mid-1980's and in the mid-1990's.

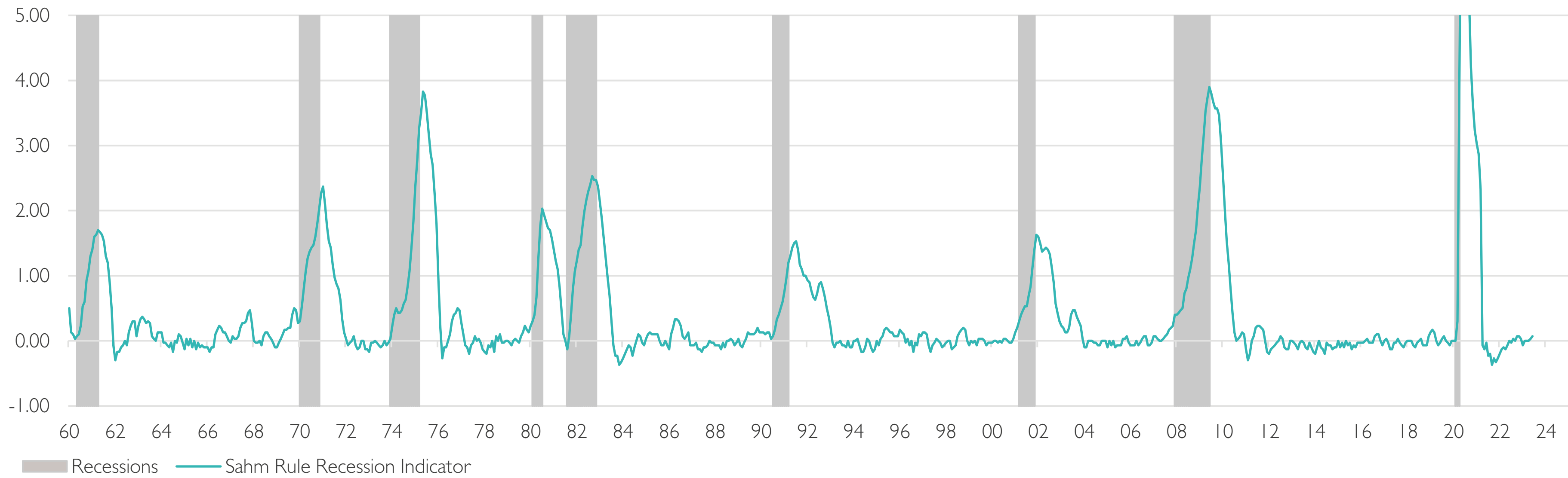
Arguably the most important indicator that is giving the market increased confidence in this happening again is that the monetary tightening seen so far has not materially weakened the labour market.

This chart is of the Sahm Rule which was created in 2019 by Claudia Sahm, an economist at the Federal Reserve. Her insight was that there has always been a recession when the three-month moving average of the unemployment rate rises by 0.5 percentage point relative to the low point during the previous 12 months.

In this cycle, the unemployment rate has not moved materially from its 3.4% low in January 2023. It is currently 3.6% and has been below 4% since February 2022.

If the labour market remains resilient then the chances of a soft landing are good. We are sceptical, but recognise it is a possibility.

Sahm Rule Recession Indicator and Recessions 1960 - current



Source: Bloomberg, Waverton. Data as at 30.06.23

THE US CONSUMER HAS BEEN RESILIENT UP TO NOW

One reason the soft landing scenario is gathering steam is the resilience of the US consumer.

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. Gasoline prices have been moving up again in recent weeks which will need to be watched closely (top chart).

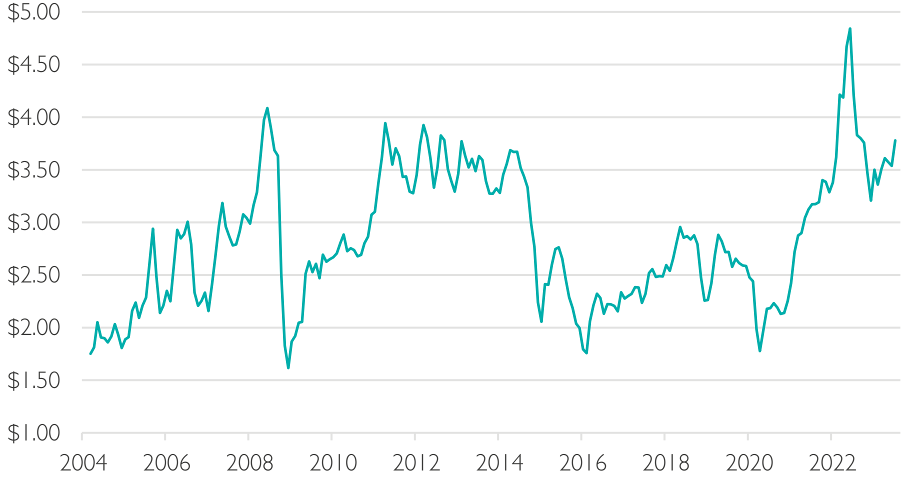
Betting against the US consumer has been, along with fighting the Fed, a disastrous trade for the last 40 years. But we have reached a point in this cycle, thanks to levels of inflation not seen for 40 years, where we need to see a curbing of consumer demand to get the Fed to stop tightening policy.

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.

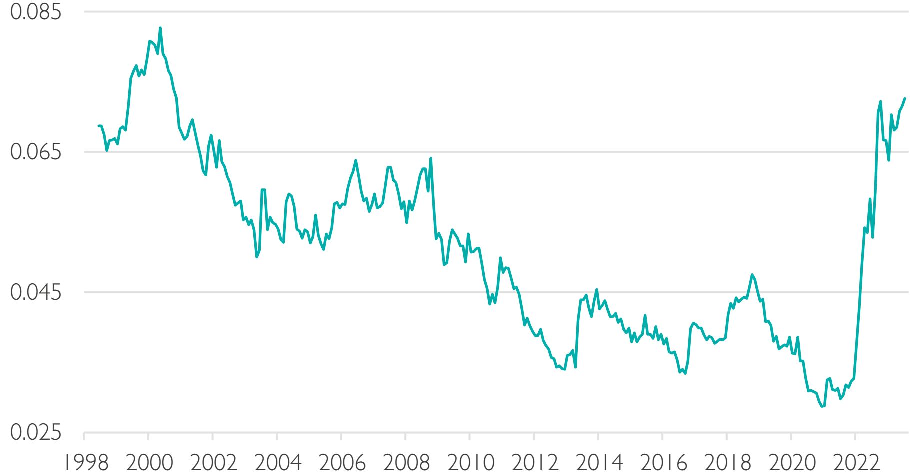
House prices nationally are still -4.5% on a year ago at the end of June and we would expect that to fall further in coming months. It peaked at 21% in April 2022.

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

US national average price of a gallon of regular gasoline 2004 – current



US National Average 30-year Mortgage Rate 1998 – current



Source: Bloomberg, Waverton. Data as at 31.07.23

THERE IS STILL A SIGNIFICANT RISK OF A RECESSION IN THE US

Although the Federal Reserve and the Bank of England has each withdrawn their internal forecasts for a recession in the US and UK respectively, many historically reliable indicators of the economic cycle continue to suggest one is likely.

The top 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.

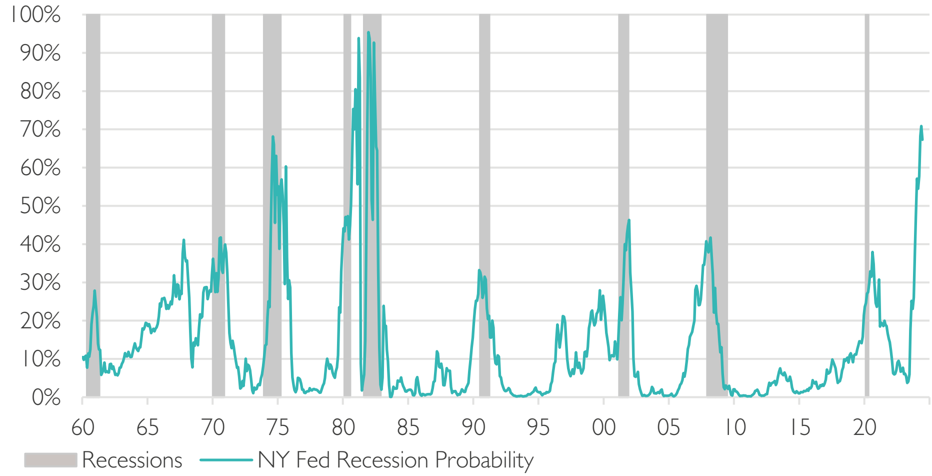
3-month Treasury bill rates have been generally above 10-year bond yields since 26 October 2022. Not surprisingly the probability of a recession has therefore been high and is 67% at the end of June.

The bottom chart is the 6-month % change in the Index of Leading Indicators which 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.

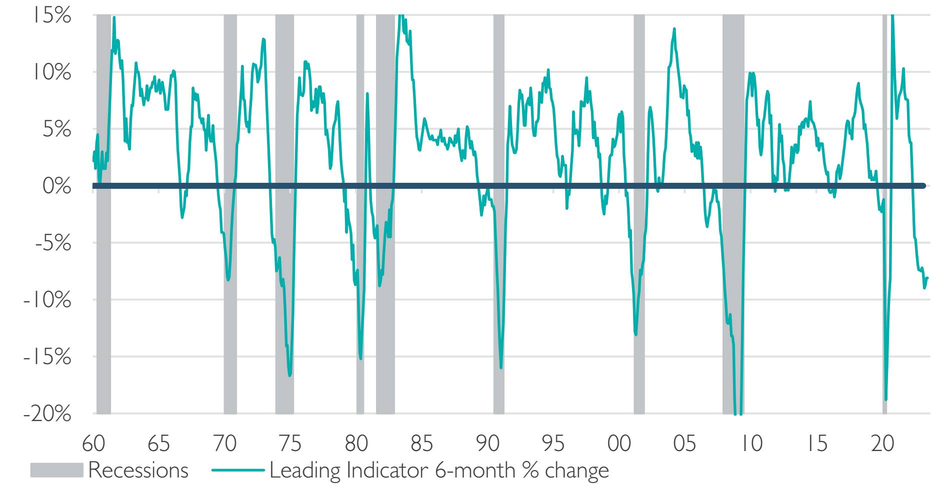
As you can see, since 1970 the US has either already been in recession, or a recession has started within three months of the change in the index being -4.0% or worse.

As at the end of June the change in the index over the last six months is -7.8%.

New York Federal Reserve Recession Probability Indicator 1960 - current



Leading indicator (% change over 6-months) & Recessions 1960 - current



Source: Bloomberg, Waverton. Data as at 31.07.23

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.

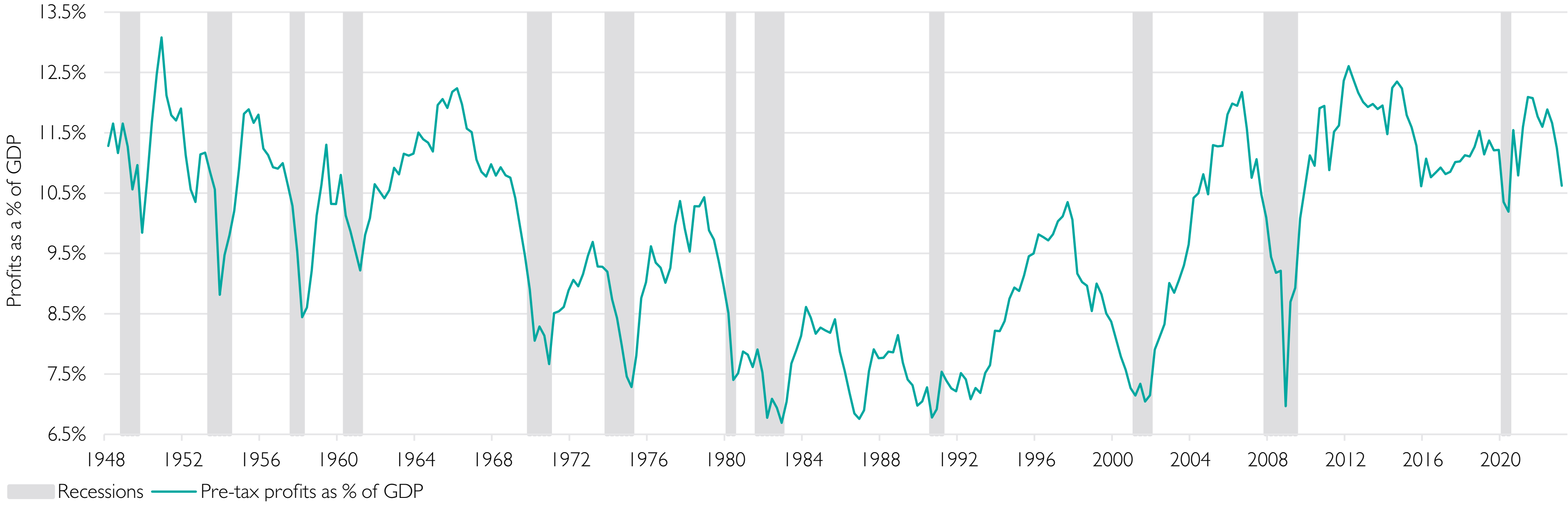
Q1 2023 profits were 10.5% of GDP, down from 11.3% in Q4 2022.

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

GOVERNMENT BONDS REMAIN 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 not raise rates again 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).

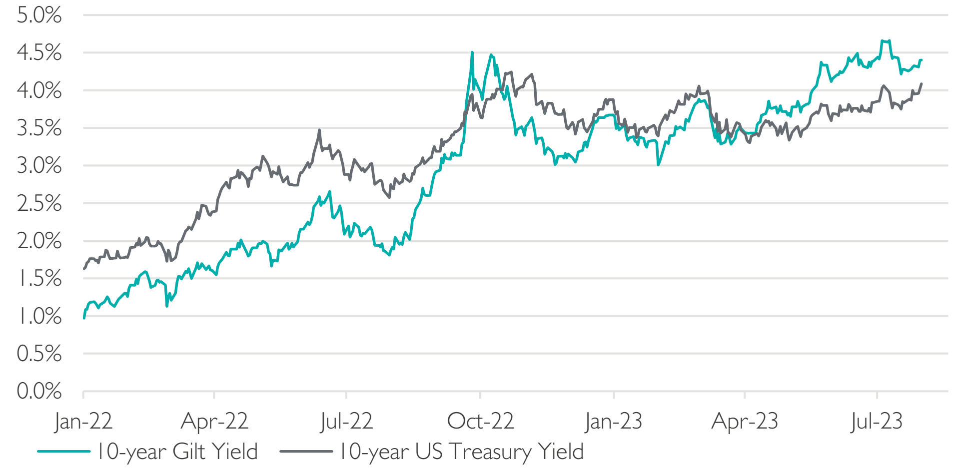
As the chart shows, both markets continue to offer, on this measure, a positive real yield.

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%.

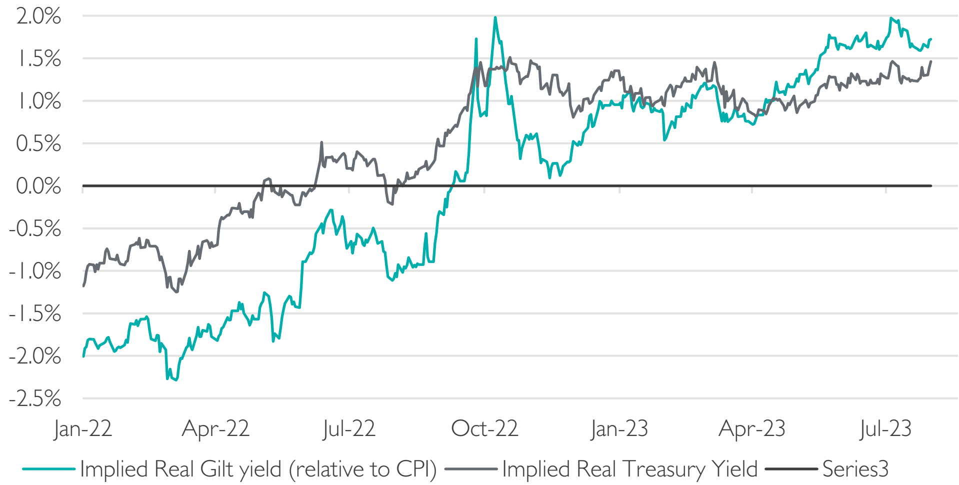
The UK linker market is less attractive (the November 2032 linker yields +0.6%).

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 UK10-year bond yields (%)



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



Source: Bloomberg, Waverton. Data as at 28.07.23

STERLING STRONG AGAINST THE EURO

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.

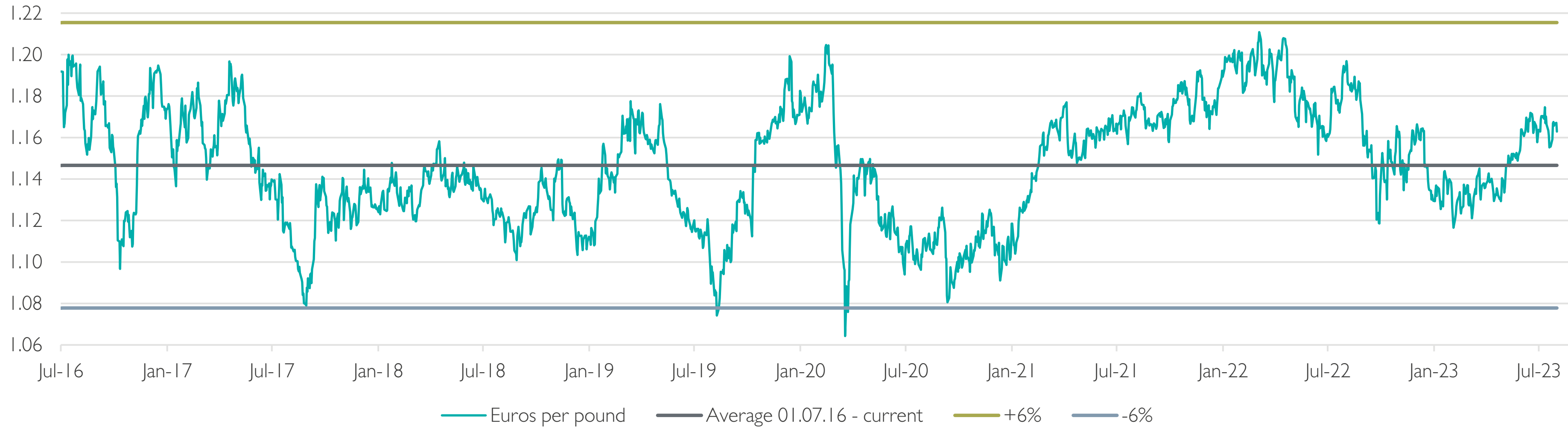
The chart shows the number of euros per pound since 1 July 2016. The average exchange rate since then is shown as the grey line and we show a range 6% either side of that average.

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 01.08.23

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 3.0%. The euro area looks like it peaked in October 2022 at 10.6% (now 5.3%) 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. But RPI is now 10.7% and CPI is 7.9%.

US core inflation (excluding food and energy) hopefully peaked at 6.6% in September. 2022 It was 4.8% in June.

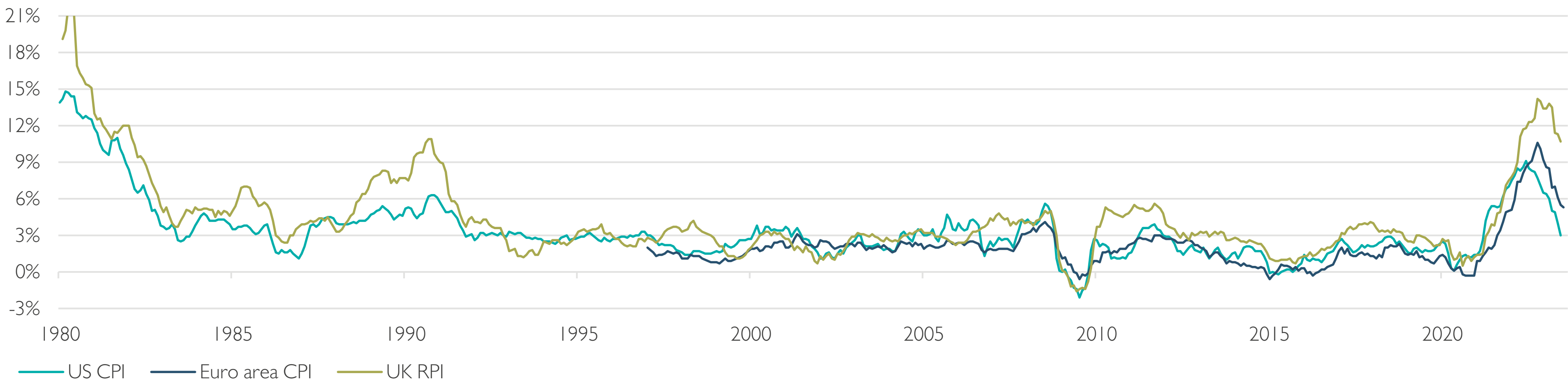
Despite the recent improvements, there remain concerns about the inflationary impulse across the developed world. The detail of recent inflation reports shows a slower reduction in price increases and Service inflation in the US in particular is a concern.

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)

1980 - current



Source: Bloomberg, Waverton. Data as at 31.07.23

EXPECTATIONS FOR FUTURE INFLATION REMAIN SANGUINE

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.

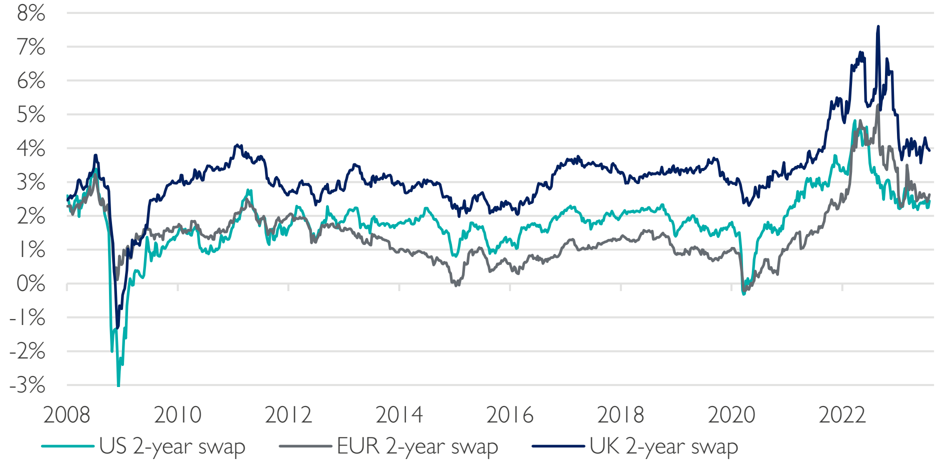
But if future inflation actually takes longer to return to target that will be an issue for investors as it will almost certainly see a reversal upward in rate expectations.

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.

It is worth noting that both have moved up a little in recent weeks. This may reflect some concern that the market is thinking the Federal Reserve is finished raising its policy rate but there is a risk that inflation remains more persistent, particularly if energy prices retain some of the strength they have shown recently. This needs to be watched.

2-year inflation swap rate (%)



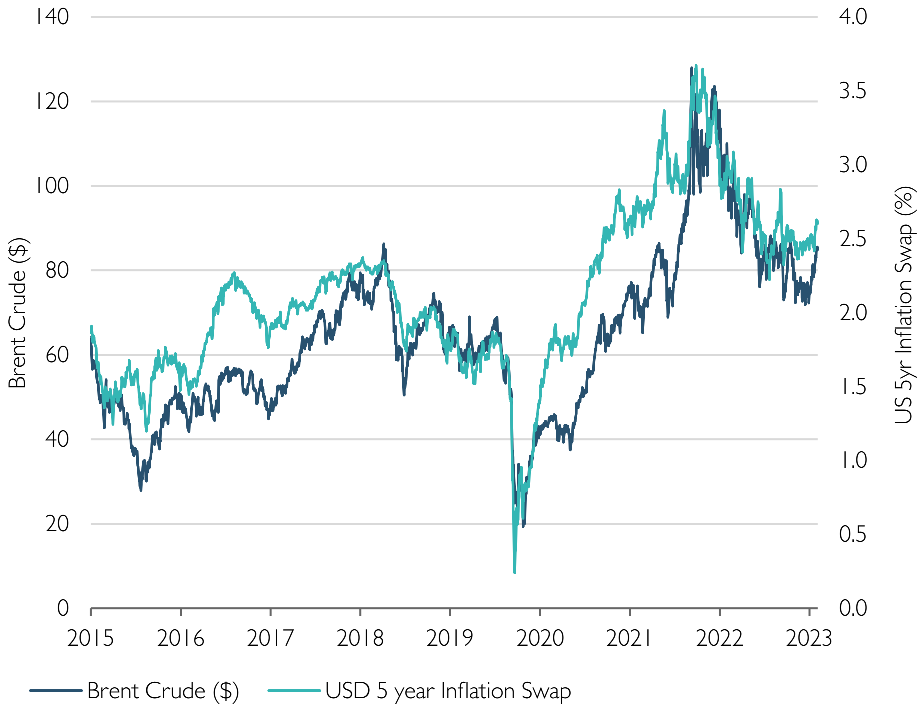
Long-term US inflation expectations

Source: Bloomberg, Waverton. Data as at 28.07.23

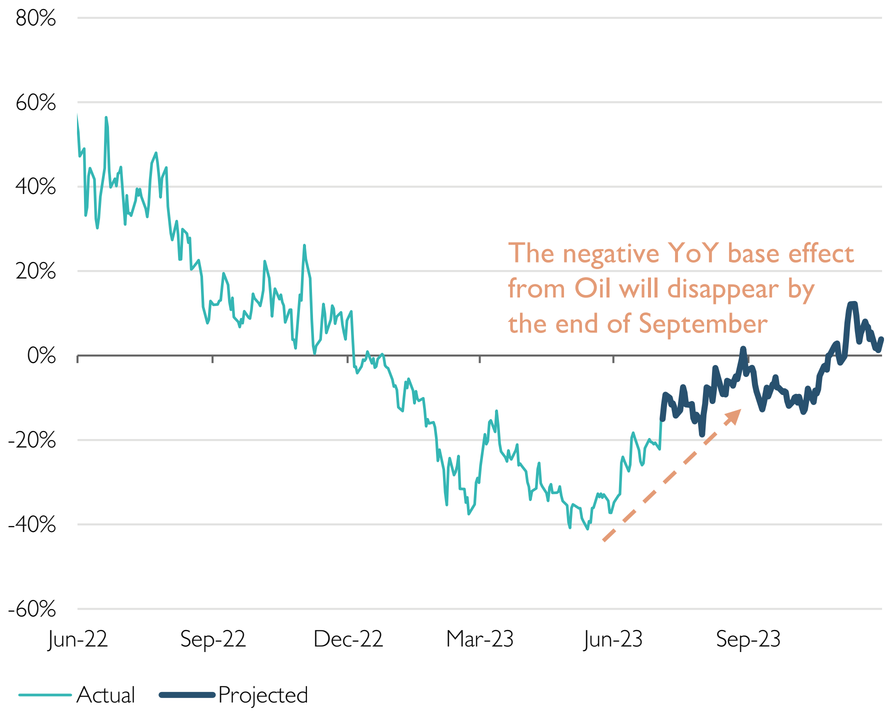
ENERGY PRICE RISES COULD THREATEN THE SANGUINE NARRATIVE

There is a surprisingly strong relationship between the oil price and inflation projections for the next five years. We saw much improved headline inflation data for June after over a year of weaker energy prices. However, from the end of June, the year-on-year comparisons get tougher. The oil price has been recovering and the annual change will be back to zero by the end of September, assuming the oil price stays at current levels. It remains to be seen what impact this will have on inflation and to what extent Central Bankers will feel able to relax monetary policy against that backdrop.

Inflation Expectations and the Oil Price



Annual % change in Oil Price (USD)



Source: Bloomberg, Waverton. Data as at 31 July 2023

THE BROAD COMMODITY COMPLEX IS WEAK

Energy prices have been firmer in recent weeks but the broader commodity complex is in the doldrums.

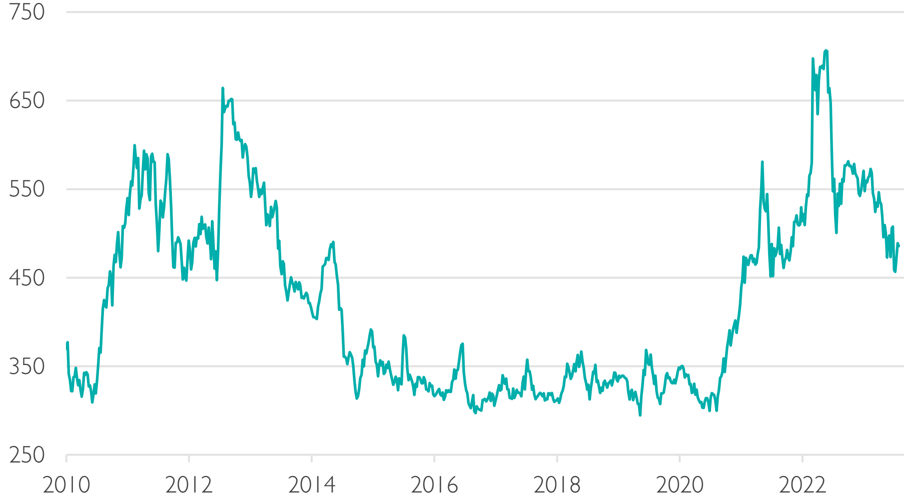
Despite the support that grain prices should have from fears of supply disruption from Ukraine, the bread basket of Europe, and Russia, grain prices fell last summer before rebounding a little and then losing momentum again (see top chart).

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 28.07.23

DOLLAR A LITTLE WEAKER

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 then weakened a little again in July.

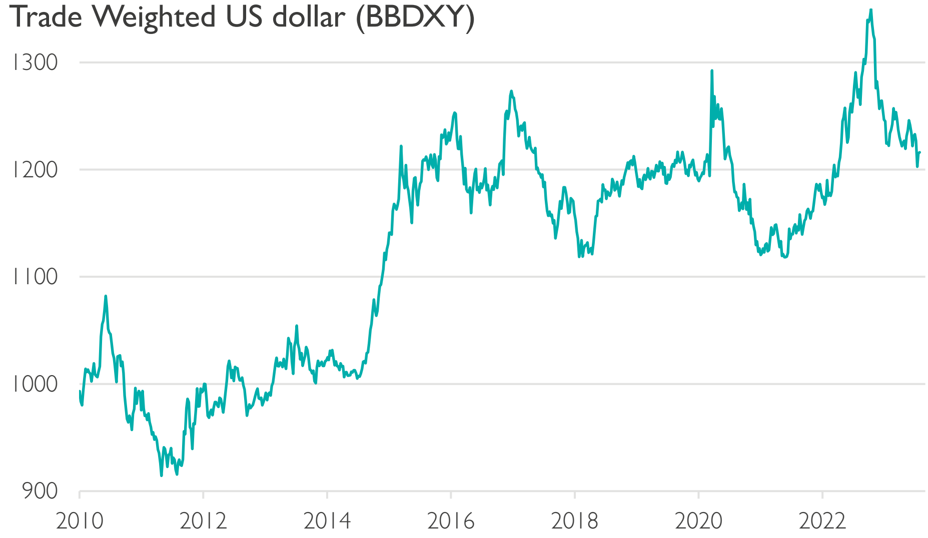
The fluctuations in expectations for Federal Reserve policy have moved the currency around. The market is now pretty convinced there will be no more hikes of the Federal Funds rate while it expects higher rates in the euro area, Japan and the UK. So the dollar has less support from relative monetary policy than it has had for most of the last 18 months.

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.

Trade Weighted US dollar (BBDXY)



MSCI Emerging Market Currency Index

Source: Waverton, Bloomberg, MSCI. Data as at 28.07.23

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 $25 below the level hit then.

In sterling terms it is £65 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.

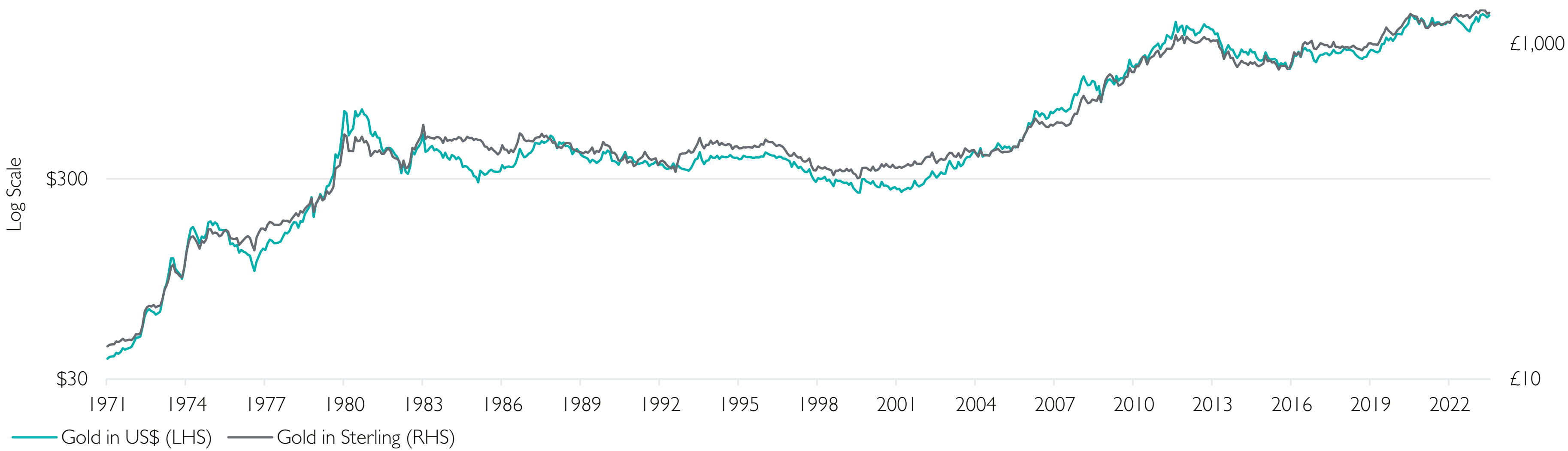
Gold benefitted from the exceptional monetary policy in evidence from 2008 to arguably 2021. With zero or even negative nominal interest rates the opportunity cost of owning gold had never been lower.

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 31.07.23

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 184% while the Dow is up 47% and the ratio has improved by 93%).

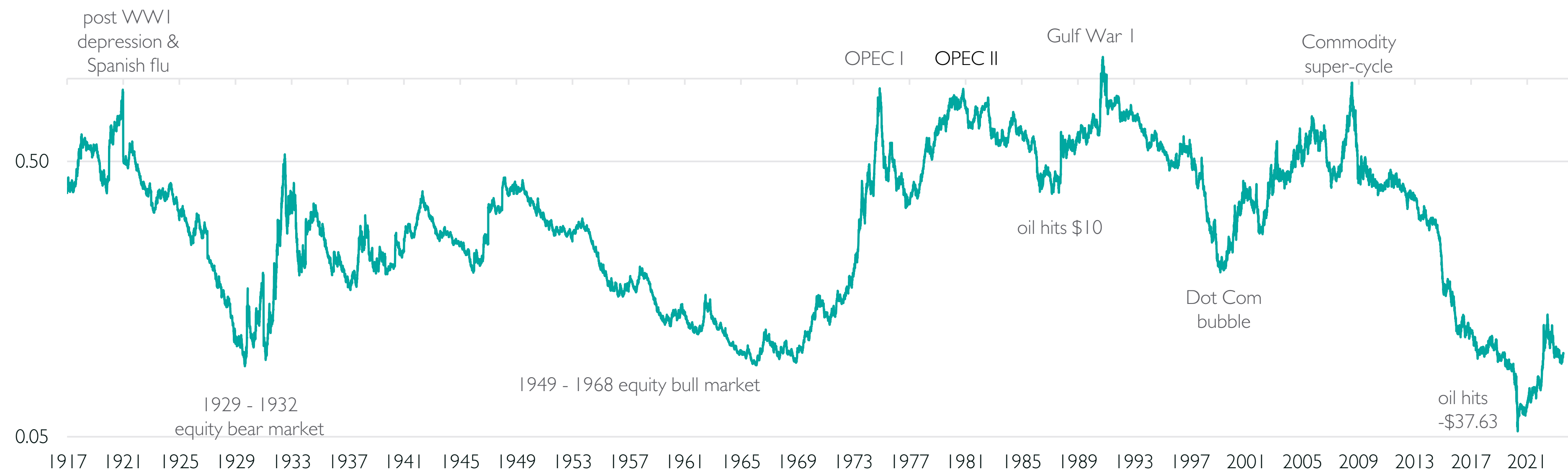
But note that since last summer the stock market has done better than the commodity complex leaving this ratio at levels in 2017 and before that 1969 and 1931.

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 31.07.23

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.

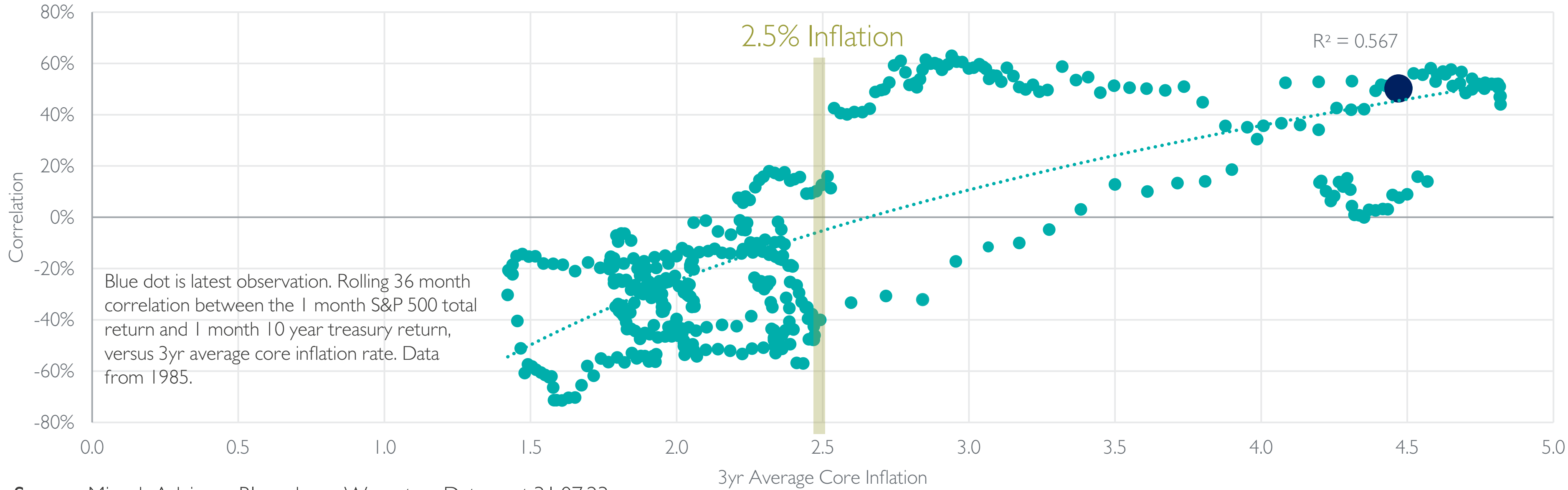
For most of the last 23 years, and particularly since 2008, the relationship between bond and equity returns has been consistently negative. That has meant that in the assorted equity market falls since 2008 the bond market has acted as a stabiliser in a balanced portfolio.

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 July. 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 50%, down a little from the 53% reached in April and May. The last five 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 31.07.23

Part 3

EQUITIES AND CREDIT

2023 EARNINGS GROWTH ESTIMATE -0.6% GLOBALLY AND 0.1% FOR THE US

Q2 earnings season has, in aggregate, so far reduced earnings estimates for the full year 2023.

The consensus for the Global Index is for EPS to decline 0.6%, slightly worse than -0.4% expected a month ago.

For the US market the consensus is +0.1%, down from +0.5% a month ago.

The 2024 estimates have been pushed up by the amount 2023 has been reduced so the net effect is that EPS estimates over the next 18 months are effectively unchanged.

Valuations have moved up given that markets had a decent July but the relative valuations of markets to the world index have not changed materially in the last month.

Earnings per share calendar year growth rate

			GROWTH RATE			
REGION	PE NTM	RELATIVE	2022	2023	2024	2025
World	16.7		+1.7%	(0.6%)	+11.3%	+10.8%
US	19.9	119%	+3.7%	+0.1%	+12.4%	+12.4%
Europe ex UK	13.3	80%	+1.7%	+9.0%	+7.1%	+9.0%
UK	10.7	64%	+19.6%	(5.1%)	+3.7%	+5.8%
Japan	14.9	89%	(3.3%)	(0.7%)	+7.9%	+8.0%
Asia Pac ex Japan	13.8	82%	(11.6%)	(4.9%)	+21.8%	+16.0%
Latin America	9.1	54%	+16.6%	(17.8%)	+6.5%	+5.2%
Emerging markets	12.2	73%	+13.1%	+5.6%	+7.1%	+8.8%
World ex USA	13.2	79%	(0.6%)	(1.4%)	+10.1%	+9.3%

Source: MSCI, FactSet, Waverton. Data as at 31.07.23

STOCK MARKET VALUATION NOT STRETCHED

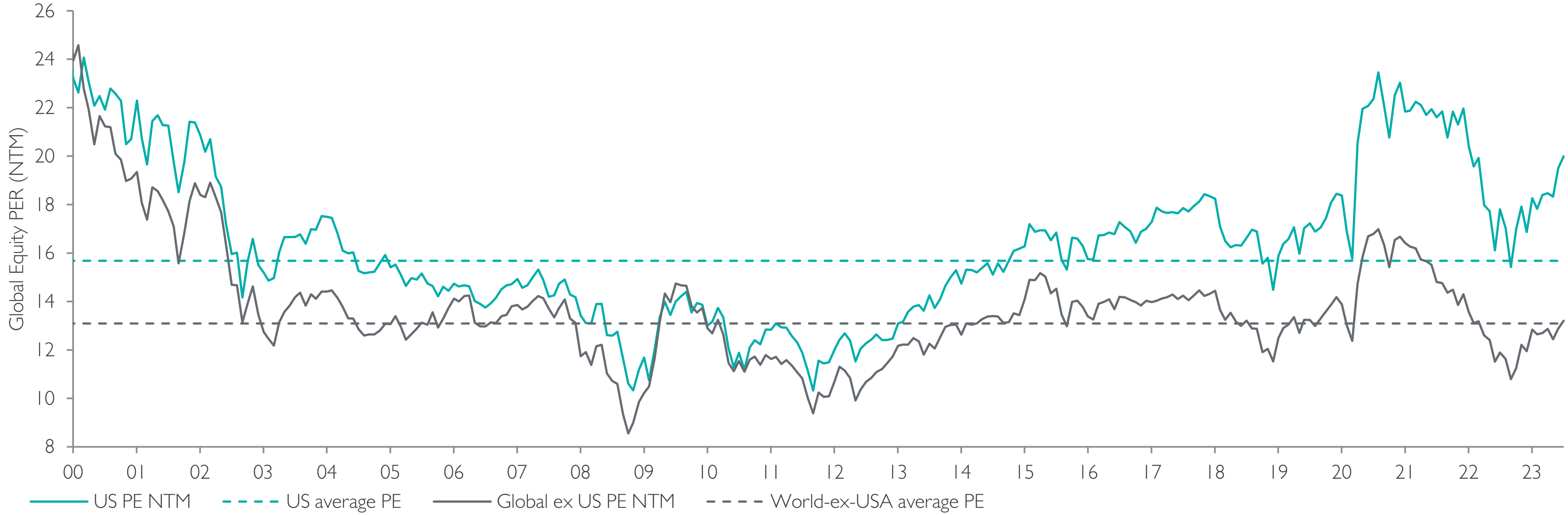
The PE ratio for the US market (solid green line) is 20.0 times.

It is again above its 20-year average of 15.7 times (the green dotted line).

The World outside the US now trades at 13.2 times earnings, a slight premium 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 31.07.23

STOCK MARKET IS INDEED DRIVEN BY EARNINGS OVER TIME

This is a simple chart but an important one. The stock market moves with earnings and has continued to do so over the last 20+ years despite the various shocks investors have had to absorb over that time. These include the 2008 crisis and Covid of course, but also the policy response to each of those events.

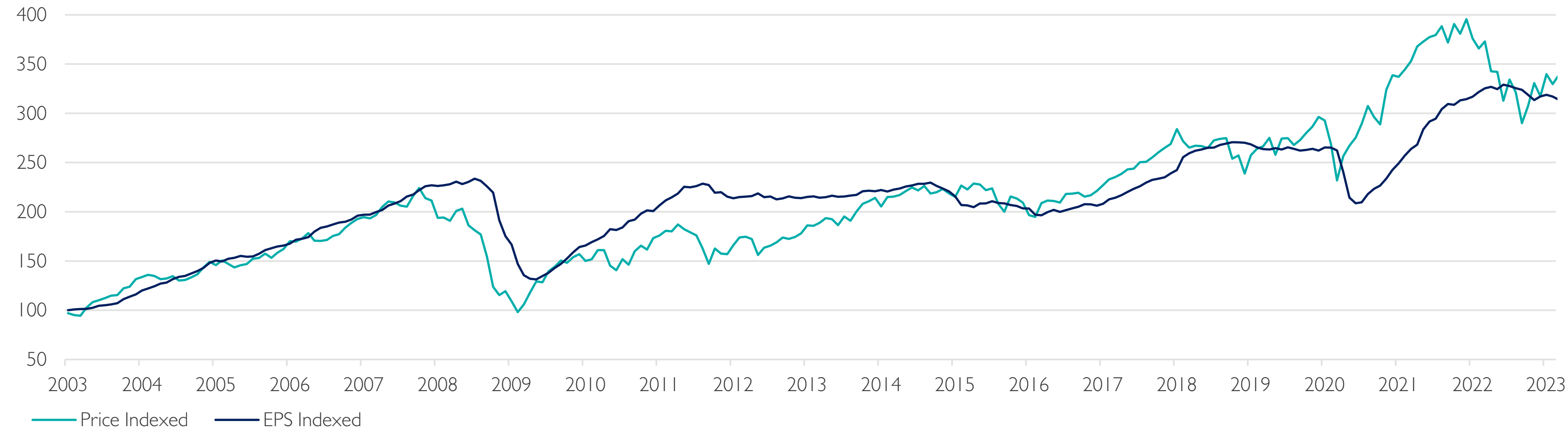
As the chart shows, the market reacted to the robust fiscal and monetary stimulus packages of 2020 by rising very strongly into 2021. Earnings recovered too but not as quickly. The market pullback last year brought prices back to the point where they were below the earnings line.

The rally this year has pushed the price line above the earnings line.

If earnings can indeed increase in 2023 that suggests the market could be well supported in coming quarters.

MSCI Global Price Index and earnings per share

December 2002 = 100



Source: MSCI, FactSet, Waverton. Data as at 31.07.23

US INVESTOR SENTIMENT NOW 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. That has changed over the summer as the sentiment measure charted here shows.

This is 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.

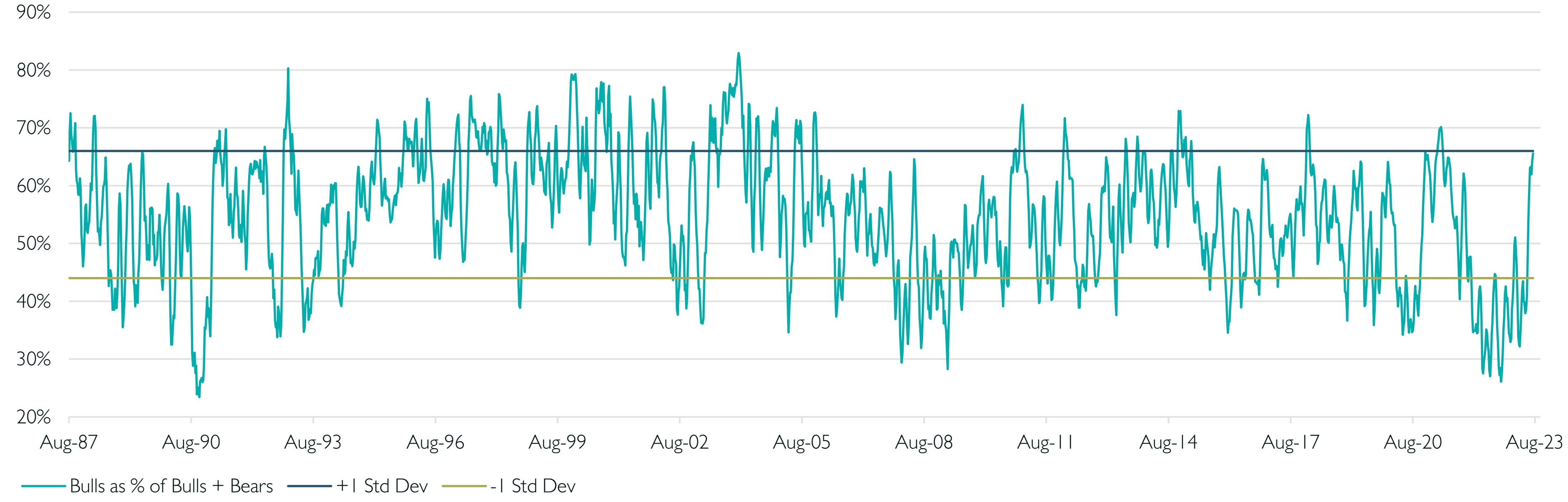
The two horizontal lines are showing one standard deviation above (black line) the average level and one standard deviation below (orange line).

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 black line your average 12-month return is +6%.

Today we are at one standard deviation above average.

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



Source: AAII, Bloomberg, Waverton. Data as at 27.07.23

CORPORATE BALANCE SHEETS YET TO SHOW REAL STRESS

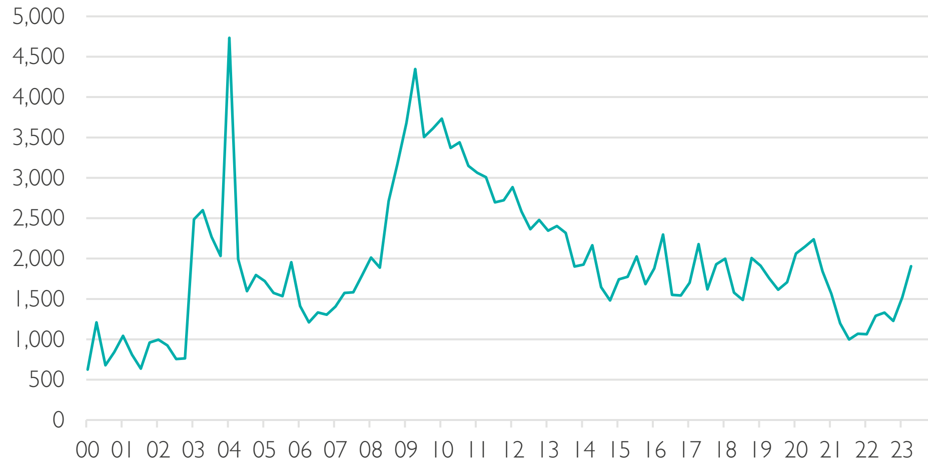
The top chart is a quarterly series showing the number of US corporate bankruptcies (officially called "Chapter 11" filings). It hit its lowest level for 18 years in Q3 2021. It has slowly moved up since then but remains at historically low levels in Q2 2023.

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.

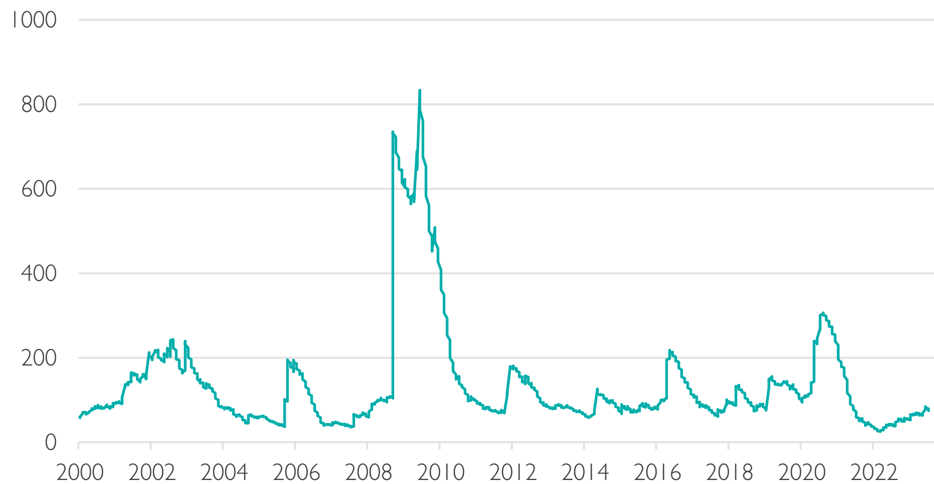
The challenge in coming months will be whether the combination of tighter monetary policy and the inflationary pressures makes it harder for corporates. We have seen an increase in corporate bond yields in recent weeks but defaults remain rare. That may well change from here.

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 28.07.23

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

The Moody's Baa yield (a benchmark for the investment grade market) has been above the earnings yield of the S&P500 Index for eight of the last ten month ends. At the end of July, the numbers were 5.7% versus 5.3%.

The last two periods when this was the case were the run up to the Dotcom peak in 2000 and it's 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 5.4%. It is the first time it has been above the earnings yield since August 2001.

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 31.07.23

CORPORATE CREDIT MARKETS NOT STRESSED

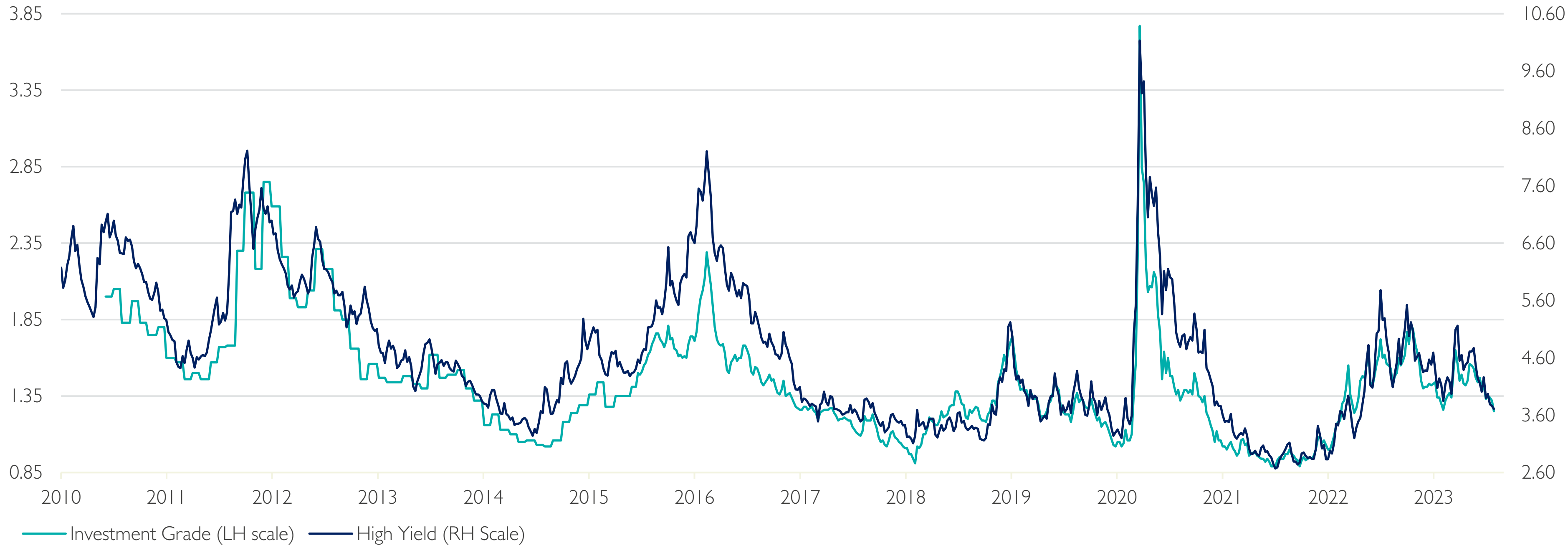
Credit spreads have tightened as the risk-on rally continued in recent weeks.

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 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 28.07.23

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 6.8% in June from a year ago and exports declined 12.4%. 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 although the currency strengthened last month.

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. But the sabre rattling around the issue will continue. Watch the Taiwan dollar to see if the market is taking it more seriously than it apparently does, quite reasonably, at the moment.

Renminbi per US dollar

Taiwan dollars per US dollar

Source: Bloomberg, Waverton. Data as at 28.07.23

Part 3

OUR APPROACH TO INVESTING RESPONSIBLY

RESPONSIBLE STEWARDSHIP OF CLIENTS 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:

PRI Principles for Responsible Investment | UK Stewardship Code | MSCI | Glass Lewis | Climate Action 100+ | CDP

RESPONSIBLE INVESTMENT AT WAVERTON

Environmental, Social & Governance (ESG) Investment

Waverton Research Process

PRI Principle 1

Signatory of:

PRI Principles for Responsible Investment

- Incorporation of ESG factors into investment analysis and decision-making
- Integrated into research process across all asset classes
- Specialist thematic, sustainable and impact fund research

Engagement & Voting

PRI Principle 2-6

Signatory of:

PRI Principles for Responsible Investment

- Active engagement with company management
- Collaborative engagement activities
- Proxy voting by Glass Lewis

UK STEWARDSHIP CODE | MSCI | GLASS LEWIS | Climate Action 100+ | CDP

Ethical Investment

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

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