



FOUNDED IN

1988

EMPLOYEES

80+

LOCATED IN

10+
COUNTRIES

ASSETS DIRECTLY
UNDER MANAGEMENT

US\$1.9
BILLION

ASSETS INDIRECTLY
UNDER MANAGEMENT

US\$24.5
BILLION



ICM Monthly Outlook

JULY 2024

Market Review

Equity Markets

The first half of 2024 will be a tough act to follow for equity markets. The S&P has returned c.18% year-to-date and 16% in the first half. Like recent years, a big theme has dominated this year's return. Approximately two-thirds of the US equity markets' returns were driven by just a few names: Nvidia, Apple, Microsoft, Amazon, and Meta. Even Tesla, one of the laggards of the Magnificent 7, has rallied lately thanks to renewed optimism for robo-taxis and higher sales.

Year-to-date, investors' returns are delineated by 'performance with tech stocks' versus 'performance without tech stocks'.¹

In June, Nvidia briefly overtook Microsoft to become the world's largest company. At one time, Nvidia was larger than the UK stock market (USD 3.3 trillion versus USD 2.8 trillion), the French stock market, or the entire global stock of publicly traded energy shares. US equities have casually dismissed the notion of an imminent correction by repeatedly reaching new all-time highs. In June 2024 alone, the S&P 500 rose 3.5%, while the Nasdaq increased 6.0%. In contrast, the Russell 2000, representative of small-cap US companies, fell 1.1% in June and is up 1.0% year-to-date.

Most of this year's gains have come from the multiple's expansion, although earnings have also grown. In June, the S&P 500's price/earnings ratio ("PE ratio") was 29.2x, versus 25.0 at the start of 2024.

The European stock market had been moving in lock step with the US market before June, but a shift to more right-wing political parties in the European elections, followed by a surprise election in France, further highlighted the decline of moderate politicians, increasing political uncertainty. In June, European equities fell by 1.7% as measured by the Eurostoxx. The decline of centrist politicians continues to be a long-term concern across developed markets (more in the next section).

The MSCI Emerging Market index was up 5.9% to the end of June 2024 and another 3.5% so far in July, bringing the year-to-date return to 9.6%. Taiwan and South Korea have significantly contributed to EM returns; both countries produce and export large quantities of semiconductors.

Interest Rates

Since July 2023, US short-term interest rates, as measured by 3-month US T-Bills, have remained remarkably stable, fluctuating within a narrow range of 5.33% and 5.46%. At the end of June, they yielded 5.35%.

In contrast, by the end of June, one-year US treasuries yielded 5.10% compared to 4.76% at the start of the year, c.34 basis points higher. The rise in yields demonstrates how previously anticipated rate cuts were added back into

Market Review continued

the yield by investors as they realised rate cuts were further away and probably fewer in number. The US ten-year treasury bond currently yields 4.40% versus 3.89% at the start of the year because investors recalibrated their assessment that rates would remain higher for longer. In June, the ten-year yield fell to 4.40% from 4.49% and to 4.20% by mid-July.

Year to date, the US Treasury bond index has returned negative 0.9%, as measured by the Barclays US Aggregate Government Index. The Federal Reserve's internal projections show only one cut for 2024.

In June, the ECB delivered its first rate cut of the cycle, cutting base rates to 3.75% from 4.00%, despite inflation of 2.6% versus the 2.0% target.

Like the US yield curve, German rates were about 50 basis points higher at the end of June than at the start of 2024. The European Government bond index has returned negative 1.3%, as measured by the Barclays Euro Aggregate Government Index.

There was a noteworthy increase in the spread between French and German government bonds, which reached a five-year high because of President Macron's snap election gamble. This has resulted in an awkward coalition between centrists and leftists. Today, the spread is c.65 basis points versus the five-year average of 50 basis points and 30 basis points before the COVID-19 pandemic.

In the UK, the Bank of England held rates steadfast even though inflation fell to 2.0%, on target, in May. Like Europe and the US, UK longer-term interest rates are c.50 basis points higher than they were at the beginning of 2024. The election of a Labour government had little impact on the markets, either bonds or equities, as the collapse of the conservative vote was so widely foreseen. The market will welcome a period of calm in the UK following the turmoil caused by the Conservatives over the past few years, even though the Labour government will lead to higher taxes to fund higher public spending.

In June, spreads in US investment-grade corporate bonds widened from 88 to 96 basis points. The spread on US investment-grade corporate bonds was 104 basis points at the beginning of the year. Wider spreads did not prevent the US Investment-Grade Corporate Bond index from increasing by 0.6%, as measured by the ICE Bank of America US Corporate Index, as once again, we saw the move in spreads drowned out by the fall in yields.

Spreads in US high-yield bonds remained relatively stable during the month. In June, the US High-Yield Bond index increased by 1.0%, as measured by the ICE Bank of America High-Yield Index. US high-yield bonds also benefitted from declining interest rates during the month.

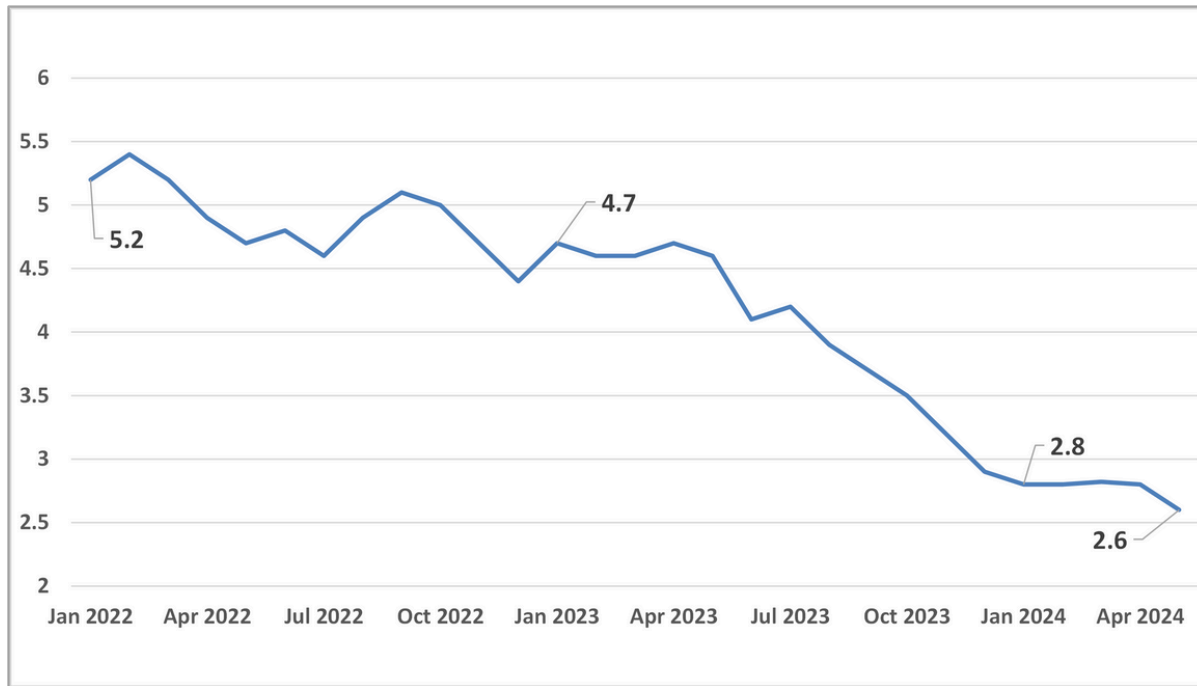
Outlook for H2 2024

As mentioned above, two-thirds of US equity growth from just five stocks is a very concentrated return, no question. Concentration risk is real if those companies were to fall back sharply; however, we do not believe these companies are vulnerable, not over the longer term anyway. None of the Magnificent 7 are speculative stocks in our minds. The standout performer, Nvidia, is an overnight success that has been twenty years in the making. Its foundations are rock solid. We do not believe the recent rise of tech stocks will become a material detractor to future returns.

Notwithstanding equity markets' high valuations, we see no reason for a significant pullback. We expect the second half of 2024 to be positive for markets, albeit at a lower rate of gain. We believe the broader market (the Russell 2000, for instance) will be dragged higher in the second half of the year by less restrictive monetary policy, which may come as soon as September in the US.

We believe that interest rates remain too restrictive for global growth to return to previous years' levels and too restrictive relative to inflation's trajectory. Recent data suggests a benign outlook for inflation over the short to medium term. In May, the US Personal Consumption Expenditure (PCE) Price Index fell to 2.6% versus 2.8% in April. This measure has dropped consistently every month since January 2023.

PCE Inflation's Steady Decline



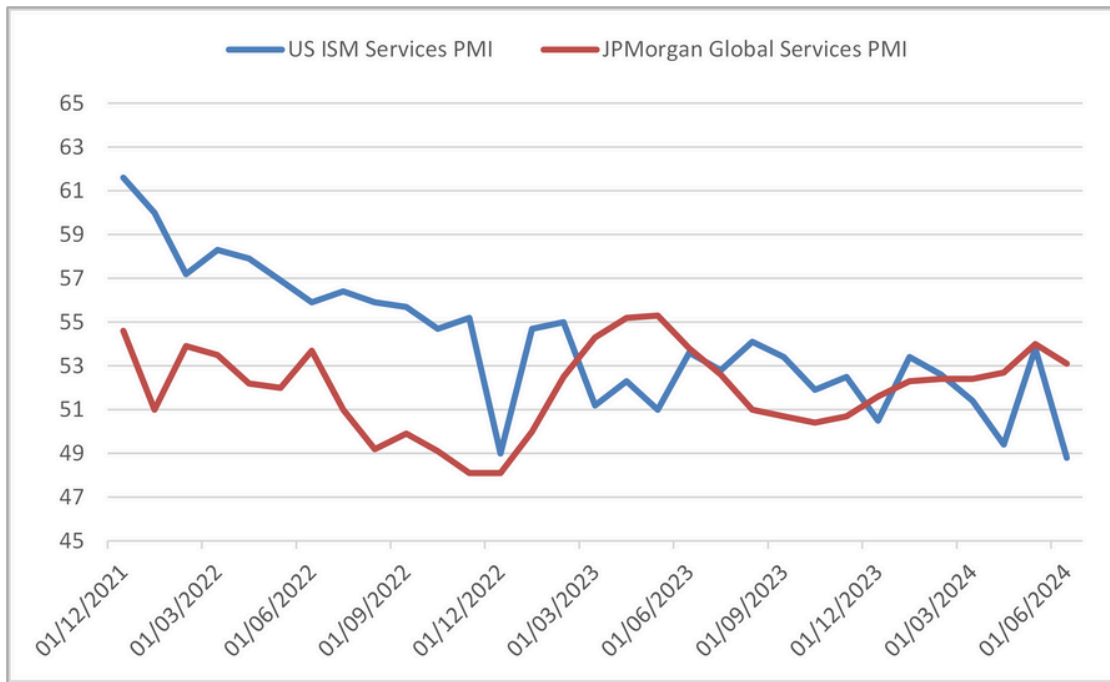
Source: Bureau of Economic Analysis

Month on month, the core PCE price index increased by only 0.1% in May versus 0.26% in April, a welcome decline. Like the CPI index for May, released in mid-June, the PCE's breakdown broadly improved across all sectors. Services inflation slowed to 0.17% from 0.29% in April, while core goods (excluding food and energy) prices posted deflation, dropping 0.18% from 0.11% in April. Remember, services have been the stickiest element of inflation. Within services, the slowdown was broad-based in May, with deflation in financial services (-0.33%), transportation services (-0.65%), recreation services (-0.34%), and other services (-0.23%).

On the other hand, housing remains sticky at 0.42%, and healthcare costs increased significantly to 0.71% from 0.06% in April. Housing and healthcare inflation support economists' and policymakers' concerns about the long-term impact of a shortage of shelter and an ageing population, which will catch up with most developed economies.²

The ISM Services PMI index looks weak, benefiting the disinflationary story.³ In June, the Services PMI Index was 48.8, only the third time it has fallen below 50 since the COVID-19 pandemic, and significantly below 53.8 in May. Another recent indicator that the US economy is just keeping pace and not powering ahead comes from the ISM Manufacturing PMI Index continuing to show tepid growth, albeit having recovered from its lows. In March, the ISM Manufacturing Index's (PMI) expansion was short-lived, falling back to 48.5 in June. A reading below 50 indicates that purchasing managers have a negative outlook on average and is generally a precursor of declining economic growth.

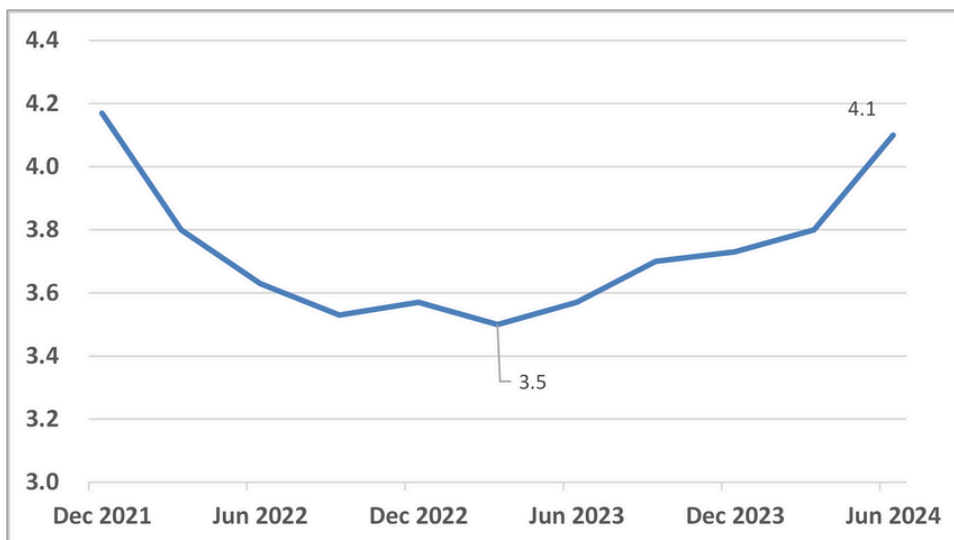
ISM Services PMI



Source: Institute of Supply Management

The US unemployment rate ticked up to 4% in June, versus 3.8% in March 2024 and 3.6% in March 2023. We feel safe to assume that the unemployment rate will continue to rise due to a slightly weaker economy, coupled with robots and Artificial Intelligence replacing labour. While the unemployment rate has already increased from its low of 3.5% to 4%, we expect it to keep climbing to c.4.5%, a rate that is still a far cry from a hard landing, especially with inflation falling.⁴

US Unemployment Rate



Source: US Bureau of Labor Statistics

Some economists and analysts predict the US will slow more and enter a recession in the second half of 2024. We disagree. Many of these same forecasters have been calling down the economy for the past two years since interest rates passed through 3%. They will eventually be right; Warren Buffet says, "Forecasts may tell you a great deal about the forecaster; they tell you very little about the future." However, we see no apparent risk of a sharp decline. Over the past two years, the market has shown fantastic resilience, enduring earnings scares and localised crises, such as commercial real estate, US bank failures, and some corporate defaults.

Continuing the trend of lower inflation and higher unemployment in the coming two months firmly opens the door for the Federal Reserve Bank to cut rates. A July cut is highly unlikely, given that the Federal Reserve Bank only revised down its expectation for cuts in 2024 from two to one at their June meeting. Bloomberg's World Interest Rate Probability index says there is a c.90% chance the Federal Reserve Bank will cut rates by twenty-five basis points at their September meeting and a 100%+ probability of a cut by the end of November if they do not cut in September. We feel the Federal Reserve Bank may be swayed not to cut rates in September ahead of the Presidential Election, even though President Powell has remained completely apolitical for his tenure so far. Whether September or November, its impact will be the same and well-telegraphed; there will be no 'big reveal.' The next big debate will be the number of subsequent quarterly cuts; the current range is four to six, depending on whom you ask, and the new terminal rate, the current expectation is 3.25% - 3.5%.

The US Federal Reserve remains matter-of-fact about the current economic data, stating that it remains data-dependent. In summary, we expect growth to slow down but not a recession and inflation to continue to fall.

Outlook Beyond 2024

We are more cautious going into 2025. The changing political landscape is the biggest risk to the global economy, in our opinion.

We expect President Trump to win the US presidential election following President Biden's disastrous debate. Time is not on President Biden's side, and we fear even worse performances from him before the election. It is hard to see who the Democrats could bring to compete with President Trump at this late stage.

According to the US Treasury Secretary, Janet Yellen, President Trump's proposed tariffs would be much broader than President Biden's existing tariffs, raising costs for US consumers and hindering US business. In fairness to President Trump, President Biden's tariff announcement in April left in place duties of up to 25% on hundreds of billions of dollars worth of other Chinese imports that President Trump imposed in 2018 and 2019. President Biden's new tariffs are aimed at protecting electric vehicles, solar energy products and semiconductors from excessive Chinese exports. Washington announced plans to quadruple duties for Chinese EVs to 100%.

President Trump could go much further, with his proposals including a 10% tariff on all imports and 60% on Chinese imports. This would be detrimental to the US' trading partners. The European Commission has also imposed extra duties on imported Chinese electric cars from July, risking retaliation from Beijing, who will undoubtedly respond with measures to safeguard its interests. Several G7 members have imposed tariffs.

One consequence of tariffs could be new inflation, as many US products rely on imports as feedstock for their end products. The increased cost will be pushed onto the consumer. Higher prices will reduce consumer demand.

Increased political risk permeates the globe. The latest election results in France and the United Kingdom increase uncertainty. While President Macron's centrist party and its left-wing allies crowded out the French far-right party in the second-round election, it came at the cost of becoming uncomfortable bedfellows. Extreme politics, either right or left, are equally unnerving for investors, and the direction of travel to the extremes increases fiscal policy risks into the foreseeable future.

The outlook for France is now one of gridlock, rancour, and continued polarisation while the centrist and left-wing parties thrash out a program for government. The far right will patiently wait for the next Presidential election against the backdrop of a worsening migrant crisis. The longer-term impact of a shaky French government will be its impact on the European Union. France has been a cornerstone of the European Union, and its continued support is crucial. While there is no imminent weakening of the European Union, the rise of extreme political parties could threaten the cordial relations of EU members thus far.

In the UK, the far-right Reform Party won five seats at the expense of the Conservative Party. Reform won 14% of the National vote versus 12% for Liberal Democrats, who won seventy-two seats. The Conservative Party will have no choice but to become more right-leaning to compete with the Reform Party in the future.

Polarised politics will lead to more extreme policies, higher taxes, less globalisation, and lower investor returns. Two simple examples in the UK include the Labour Party's plan to end the VAT exemption on private school fees and closing a tax treatment known as non-domiciled, or non-dom, status, which sees the UK's wealthy avoid the payment of UK tax on

overseas income. Labour's pre-election projections suggested that abolishing these would raise over GBP 3 billion annually, which could be spent on the health system.

Market Implications

Against a backdrop of increased tariffs and higher taxes, we are not Pollyannaish for global trade, which could result in a lower oil price from reduced demand. On the other hand, the value of the US dollar should decline against its trading partners if the Federal Reserve Bank starts to cut rates faster than the other major central banks, which is likely. This would be welcome news for emerging economies. Typically, looser financial conditions and credit expansion favour the real side of emerging market economies. Improving global liquidity and a lower oil price makes it easy to see a path to higher global growth.

Conor Spencer

16 July, 2024

Source Data: ICM, Bloomberg as of 30 June, 2024.

[1] Bloomberg

[2] US Bureau of Economic Analysis, Personal Income and Outlays, May 2024.

[3] "The recent data lead me to believe this will take more time than previously thought," Collins said in a speech at the Sloan School of Management at the Massachusetts Institute of Technology. "There is no pre-set path for policy."

[4] Bureau of Labour Statistics, The employment situation, June 2024.

Risk Warning

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