# Current Positioning
# December 2024

## The past month summed up

With the US stock market and economy roaring ahead, is the world becoming a little bit unbalanced?

## The rationale

Our central view remains that inflation has stabilised, albeit at higher levels than before COVID, and that the US economy is in robust health. Markets have digested the news of Donald Trump's election extremely well believing, on balance, that it will be positive for the US. Currently the market view is that what is good for the US will prove bad for everybody else.

There is an abundance of uncertainty in the world at present. We have increased global tensions which will probably be exacerbated by a more muscular and strident US. We have an ongoing war in the middle of the European landmass bringing the Russia/NATO relationship to its lowest point in decades while in the Middle East the war between Israel and Hamas continues and a ceasefire between Israel and Hezbollah remains precarious. In just a week, we've had the wholly unexpected routing of the Assad regime in Syria and a new Islamist government taking over which, while making all the right conciliatory noises, has its origins in jihadism. To cap it all, South Korea, one of Asia's few liberal democratic societies, held a short-lived half-day experiment in dictatorship after its president declared and then reversed martial law.

And then there's the economy. The world's second-largest, China, as we have noted in previous epistles, is suffering from chronic malaise. In Europe things seem to be getting worse – Germany's government has collapsed and an election isn't expected until March. In France, the government also collapsed after the rejection of its budget by an alignment of far left and far right members of Parliament. If the EU is powered by the Franco-German engine, then it is spluttering at best. The prospect of Trump-inspired tariffs can only further dampen Europe's animal spirits.

## America, first without equals?

With that picture painted, it's no surprise that all the talk is of American exceptionalism. The country notched up growth of 2.8% in the third quarter. It added a more-than-expected 227,000 jobs in November and revised up figures for the previous two months. As if to emphasise the difference in prospects, the S&P roared ahead 5.7% over November, the Russell 2000 index of smaller US companies soared 10.8% higher, while in Europe the Stoxx 50 index was essentially flat. Earnings expectations emphasise the difference as well, with Bank of America data showing falling expectations globally but a rise for those in the US.

The question then is what is the cause of America's leading performance? It's no secret its liberalised economy and less stringent labour regulations, which make it easier to hire and fire, allow the economy to deploy labour more immediately to where it's needed. An abundant supply of labour via immigration is also a key ingredient – the fact that Trump's deportation plans would stymie this input seems to be somewhat overlooked at the moment, with markets perhaps assuming that's more bluster than an achievable goal.

Years of investment in world-class universities and a culture of innovation have made the US the go-to location for anyone looking to innovate, a cluster that continues to attract the best brains and ideas. Finally, and ironically, given that the economy and price rises were reasons cited by voters for supporting the Republicans in November, the careful management by the Federal Reserve of interest rates, alongside President Biden's infrastructure investments, have guided the economy relatively unscathed through the aftereffects of Covid and the rampant inflation that followed the pandemic.

## The easy option

It may well then be tempting for some investors to shrug and bank solely on the US as the only game in town. The problem is that there are some risks attached to the basic narrative that the US can continue as is and all will be fine. Zoning in on President Trump, we highlighted last time how markets were relieved that the new administration had been emphatically chosen by the US people, removing the prospect of weeks of wrangling as to who was the actual winner. However there are good aspects and bad aspects to his policies. Investors love the deregulation and the idea of lower taxes, but the overall totality of Trump's populist plans, including the deportation of immigrants and tariffs, could be inflationary in the longer term, erasing the Fed's work of recent years while also adding to the budget indiscipline that has raised the hackles of so-called bond vigilantes. Indeed, in a recent interview Trump refused to rule out that higher inflation may well be a consequence of some of his policies.

Most significant is the indulgence shared by some that the US can act at will without any consequences. There's a reason why economists in the latter half of the 20th century advocated for free trade and that's because by allowing nations and regions to specialise in what they're best at it tends to make everyone richer on average (average being the key point as left-behind post-industrial areas of the US and Europe are the hotbeds of support for populist right-wing parties). The early 20th-century shows that when tariffs are introduced this just leads to tit-for-tat reprisals from the other side. Already China is sharpening its arsenal of economic weapons by blocking US companies from buying minerals such as gallium, germanium and antimony, which are widely used in military applications.

Then there's the risk that expectations are too focused on the tech sector and the possibilities that generative AI can bring. It's of note that even in the global MSCI AC World index, only 14 companies, including the likes of Apple, Tesla and Nvidia, were responsible for 50% of its November advance.

Finally, there is the all too prevalent risk that things are just getting ahead of themselves. Even analyst Ed Yardeni, who steadfastly remained a disciple of the soft landing theory even when it looked like the economy was giving way under the weight of higher interest rates, has sounded a note of caution. There are just too many positive investors out there with the proportion of consumers who expect stocks to be higher in the next 12 months now exceeding the proportion at the height of the tech boom. Bank of America's fund manager survey shows a surge in bullish sentiment, with growth expectations leaping from -10% in October to a positive 23% in November, the highest number in three-and-a-half years.

## Still a good news story

While acknowledging the issues faced by the US's ascendance, it's also important to recognise the valid factors for such a situation. We mentioned the economic and structural tailwinds earlier, with a level of self-sufficiency, particularly in energy, that other countries can only look upon in envy. It is also custodian of the global reserve currency which gives it wide ability to manoeuvre where other countries can't.

The question then is to whether the US still provides value when shares in the S&P 500 index cost 22 times expected earnings? Although an historically high figure, investors recognise the US's dominance in technology and the fact that many of the companies leading the stock rally are established, successful and hugely profitable businesses. If anywhere is going to be able to tap the potential of AI, it's going to be in the US, and we believe strongly that the benefits will spread to an ever-wider group of companies actually harnessing AI rather than building the generative infrastructure.

A further reason for understanding these elevated prices is what we have discussed throughout this piece – the dearth of other opportunities elsewhere which by simple supply and demand makes US companies more valuable. In addition, the number of new businesses floating on the market has been curtailed by the growth in private equity.

So we have a balance to straddle – the superiority of the US model, leaving little visible evidence of an impending economic shock or downturn balanced against high valuations that may need only a little nudge on the downside in order to become unstuck.

## Conclusion

Our approach to investing in this environment has been to carefully explore those US companies where valuations as yet are not stretched, providing better opportunities than equity holdings in many regions in the rest of the world. To protect against any shock, we maintain a significant holding of fixed income designed specifically for this environment: namely, a focus on UK gilts where the dampened economic prospects make fixed income a potentially more effective option then US Treasuries, where the ongoing turbocharged economy and the possibility of increased inflation and interest rates make government bonds there less defensive.

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