FISHER INVESTMENTS EUROPE™

MARKET PERSPECTIVES
REVIEW & OUTLOOK

FIRST QUARTER 2024

FIRST QUARTER 2024 REVIEW & OUTLOOK

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FIRST QUARTER 2024 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

11 April 2024

PORTFOLIO THEMES

- We believe the strong start for global equities in 2024 likely continues throughout the year.
- Positive global economic growth, easing inflation, and improving sentiment should support markets.
- While growth has led thus far in the market cycle, we remain watchful for a potential lasting shift to more cyclical categories, which typically lead in a stronger than expected economic environment.

MARKET OUTLOOK

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

The good-to-great year we anticipated started strong for global equities, as the MSCI ACWI rose 8.2% in Q1, its fastest start in five years.[i] Emerging markets (EM) lagged developed markets but also participated in the first quarter's positive start, ending Q1 up 2.4%.[ii] Within global equities, Tech and the Tech-like portions of Communication Services led all other sectors, though some more cyclical, value-oriented categories also outperformed, including Financials and Energy—highlighting this bull market's underappreciated breadth.[iii]

The strong Q1 caught investors' attention, improving sentiment considerably. Where many pundits once saw a narrow surge with only AI-related companies rising, the broader rally is now clear to investors, with most countries and sectors participating to varying degrees. Several sentiment surveys show more optimism, including investor and fund manager surveys. Sir John Templeton famously said: "Bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria." We appear to be early in optimism now, giving equities more room to run as proverbial animal spirits stir and prompt investors to bid equities higher.

i Source: FactSet, as of 31/03/2024. MSCI ACWI Index return with net dividends, 31/12/2023 – 29/03/2024.

ii Source: FactSet, as of 05/04/2024. MSCI EM Index return with net dividends, 31/12/2023 – 29/03/2024.

iii Source: FactSet, as of 01/04/2024. Statement based on Q1 MSCI ACWI Index sector returns.

Still, the strong start—with returns near equities' historic annualised average already—has some questioning whether the market has gotten ahead of itself. In our view, the environment looks healthy, and normal for an early bull market. Many investors have long fixated on the Fed, hoping rate cuts will come to give equities fresh energy. This is misplaced. Equities have already shown they can thrive in the current interest rate structure. So has the economy, with US GDP growth strengthening as Fed rates rose. Even in the UK, Japan and parts of Europe, where data are more mixed, there are several green shoots of improvement amid higher rates. Purchasing managers' indexes have returned to expansion in much of the developed world. Monthly GDP is turning up in the UK and Canada. Business investment is already growing in the UK and Japan, broadening the offensive posturing we are seeing in the US. This augurs well for future growth and earnings.

Emerging Markets have also displayed resilience to begin the year. Despite some soft patches, the latest economic data show the largest EM regions continue growing. In China, industrial production accelerated to 7.0% y/y in January – February (combined to control for shifting Lunar New Year holidays) from December's 6.8%, while retail sales rose 5.5% y/y, above expectations, though slower than December's 7.4%.[iv] In Brazil, industrial production accelerated to 3.6% y/y in January from December's 1.0%, while its timelier manufacturing purchasing managers' index (PMI) rose to 54.1 in February from January's 52.8.[v]

While positive economic developments have helped fear ebb, scepticism remains prevalent, particularly toward China. We think this makes for a bullish EM backdrop because it leaves plenty of room for upside surprise.

In global politics, Q1 saw the conclusion of Portugal's election, with the centre-right Democratic Alliance (AD) winning a narrow plurality. With a hung parliament, however, continued gridlock is expected—keeping debt crisis-era reforms intact and legislative risk low. In nearby Spain, Catalonia's regional government called a snap election, forcing PM Sánchez to cancel fiscal policy negotiations and extend 2023's Budget instead. While this extends the status quo, it also preserves uncertainty over the financial and energy sector windfall taxes, which the government had pledged to make permanent in the upcoming Budget. The taxes haven't proven to be a huge roadblock for Spanish equities, but businesses would likely benefit from clarity on their future either way.

Later this year, several other European elections are scheduled (or may be called) including European Parliament, Belgium, Austria, and possibly the UK general election. We are watching these contests closely but reduced uncertainty as these elections pass will likely be positive for markets as the year progresses.

In the US, Congress is highly gridlocked, managing to avoid a government shutdown but doing little else. Expect more of the same as November's election becomes the main focus, giving politicians little incentive to pass anything substantial—lest they alienate voters with bills even remotely contentious. The current political environment keeps legislative risk low, giving investors additional freedom to take risk and businesses more confidence to deploy long-term projects. As more companies use their strong balance sheets to unleash fresh capital, equities should ride a wave of earnings growth and investment.

iv "China Jan-Feb Industrial Output Rises 7%, Beats Expectations," Staff, *Reuters*, 17/03/2024.

v Source: FactSet and S&P Global, as of 02/04/2024.

The US election, which we will detail more in the full Review, is taking shape. As a reminder, we favour neither political party nor any politician. Partisan bias is blinding in investing—and underpins many errors. Today, most attention centres on President Biden and former President Trump, who now have enough delegates to be their parties' presumptive nominees. Poll averages compiled by *RealClearPolling* give former president Trump a narrow edge nationally and in swing states, as does Electoral College math. The two candidates are quite well known, even if they aren't well liked, which seemingly lowers the potential swing from here. But anything can still happen—we rule out no outcome yet.

For all the attention the US presidency gets, the Senate and House races are equally significant, if not more so. They largely determine how much gridlock we get in 2025 and whether equities are set for relief or disappointment that year. It is too soon to know now, but we are watching closely. Will the Republicans' splintering House majority manage to hold, or will Democrats take advantage of the chaos and vacated seats and flip it? In the Senate, will Republican candidates take advantage of the most favourable map they will have for years, flipping key seats? Or will Democrats ride their significant fundraising advantage and lock in their majority?

Election details aside, the most important thing about the election year is its simple history of bullishness. As past Reviews showed, year four has the second-highest returns for US equities of the presidential cycle, at 11.4%, as well as the second-highest frequency of positivity.[vi] Better still, when year two is negative—as 2022 was—year four was up every time except 1932—amid the Great Depression. It is a simple, secret bullish history that few know or fathom, extending its power.

In past writings, we have detailed that 2022's bear market looked quite similar to 1966's—and 2023's recovery echoed 1967's. Now 2024 looks like 1968, another good-to-great year with a contentious, tiring presidential election and deep polarisation. Yet that was a short bull market, with a bear market arriving in 1969. Will the parallel hold to a 2025 bear market? We are watching for possible overstretched sentiment and potential shocks that could complete the parallel, although we see none yet.

So for now, we predict more of the same. Expectations remain too low, and most economic readings continue beating them. Earnings, too, are coming in better than most anticipated. Even with rising optimism, few fathom businesses shifting to an offensive posture. Most question the economy's vibrance, missing that we have returned to prepandemic normal growth rates. We believe there remains plenty of room for positive surprise to power equities higher.

vi Source: Global Financial Data, Inc., as of 31/03/2024. S&P 500 total return average in presidential election years, 1928 – 2020.

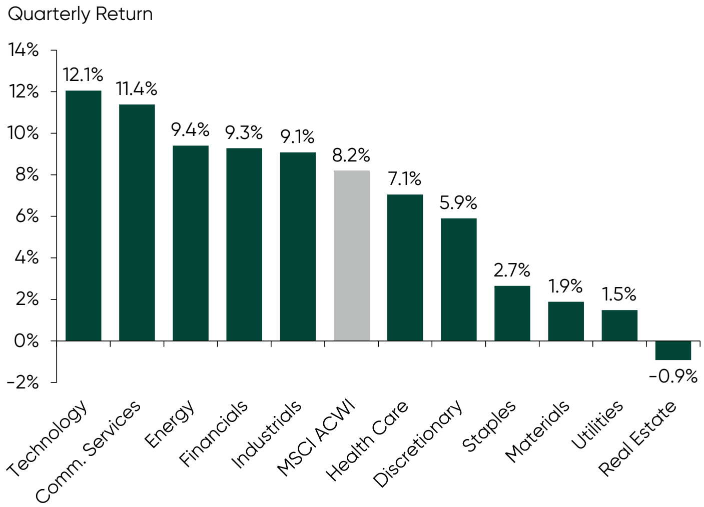
GLOBAL UPDATE AND MARKET OUTLOOK

7 May 2024

MARKET RECAP

Global equities rose to start 2024 as warming sentiment helped to broaden the equity market rally. Nearly every sector was positive and markets were led by Tech and Tech-like equities in Communication Services.[vii] (Exhibit 1)

EXHIBIT 1: MSCI ACWI Q1 SECTOR RETURNS



Source: FactSet, as of 25/04/2024. MSCI ACWI and sector returns with net dividends, 31/12/2023 – 31/03/2024 in USD.

While several value categories outperformed in Q1, this may not be a sharp leadership shift. Rotations often act more like a dimmer switch than an on/off, with false starts. Either way, the bull market has ample fuel. Political tailwinds abound, backed by election years' history of above-average returns and frequent positivity. Economic conditions globally are much better than perceived. And while past returns don't predict, once bull markets reach one year—as this one did last October—a second followed. We are vigilant for risks, and negativity is always possible. But equities have many reasons to thrive.

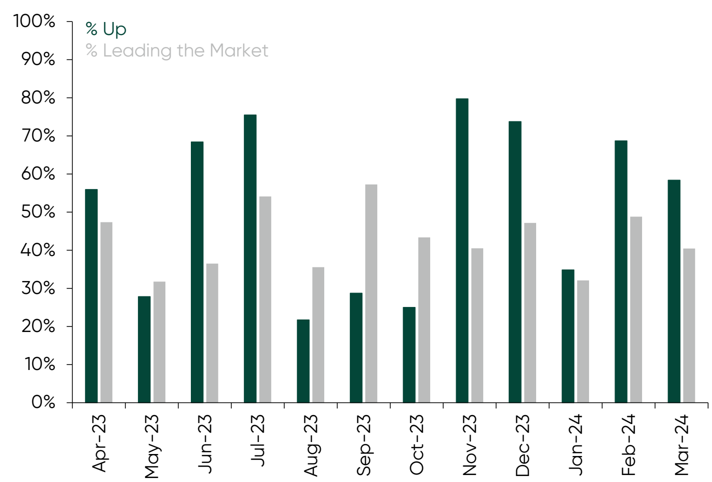
A WORD ON BREADTH FEARS

At 2024's dawn, many deemed this bull market a figment of optimists' imagination. Equities were rising, the story went, because AI exuberance pushed the huge "Magnificent 7" (comprised of seven of the world's largest companies by market capitalisation: Apple, Microsoft, Nvidia, Meta, Amazon, Alphabet, and Tesla) to new heights. But as equities kept climbing, many noticed broader gains, talking as if breadth were new.

This is merely sentiment warming gradually. The rally has long been broad and global. Consider all the indexes hitting record highs in Q1: Australia's ASX 200, Britain's FTSE 100, the MSCI Denmark, France's CAC 40, Germany's DAX, Ireland's ISEQ, Italy's MIB, Japan's TOPIX, the Netherlands' AEX and Spain's IBEX.[viii] The all-US Magnificent 7 can't explain these records. Most outside the Netherlands aren't Tech-heavy.

Here is another way to see this. Exhibit 2 shows the share of the more than 1,400 continuously listed MSCI ACWI constituent equities rising and outperforming on a monthly basis in the last year. A broad bull market is nothing new.

EXHIBIT 2: THE BROAD-SHOULDERED BULL MARKET



Source: FactSet, as of 25/04/2024. MSCI ACWI constituents, non-cumulative total return in USD, monthly, April 2023 – March 2024. "% Up" calculated as the percentage of companies in the index with positive returns in the month, "% Leading the Market" calculated as the percentage of companies in the index beating the MSCI ACWI in the month.

vii Source: FactSet, as of 12/04/2024.

viii Ibid.

THINKING BEHAVIORALLY

Equities have had a solid 6-month run since the correction ended in October, extending the now 18-month-old bull market. Though some investors see the market's rise as "too far, too fast," we have long argued successful investing isn't about timing short-term swings. It is about capturing longer, more durable trends. Besides, we actually haven't come hugely far hugely fast. The 18 months through 12 April is the fourth smallest bull market start since 1928. (Exhibit 3)

"Too far, too fast" discussions speaks to how people underrate *positive volatility* in bull markets. They mistake the long-term, roughly 10% annualised S&P 500 return for normal. But that includes bear markets. Strip them out to see positivity's true bull market power: Before the current one, they annualised 23%.[ix] Or, as Ken Fisher recently noted, equities outperformed their 10% long-term average in 58 calendar years. Equities fell—to any degree—less than half as often, 26 times.[x] Meaning that historically, equities are twice as likely to achieve higher than average returns than encounter down years. Equities climb in nearly three-fourths of calendar years. Returns are more often up big than down. Volatility is generally *good*.

EXHIBIT 3: BELOW-AVERAGE RETURNS TO START THIS BULL MARKET

Date of Low	Return From Low After...		
	6 Months	12 Months	18 Months
01/06/1932	52.6%	120.9%	124.9%
28/04/1942	24.6%	53.7%	60.1%
13/06/1949	22.8%	42.0%	45.1%
22/10/1957	9.8%	31.0%	48.1%
26/06/1962	20.5%	32.7%	42.0%
07/10/1966	22.1%	32.9%	27.4%
26/05/1970	22.8%	43.7%	132.7%
03/10/1974	30.9%	38.0%	64.2%
12/08/1982	44.1%	58.3%	54.0%
04/12/1987	19.0%	21.4%	45.4%
11/10/1990	27.8%	29.1%	36.8%
09/10/2002	11.5%	33.7%	46.7%
09/03/2009	52.7%	68.6%	63.2%
23/03/2020	44.7%	74.8%	98.8%
12/10/2022	14.4%	21.6%	43.2%
Pre-2022 Average	29.0%	48.6%	63.5%

Source: Global Financial Data, Inc., as of 16/04/2024. S&P 500 price returns in USD in bull markets' first 6, 12 and 18 months, 01/06/1932 – 12/04/2024.

BEYOND 2024

While we think 2024 will shine, we are looking toward 2025 and the possibility of hitting euphoria and a bear market then. This fits with presidential trends. A president's first and second years carry much more legislative risk than the third and fourth, as they push signature legislation early, before the post-vote honeymoon ends. Exhibit 4 summarises this trend.

EXHIBIT 4: PRESIDENTIAL TERM ANOMALY SUMMARY

	Year 1	Year 2	Year 3	Year 4
Average Return	11.3%	7.5%	18.7%	11.4%
Number Positive	15	15	23	20
Total Number	25	25	25	24
Frequency of Gain	60.0%	60.0%	92.0%	83.3%

Source: Global Financial Data, Inc., as of 03/04/2024. Average returns in USD through US Presidential cycles.

ix Source: Global Financial Data, Inc., as of 14/03/2024. S&P 500 annualised total return in bull markets, 1932 – 2022.

x "Why investors are grappling with a 'fear of heights' in 2024 — and what 98 years of history tells us," Ken Fisher, *New York Post*.

Furthermore, we have long said 2022's bear market resembled 1966's recession-less downturn. The parallel held: A small bear market, driven partly by inflation and Fed fears, ended without capitulation. As Ken detailed in the *New York Post*, 1967 was a year of recovery, much like last year. Now we enter 1968, with 2025 potentially paralleling 1969—a bear market year.

1968 contained a contentious election with partisan and civil strife. The incumbent, Lyndon Baines Johnson, was hugely unpopular and abandoned re-election—although this wasn't known early in the year. The Republican nominee, Richard Nixon, was among the best-known and most-hated Republicans of his day, having served as Dwight Eisenhower's Vice President from 1953 – 1961, before his failed White House bid in 1960.

In 1968, the two establishment candidates had no one satisfied—a direct parallel to today. While we aren't saying this means a bear market strikes next year, it points to risk increasing and needing to be prepared for it. But 2025 is too distant, with too many unknowns, to predict now.

ON SENTIMENT

Sir John Templeton famously said, "Bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria." Three months ago, scepticism and pessimism dominated. Most investors harboured fears from the Middle East to Ukraine, resurgent inflation to weak market breadth. And more.

But the strong rally since thawed that some. Now we see signs in sentiment gauges like Bank of America's fund manager surveys and the American Association of Individual Investors' surveys, interactions with Institutional and Private Clients, and more suggesting warmer sentiment. It looks like we have entered optimism.

Perhaps this seems alarming or too optimistic. But other indicators are far from frothy. Consider initial public offerings (IPOs). A rush of low-quality IPOs is a classic euphoria signal. Usually, as sentiment warms, high-quality firms start going public as early investors see opportunities to reap high prices. As that trend develops, lower-quality firms start taking advantage. Eventually, investment bankers see profits in bringing anything to market.

Today, there aren't many IPOs. The few happening are more established companies (like Reddit or Shein), not junk. Many are using proceeds to retire more costly debt. That isn't a euphoria sign, in our view—it is basic, logical corporate finance. Yes, there are outliers, like former President Trump's boom-and-bust social media company. But that is the exception, not the rule.

Even euphoria isn't a trigger. It can make equities susceptible to negative shocks or disappointment. But you can have great returns while it reigns before people miss deteriorating fundamentals.

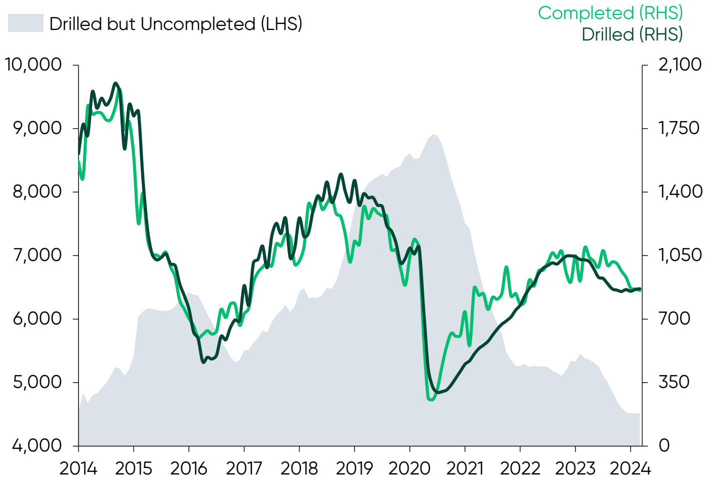
ENERGY OUTLOOK

After booming in 2022 as fears of oil and gas shortages sent prices spiking, Energy stocks lagged badly in 2023. Accordingly, sentiment shifted markedly. Where many analysts once saw stratospheric oil prices and huge Energy profits, they shifted wildly and extrapolated lag forward into 2024 as markets proved amply supplied. But in our view, this reversal is too extreme. Energy already delivered mild outperformance in Q1. And, although we don't expect oil prices to spike, we think outperformance should persist, as dwindling production growth pushes oil prices toward the upper end of the roughly \$70 – \$95 per barrel range they traded in throughout 2023—and helps deliver fine Energy profits.

This isn't about war in the Middle East and/or Ukraine. Nor is it about OPEC+ quotas, which have long proven feckless as non-OPEC producers like the US, Brazil, Guyana and Norway ramp output up when prices climb sufficiently.

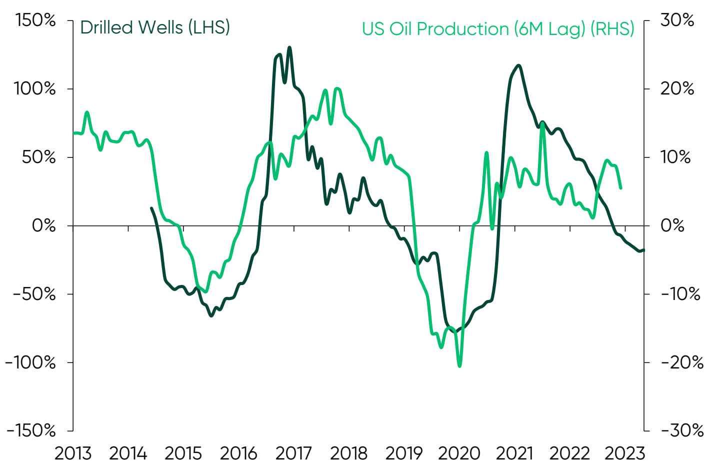
Behind our expectation of rising oil and Energy outperformance is cooling production growth. US producers are completing wells faster than they are drilling new ones, meaning there is less inventory to bring online quickly. (Exhibit 5) Moreover, as Exhibit 6 shows, there is a declining backlog of drilled wells—down -15.5% y/y currently—which implies lower production.[xi]

EXHIBIT 5: DWINDLING CUSHION OF DRILLED BUT UNCOMPLETED WELLS



Source: FactSet, as of 19/04/2024. Drilled, Completed and Drilled but Uncompleted Wells, 31/01/2014 – 31/03/2024.

EXHIBIT 6: US OIL PRODUCTION SET TO SLOW—OR CONTRACT



Source: FactSet, as of 19/04/2024. Percentage change in weekly Field Production of Crude Oil (thousands of barrels per day) and Drilled Wells, 30/11/2013 – 31/01/2024.

Slower production growth—or falling production—raises the probability oil prices move higher from here, should demand prove relatively consistent. And, with China proving resilient, the US growing steadily and pockets of weakness looking set to improve in Europe, we suspect energy demand is likely to prove stronger than some feared late last year.

This should boost oil prices, aiding Energy profitability, which is highly oil-price sensitive. It should also buoy Energy sector outperformance. Additionally, larger firms in the sector have underappreciated quality characteristics like high return on equity and low debt that we expect investors to increasingly favour. Meanwhile, Energy sentiment entering the year was dour based on fund flows, manager surveys and positioning, and relative valuations.

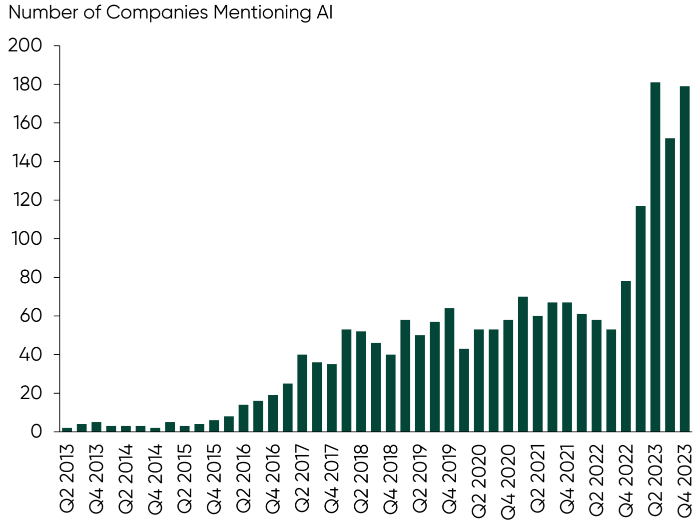
IS AI HYPE REAL OR "ARTIFICIAL"

In our view, AI is neither the world's best hope nor its biggest threat. It presents real opportunities—potentially big ones. But they are more limited than many suspect, and the risk in chasing a false dream remains present.

AI talk has escalated over the last year. Consider Exhibit 7 (next page), which tallies AI mentions in corporate earnings releases and presentations. Yes, big Tech mentions it. But so do automakers, Health Care firms, banks and even Yum! Brands, parent of KFC and Taco Bell. Some mentions are legitimate. But some are hype and still more are likely window dressing, like the two small financial firms the SEC recently charged with "AI Washing"—making fraudulent statements about using AI in their investment approach. Whether in finance or elsewhere, that is a real risk those chasing AI hype must consider.

xi Source: FactSet, as of 22/04/2024.

EXHIBIT 7: MENTIONS OF AI ARE RISING



Source: FactSet's Earnings Insight, as of 15/03/2024.

THE REAL OPPORTUNITIES

AI isn't a fad, in our view. Its opportunities are real, just not dizzying as much of the chatter presumes. Much of the current AI talk is a misnomer that presumes this is all-new ground. It isn't.

What people call AI today is *machine learning*—algorithms trained on real-world data to recognise text, images, sound or other inputs and generate output based on all they absorbed. This is *generative AI*: ChatGPT and its ilk. This is AI software, which many see as displacing certain white- and blue-collar jobs, revamping everything from fast food service to auditing corporate books—all ideas that connote huge societal change… and investor opportunity. But most of those applications aren't close to reality in a meaningful, profit-and-loss sense.

WHERE WE ARE IN AI

Today, AI's impact is about restructuring chips. We are leaving a world where computers take information and calculate with memory to show you things. We are entering one where you build computers to solve a problem using multiple different approaches, yielding results after optimising via trial and error. Essentially, the world is spending mountains of money over many years to rebuild global computing machinery—a painstaking process. It has already been decades. It takes a very long time to arrive because it will likely take many years to reach AI's potential.

As Nvidia founder and CEO Jensen Huang said at the company's mid-March conference, "Accelerated computing has reached the tipping point—general purpose computing has run out of steam. We need another way of doing computing—so that we can continue to scale so that we can continue to drive down the cost of computing, so that we can continue to consume more and more computing while being sustainable. Accelerated computing is a dramatic speedup over general-purpose computing, in every single industry."[xii] Hence, Huang continued, there is a vast need for bigger, more powerful graphics processing units—advanced chips. There will be attendant opportunities in cloud computing, chip design, equipment and production, as well as energy to power the ongoing shift. All, in our view, have more immediacy than speculating on which software functions best long term. This, AI's architecture, is where profits come from today—and thus where portfolio exposure is.

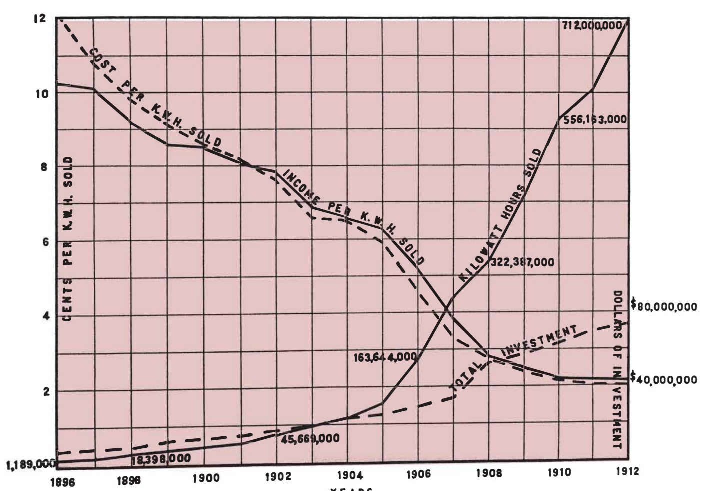
Eventually, when the infrastructure exists, downstream opportunities are expected across myriad businesses. But that isn't now. So AI will likely be big, but it is further away than many speculate. Investing in it today isn't about the algorithms, in our view.

xii "GTC Wrap-Up: 'We Created a Processor for the Generative AI Era,' NVIDIA CEO Says," Brian Caulfield, *Nvidia Company Blog*, 18/03/2024.

Today, AI is just a tool large Tech firms use to enhance products and services, like Microsoft trying to make its spell checker a more well-rounded editor. There is a future where these enhancements displace jobs, with other industries and roles taking their place. This isn't new to AI—it is capitalism's story since the flying shuttle, steam power, internal combustion engine, computer, smartphone and more. All displaced workers. All created more jobs in their wake. Just think of jobs like App Designers. Those positions would have been incomprehensible in 1994.

Or consider Exhibit 8, a chart created in 1912 and featured in Ken's 1987 book, *The Wall Street Waltz*. It highlights a key fact: Electricity prices plummeted after the infrastructure was built, fostering electrification on a grand scale. There was a learning curve that meant building infrastructure got cheaper with practice. Huang sees this future for AI chips. While he expects chip demand to require more fabrication plants, he noted improved computing efficiency counterbalances this some. This non-linear relationship repeated many times when new technologies spread. AI would likely echo this—creating more jobs than it destroys.

EXHIBIT 8: ACCUMULATED KNOWLEDGE VS. COSTS: ELECTRIC UTILITY INDUSTRY, 1896 – 1912



Source: Proceedings of the Second Annual Convention of the Investment Bankers Association of America, Chicago, 1913, *The Wall Street Waltz* and Fisher Investments.

WHAT ABOUT BIG TECH AND COMPETITION?

Still others fear AI will entrench big Tech at the top, creating a moat so wide no competitor can cross—a fact some in both US political parties see as justifying a government crackdown. This talk simmered after the Department of Justice filed suit against Apple for allegedly anticompetitive practices, following similar Federal Trade Commission cases against Google and Meta.

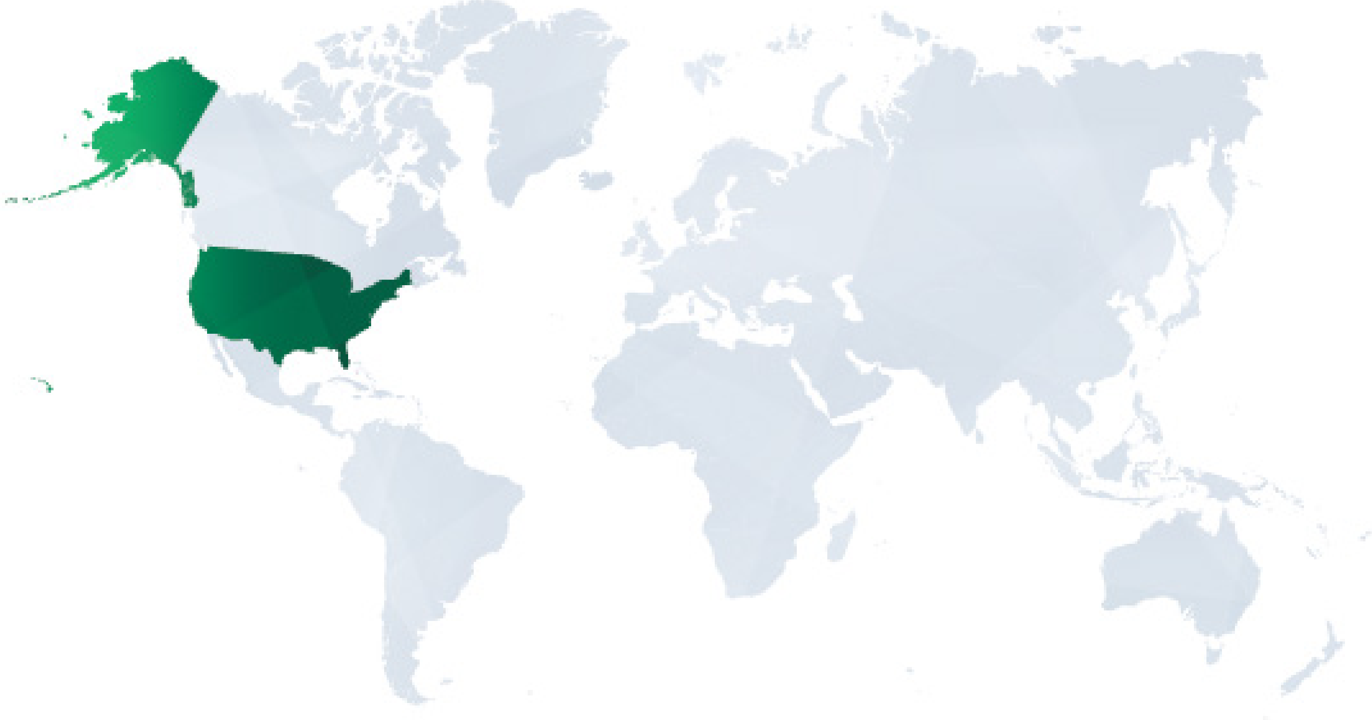
But investors have said this about the largest firms since time immemorial. Beyond a few big Energy firms, the biggest companies by market capitalisation turn over regularly. Exhibit 9 (next page) shows this, ranking the top 20 global firms by market cap over time. In 1970, IBM held the top spot. By 1990, it was fourth. It fell to 16th by 2010 and is completely off the list now. Others are even more stark: Ford, 20th in 1970, can't be found in the subsequent lists. The same can be said for GM, Sears and 3M, to say nothing of Eastman Kodak and Xerox, both eroded by competition. Or consider some of the foreign names that emerge at points. Several Japanese names dot 1990's list in the Nikkei bubble's wake—Nippon Telegraph and Telephone, Toyota and more. None were on the list by 2010, with several Chinese names largely replacing them. Nestle and HSBC were huge then. But now, 14 years after that, the Chinese names are all out of the top 20, as are Nestle and HSBC. Actually, just 4 of today's top 20 were on the list in 2010. Competition and creative destruction are constantly eroding big firms' edges.

EXHIBIT 9: TURNOVER IN THE TOP TWENTY FIRMS BY MARKET CAP

Rank	1970	1990
1	IBM	Nippon Telegraph and Telephone
2	AT&T	Shell Transport & Trading Co. Plc
3	GM	BP Amoco Plc
4	Standard Oil Co NJ	IBM
5	Eastman Kodak	Exxon
6	Sears Roebuck & Co	GE
7	Texaco	Imperial Chemical Industries
8	GE	Philip Morris
9	Xerox	Royal Dutch Petroleum
10	Gulf Oil	Toyota
11	DuPont	Bristol-Myers Squibb
12	Mobil Oil	Merck
13	3M	Walmart
14	Royal Dutch Petroleum	British Telecom
15	Avon Products	AT&T
16	Coca Cola	Coca Cola
17	Shell T & T	Procter & Gamble
18	Procter & Gamble	Nikko Cordial
19	Standard Oil Co California	NEC
20	Ford	Tokyo Electric Power Company
Rank	**2010**	**2024**
1	Exxon Mobil	Microsoft
2	PetroChina	Apple
3	Apple	NVIDIA
4	Microsoft	Saudi Arabian Oil Co.
5	Industrial and Commercial Bank of China	Alphabet (Google's Parent)
6	Petroleo Brasileiro	Amazon
7	China Construction Bank	Meta Platforms (Facebook's Parent)
8	CNOOC	Berkshire Hathaway
9	Royal Dutch Shell	Eli Lilly
10	Nestle	Taiwan Semiconductor Manufacturing
11	China Mobile	Novo Nordisk
12	Berkshire Hathaway	Broadcom
13	GE	Visa
14	Walmart	JPMorgan Chase
15	Chevron	Tesla
16	IBM	Walmart
17	HSBC Holdings	LVMH Moet Hennessy Louis Vuitton
18	Procter & Gamble	UnitedHealth Group
19	AT&T	Mastercard
20	Vale	Exxon Mobil

Sources: FactSet, Clarifi and DataStream, as of 21/03/2024. World's largest companies are MSCI EAFE and S&P for 1970; 1990 – 2024 are MSCI All-Country World Index.

UNITED STATES COMMENTARY



THE UNDERAPPRECIATED US EXPANSION

Unsurprisingly, sentiment dwells on inflation's stubbornness, as the reaction to March's Consumer Price Index (CPI) report demonstrated. Headline CPI sped from 3.2% y/y to 3.5% as energy costs rose, fanning fears and volatility despite core inflation (which excludes food and energy) staying at 3.8% y/y and goods *deflation* deepening.[xiii] Equities and bonds took a hit, but we doubt it lasts long. CPI inflation has hovered between 3.0% and 3.7% since mid-last year, a much smaller and lower bandwidth than 2022's spike.[xiv] Wiggles may spur headlines as investors fight the last war, but markets move on fast.

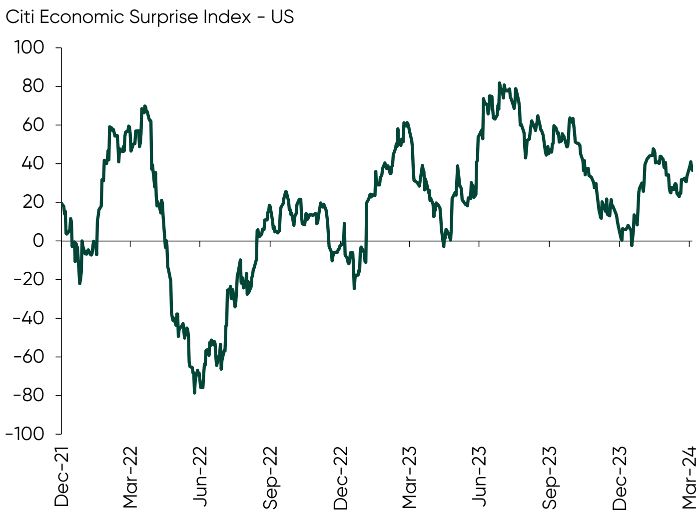
Meanwhile, most economic indicators keep beating expectations. Consumer spending. Industrial production. Factory orders. Services and manufacturing purchasing managers' indexes (PMIs). Exhibit 10 shows this, plotting Citigroup's Economic Surprise Index—a gauge measuring how incoming data compare to expectations. Readings above zero indicate positive surprise, which has been the norm lately.

xiii Source: FactSet, as of 10/04/2024.

xiv Ibid.

These stronger-than-expected readings represent the positive surprise that boosts equities and broadens the rally as growth permeates more cyclical areas of the economy. Recent years trained society to expect either wildly abnormal economic data (COVID lockdowns, 2021's boom) or sluggish growth married with recession fear. Now we have a more normal, prepandemic environment that feels odd to many. Equities benefit from people not recognising how normal things are. It builds a wall of worry despite warmer sentiment elsewhere.

EXHIBIT 10: THE US ECONOMY IS BEATING EXPECTATIONS



Source: FactSet, as of 04/04/2024. Citi Economic Surprise Index – US, 31/12/2021 – 04/04/2024.

DON'T OVERRATE CONSUMER SPENDING

The focus on consumers illustrates this. Consumer spending is two-thirds of GDP, so naturally it generates abundant scrutiny and, lately, scepticism. When it jumps, as in February, headlines flag credit card debt's trip past $1.1 trillion and claim consumers are on borrowed time.[xv] This, plus abundant anecdotal reporting on families struggling with credit card, student loan or other debt, colors folks' economic views. It won't be long, many conclude, before high rates force belt-tightening and spending falls.

This is misplaced. One, credit card debt is just 4.0% of GDP, below its long-term average (4.5%) and levels seen early in the mid-2000s' expansion.[xvi] Debt, while up, grew with the economy. It also grew with disposable income, which is more relevant to servicing debt. Credit card debt finished 2023 at 5.6% of disposable income, down from 8.3% in 2003 and below the long-term average of 6.1%.[xvii] Factor in high household cash reserves, and consumers clearly aren't tapped.

More importantly, consumer focus is misplaced. Spending isn't the swing factor—business investment is. Businesses' swings from offence to defence are more volatile, often driving recessions, recoveries and reaccelerations. Most consumer outlays go to essential goods and services—food, toiletries, clothes, utilities, housing and healthcare. This holds steady despite the economy's cycles. Discretionary spending on durables (goods meant to last more than three years) doesn't, but it is the minority. Meanwhile, businesses slash investment and inventories to survive tough times, then go on offence to capture market share when things look better. Thus, business investment swings more than consumer spending during recessions and recoveries. (Exhibit 11)

EXHIBIT 11: BUSINESS INVESTMENT, NOT CONSUMER SPENDING, DRIVES RECESSIONS

	GDP	Consumer Spending	Business Investment
Q4 1948 - Q4 1949	-1.5%	4.2%	-11.4%
Q2 1953 - Q2 1954	-2.4%	0.7%	-2.3%
Q3 1957 - Q2 1958	-3.0%	-0.5%	-11.9%
Q2 1960 - Q1 1961	-0.1%	-0.3%	-3.4%
Q4 1969 - Q4 1970	-0.2%	1.7%	-4.4%
Q4 1973 - Q1 1975	-3.1%	-0.7%	-9.4%
Q1 1980 - Q3 1980	-2.2%	-1.2%	-4.0%
Q3 1981 - Q4 1982	-2.5%	2.8%	-7.3%
Q3 1990 - Q1 1991	-1.4%	-1.1%	-3.5%
Q1 2001 - Q4 2001	0.5%	2.2%	-6.0%
Q4 2007 - Q2 2009	-3.8%	-2.3%	-16.6%

Source: US BEA, as of 04/04/2024. Cumulative change in consumer spending and nonresidential fixed investment during recessions, 1948 – 2009. COVID-era recession omitted because lockdowns distorted spending.

xv Source: New York Fed, as of 02/04/2024.

xvi Source: New York Fed and US Bureau of Economic Analysis, as of 02/04/2024.

xvii Ibid.

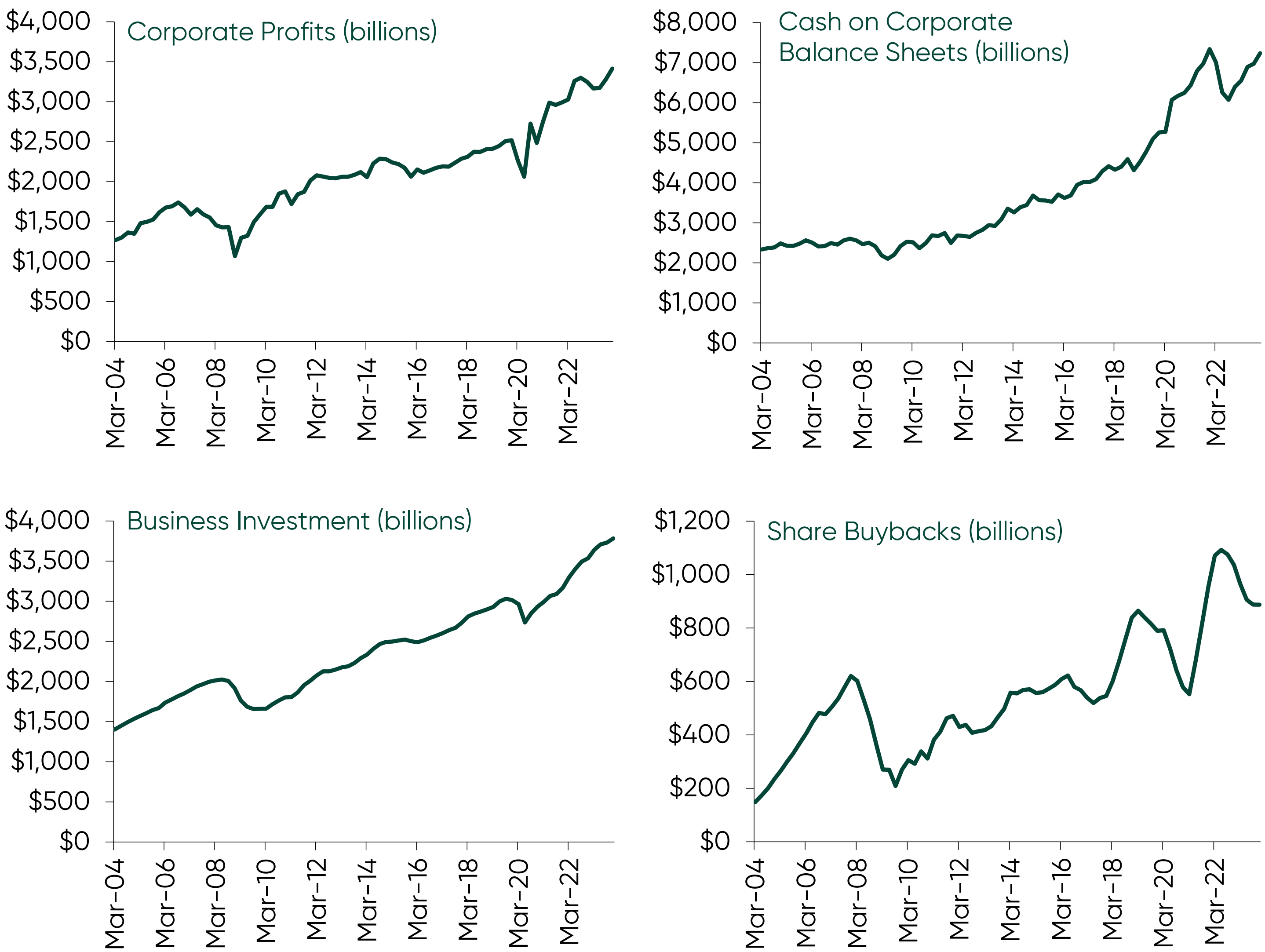
BUSINESS INVESTMENT RAMPS UP

Anticipating a recession that never came in 2022 and 2023, many companies slashed inventories, headcount and investments. Equipment investment fell from double-digit growth in early 2022 to four contractions in the past five quarters.[xviii] Cutbacks showed in manufacturing PMIs, where output and new business fell over a year as inventories depleted.

The tide is turning. PMIs show businesses restocking. New orders are up. So are durable goods orders and their less volatile subset, core capital goods orders, which excludes volatile defence and aircraft investment. All signal businesses splashing on new equipment and opportunities.

This is just getting started. Business lending is slow, but that isn't the whole story. Corporate bond issuance is jumping. Balance sheets are strong and cash rich, giving businesses plenty of firepower to deploy new investments without borrowing. (Exhibit 12)

EXHIBIT 12: CORPORATE AMERICA IS STRONG



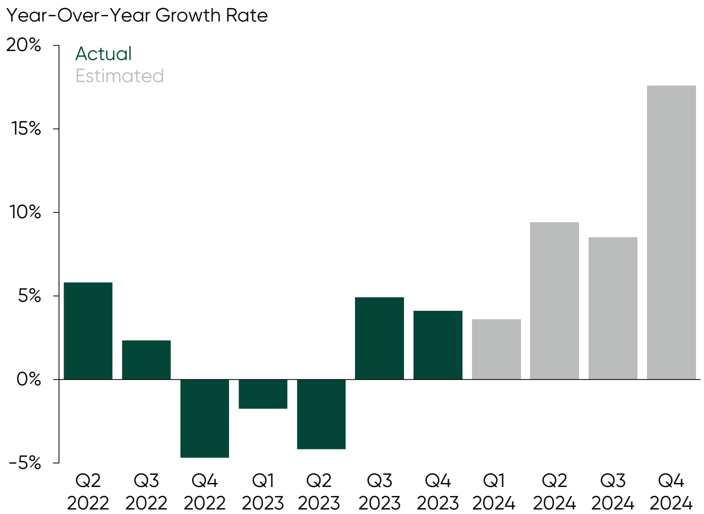
Source: FactSet and Clarifi, as of 22/03/2024. Corporate profits, total liquid assets on nonfarm nonfinancial corporate businesses' balance sheets, private nonresidential fixed investment and trailing 4-quarter S&P 500 realised share buybacks, 31/03/2004 – 31/12/2023, Quarterly in USD.

xviii Source: FactSet, as of 02/04/2024.

EARNINGS GROWTH IS JUST GETTING STARTED

One reason people disbelieved this bull market: S&P 500 earnings were dropping. This is normal. Markets lead economic activity and earnings. 2022's bear market, while primarily driven by fear, nonetheless presaged—and pre-priced—falling earnings. The recovery did the same, anticipating renewed earnings growth. That growth is now here. (Exhibit 13)

EXHIBIT 13: CORPORATIONS ARE READY FOR OFFENCE

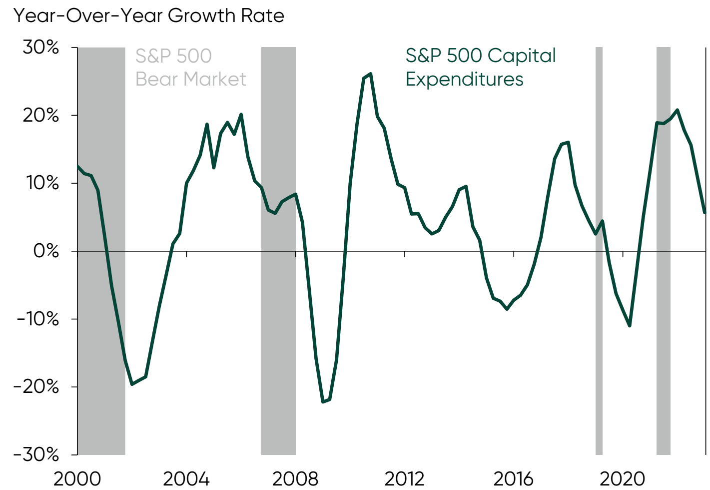


Source: FactSet, as of 15/03/2024. S&P 500 earnings growth and projections, Q2 2022 – Q4 2024.

In Q3 2023, analysts expected S&P 500 earnings to drop -0.7% y/y, for their fourth straight decline.[xix] Instead, they grew 4.8% y/y with only three sectors (Energy, Materials and Health Care) dropping. Broad growth continued in Q4, with earnings up 4.2% y/y.[xx] Consumer Discretionary earnings jumped 34.3% y/y. Even Industrials, which is more cyclical, enjoyed 6.4% y/y earnings growth. 79.3% of S&P 500 companies beat expectations. Much of this growth came from sales, not cost cuts: Revenues rose 4.1% y/y, with 8 of 11 sectors up.[xxi]

Companies also have the financial firepower to support it, as Exhibit 12 showed.[xxii] Now, it would be unrealistic to expect all of their $7 trillion in cash to pour into new projects. Lockdowns showed the importance of higher cash reserves, as did the financial crisis. But businesses can leverage balance sheets if they want to continue holding cash, collateralising cheap funding for future projects. Whatever path they choose, they have resources for new products, projects and R&D, all of which will likely compound earnings growth over time. (Exhibit 14)

EXHIBIT 14: BUSINESSES HAVE ROOM TO RAMP UP INVESTMENT



Source: Clarifi, as of 28/03/2024. S&P 500 capital expenditures, quarterly, 31/12/2000 – 31/12/2023.

MARKETS CAN THRIVE UNDER ANY RATE ENVIRONMENT

Companies can prosper in a variety of rate environments, showing how misplaced Fed rate cut obsession is. The US economy is already proving it is strong enough to grow and thrive with today's interest rates. Those UK and eurozone green shoots are emerging despite the Bank of England and ECB maintaining its respective rate policies. It is a similar story in Canada and Australia. All endured some headwinds in rate-sensitive sectors. Society adapted, remembering how to grow amid higher borrowing costs. Now Japan, which finally ditched negative rates in March, should see the same.

xix Ibid.

xx Ibid.

xxi Ibid.

xxii Source: Federal Reserve, as of 02/04/2024.

If rate cuts aren't necessary, might they help? Maybe, depending on *why* cuts happen. If it were merely because inflation is down and the Fed, in its wisdom, says policy is unnecessarily restrictive, fine. But if they wait too long, rate cuts may not be worth anything. Usually, the Fed cuts rates in reaction to perceived weakening. Those cuts usually aren't sufficiently strong to alleviate said economic weakening, which there is a long history to support. Absent the rare scenario of preemptive cuts, rate cuts are usually too little, too late to positively affect growth and markets. This prospect also feeds into 2025 carrying more potential negative surprise than 2024.

Looking forward to the rest of 2024, we expect rates to behave similarly to last year. Our Q4 2023 Review highlighted how 2023 featured range-bound long rates that finished almost exactly where they began. So far this year has been similar, with 10-year Treasury yields rising from 3.87% as the year began to 4.57% in mid-April—still well below the nearly 5% yields we briefly saw late last year.[xxiii] We expect a continuation of rangebound yields without a significant breakout higher or lower.

POLITICAL WINDS ARE AT EQUITIES' BACK

As always, our political commentary is non-partisan. We are politically agnostic, preferring no party nor any politician, and we assess developments for their potential market impact only.

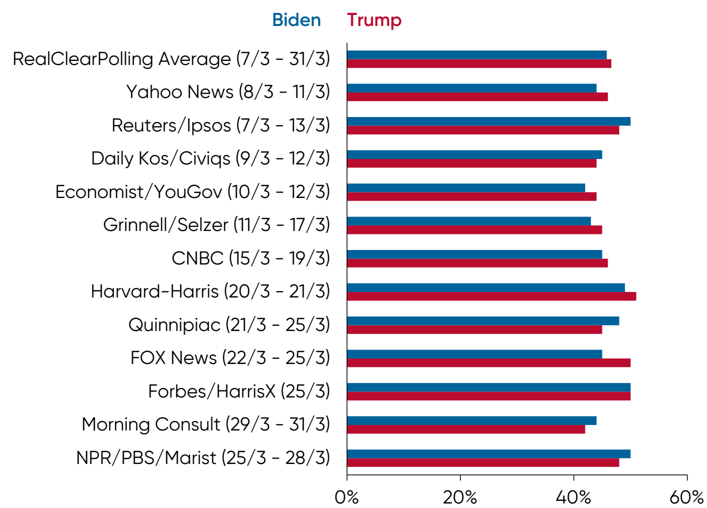
Equities' solid Q1 illustrates the risk of waiting for a back-end-loaded election year, as Q4 2023's Review counseled. Given November's matchup between President Biden and former President Trump crystalised earlier than usual, perhaps markets pre-priced clarity sooner than they normally could—especially since the two candidates are so well-known. This could invite volatility later, especially if wildcards manifest. But we will get a winner, and sentiment should coalesce around a candidate. Falling uncertainty should help equities regardless of the winner's party or personality. Better still, global gridlock bolsters the bullish backdrop, keeping legislative risk low.

THE STATE OF THE RACE

It is too early to predict November's outcome, but polls show the state of play and challenges both candidates must overcome.

Clients ask how to track polling, particularly in swing states. In our view, the best sites, with abundant data and minimal editorialising, are RealClearPolling and 270 to Win. National polls show former President Trump narrowly ahead. Polls aren't predictive and have been wrong recently. Things can also change as the campaign progresses. (Exhibit 15)

EXHIBIT 15: NATIONAL POLLS FAVOUR TRUMP



Source: *RealClearPolling*, as of 05/04/2024.

It is crucial to recall how the Electoral College, which determines the victor, works. We showed this in 2016, then laying out Trump's potential White House map. It held then and still can.

The Democratic Party has a natural edge in the popular vote, based largely on population and mathematics. The party enjoys overwhelming support in big states like California, Maryland, Massachusetts and Washington. Biden is almost assured to win those states by huge margins. Meanwhile, the Republicans have majorities in populous states like Texas and Florida, but their support isn't nearly as lopsided. While Trump is highly likely to win them, the vote margin is almost certainly much smaller.

xxiii Source: FactSet, as of 12/04/2024.

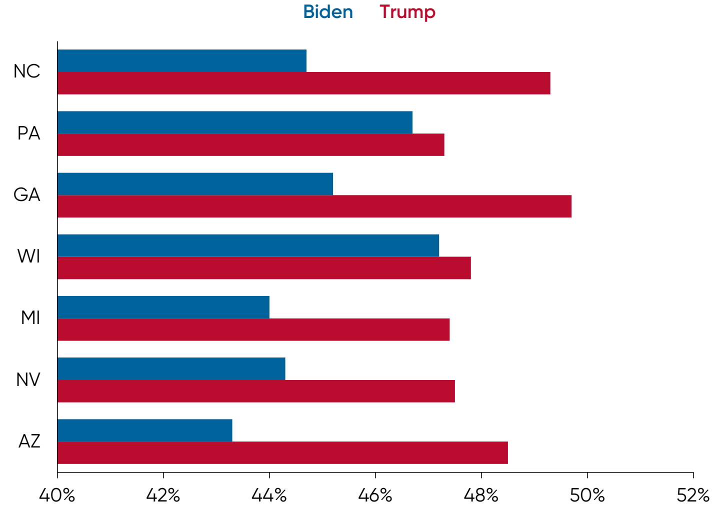
This means the Democrats are very likely to win the popular vote. But because the Electoral College is winner-take-all (outside a couple of very limited exceptions), Trump could lose the popular vote, perhaps even by up to approximately 3 percentage points, and still win the Electoral College—and, therefore, the White House.

Theoretically, Trump has good odds. People know Trump and Biden better than any candidates in any modern election—and have rigid views after years of experience and observation. It is near-impossible to change people's minds about either. Consider everything you have heard in the last six months, all the economic data, court cases, investigation results, all of it: In a typical election, any of these factors may swing polling noticeably. This time, however, opinions on both candidates have long been cemented and polls barely budged. Trump's edge stayed between about 1 and 2.5 ppts since October.[xxiv] This is the baseline case for a Trump win.

Biden has an equally viable path. The election likely hinges on seven states: Arizona, Nevada, Michigan, Wisconsin, Georgia, Pennsylvania and North Carolina. This is where ground game matters, and in some of these, the GOP has awful on-the-ground machinery. But the Democrats' infrastructure is excellent, and they have a much stronger get-out-the-vote effort. They also have more money to blitz these states with ads. A strong Biden campaign could win on swing-state turnout despite today's polling.

Regardless, the closer the race on a popular-vote basis, the more each candidate needs Georgia or Pennsylvania (or both). You can see this on *270 to Win*, too.

EXHIBIT 16: SWING STATE POLLS SHOW PRESIDENT TRUMP'S EDGE



Source: *RealClearPolling*, as of 05/04/2024. Polling averages on 03/04/2024.

WHAT ABOUT THIRD-PARTY BIDS?

Jill Stein's Green Party bid is attracting a smidge of support, as is Cornel West's independent campaign. Both likely detract more from President Biden's support than former President Trump's. Of the two more significant third-party efforts, one is progressing and one just ended.

The latter is No Labels, the centrist group originally spearheaded by former Senator Joe Lieberman, who passed away in March. It sought to field a unity ticket with a well-known moderate Democrat and Republican, but it stood down on 4 April, admitting it couldn't find a candidate. It approached well-known names from Nikki Haley and Joe Manchin to actor Dwayne "The Rock" Johnson, but none agreed. Ultimately, none saw a credible path to victory.

This leaves Robert F. Kennedy, Jr.'s independent ticket, which currently polls around 10% in surveys covering all candidates, as the main wildcard.[xxv] While he won't win, he could affect total support for President Biden and President Trump, echoing Ross Perot in 1992.

xxiv ....Source: *RealClearPolling*, as of 03/04/2024.

xxv Ibid.

Some argue RFK is likely to siphon more voters from Trump than Biden. While many of his views are conventionally liberal, with economic policy recalling FDR-era Democrats, he attracted more libertarian Republicans recently. The issues central to this popularity loom large in his campaign, appealing to many disillusioned with mainstream Republicans.

However, his selection of Nicole Shanahan—a Silicon Valley tech insider with strong Democratic ties—as running mate may change this. Shanahan lacks political experience, and nothing on her resumé implies she can govern if RFK were unable to serve. But she has deep pockets and is one of his top donors, and as running mate she will have more flexibility under campaign finance laws to extend funding. Whatever the motivation, RFK's campaign is becoming more visibly left-leaning, which may alienate some Republicans who considered him as a Trump alternative.

This is the typical story of third-party candidates. They make noise and a marginal impact but don't have a realistic chance of winning. It is perhaps just louder and more extreme because of today's polarisation and the broad dislike for the main parties' presumptive candidates.

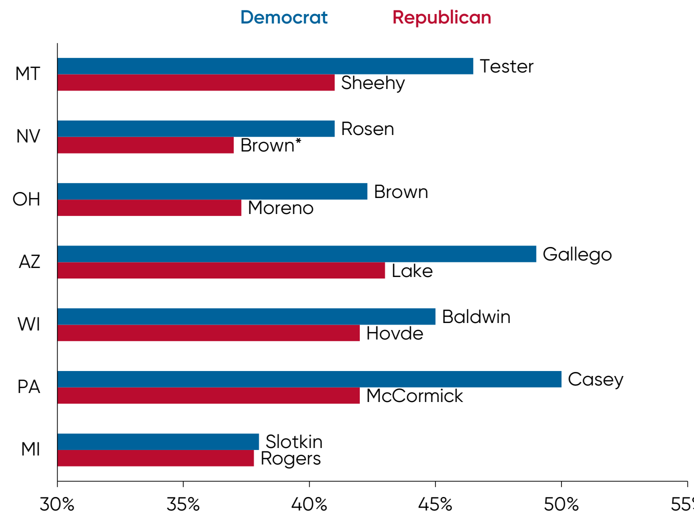
SENATE RACE SPOTLIGHT

While many dwell on the president's personality and proposals, what matters for equities is policy—and whether we get bullish gridlock or more legislative risk. Here, the Senate is critical.

This year, eight Senate races have a reasonable chance of swinging: Arizona, Michigan, Montana, Nevada, Ohio, Pennsylvania, West Virginia and Wisconsin. All have Democratic or Democratic-aligned senators in the current Congress. Given Trump leads in most of these states presently, this is the most favourable Senate map Republicans have had in years—and will likely have for years.

Yet aside from West Virginia, where whoever wins May's Republican primary (almost certainly Jim Justice) will likely cruise in November, most Republicans in these states are polling behind Trump as well as their opponents. Their name recognition is weak. Many face strong incumbents. Jon Tester (MT) and Sherrod Brown (OH) are quite popular Democratic senators. Can Republican candidates reverse their fortunes, improve their name recognition and catch up with Trump? Or will he slide and take them down?

EXHIBIT 17: THE SENATE MAP FAVOURS REPUBLICANS, BUT EARLY POLLS DON'T



Source: *RealClearPolling*, as of 05/04/2024. *The Nevada GOP Senate Primary occurs 11 June, but Sam Brown is the front runner.

AS FOR THE HOUSE OF REPRESENTATIVES

While Republicans have a fighting chance in the Senate, they are at risk of losing the House. The party's already-slim 219 – 213 majority narrowed further in March, as Ken Buck (CO) exited and Mike Gallagher (WI) announced he will resign on 19 April—slimming the majority to 217 – 213. Former Speaker Kevin McCarthy's moneymaking machine is gone, and party leadership struggles to replace it. Perhaps a Republican Senate and/or White House victory could ripple into House races, but big coattails are unlikely.

This doesn't mean the Democrats are safe in the House, though. While much is made of Republican retirements and the internal party divide, the number of congresspeople in each party not seeking reelection is roughly equal. Of those, the Democrats have more open seats in Republican districts than the Republicans do in Democratic districts.

SEC DIALS BACK CLIMATE DISCLOSURE REGULATIONS

The SEC approved the final version of its climate disclosure regulations in early March by a 3-2 vote, giving investors and companies more clarity on what information will be required and on the associated compliance costs. The rule is currently stayed pending the outcome of legal challenges, and opposition is heavy on both sides of the climate debate. So while we don't think the rule is a major market-mover, there is still room for uncertainty to fall.

The rules, which the SEC has been weighing for two years, differ in some key ways from earlier drafts. The initial proposal would have required publicly traded companies to report all climate risks and direct and indirect greenhouse gas emissions according to the following categories:

- **Scope 1:** All emissions generated from their own operations
- **Scope 2:** All emissions generated by their energy purchases
- **Scope 3:** All emissions generated by suppliers and customers in the course of making components, sourcing raw materials and using the end product

The final rule, which will apply to large companies in 2026 and smaller firms in 2028 if it takes effect, is watered down modestly from this initial outline. Rather than adopting a blanket disclosure requirement for all firms, it stipulates companies must disclose this information if climate-related risks have a "material" impact. "Material" is an ambiguous term, but regulators say it would apply to companies that would face business risks from changes to climate policies or climate-related market trends, which companies will also have to document and report.

The other big difference is that companies won't have to disclose Scope 3 emissions—only Scope 1 and 2. This is something many businesses argued for, citing the complexity of tallying all their suppliers' and customers' emissions. Several noted that a Scope 3 requirement could have effectively forced disclosure requirements on legions of small and private businesses (as well as international suppliers) who wouldn't be subject to the rule on their own, raising some challenging questions about regulatory reach. On the other side, those who sought tougher disclosure rules expressed disappointment over Scope 3's omission, arguing it diminishes the purpose and does little to actually highlight society's emissions. While this objection is more sociology than market-related, it highlights the blowback that could yet threaten the rule.

In the meantime, the rule as approved likely carries lower compliance costs than initially feared, making it something of a positive surprise—as usually happens when rules get watered down over time. We say this not because we have particular climate views, but simply because when companies expect regulatory costs to be one thing, and then they turn out to be lower, then it is a positive development from a pure financial standpoint. Companies have also long argued estimating, measuring and reporting Scope 3 emissions would be hugely troublesome and unclear to investors. Now they don't have to—likely a relief to equities.

But it doesn't remove *all* uncertainty. The rules could get further revised or watered down, if not struck down entirely before 2026 ever comes. This is a very realistic possibility worth considering.

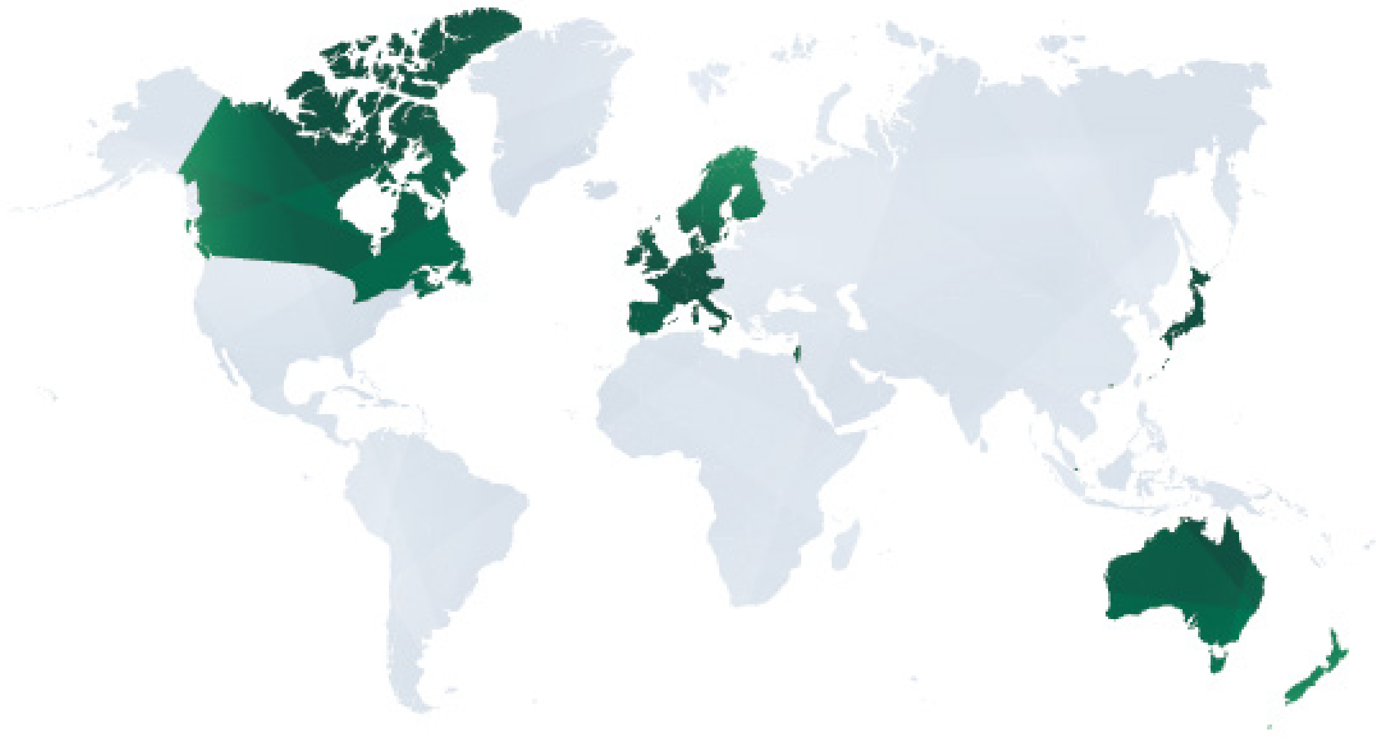
Furthermore, it is possible the election in November shifts things. While the SEC doesn't turn over at an election (the five voting commissioners serve staggered five-year terms), two of these posts open before 2026, when the next president would nominate a new chair. Maybe that new chair has differing views about what is relevant to investors. And, considering this rule passed 3-2, further revision cannot be ruled out.

The gradual process also helps mitigate the changes' potential market impact. While the new rules probably will raise compliance costs, businesses have time to adjust and markets have been pricing in that possibility since the first proposal in March 2022. Contrast this with Sarbanes-Oxley, which passed lightning fast in 2002, with Congress enacting the stricter of two competing proposals in the legislature. This forced equities to price a radical upheaval of corporate reporting rules in a hurry. The climate rules' financial impact isn't on par with SarbOx's, which carried criminal penalties for executives in the event of accounting errors, but the differing timelines nonetheless illustrate the point. The climate rules are unfolding much more slowly, sapping their surprise power. By the time they take effect, if they do, the higher compliance costs would likely be a well-known headwind, faded into the structural backdrop.

Perhaps the rules add more incentives for companies not to go public, but this, too, is a structural issue rather than cyclical driver of corporate earnings. And, from an investors' standpoint, relatively fewer IPOs means less equity supply—that isn't bad for prices.

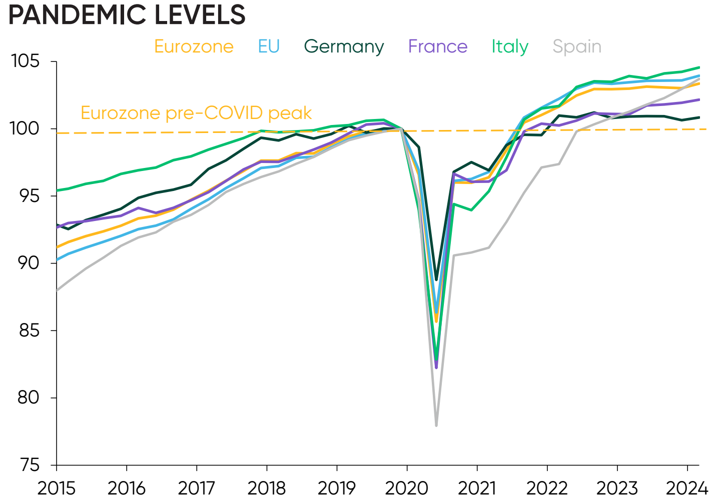
Still, we will keep an eye on this, both on the electoral and legal fronts, and watch where it goes from here. But we doubt it is make-or-break for equities either way.

GLOBAL DEVELOPED EX-US **COMMENTARY**



While recession fears have decreased, economic sentiment remains guarded. Twin UK GDP drops heightened recession chatter, while recovering business investment and other green shoots go unseen. In the eurozone, the first estimate of Q1 2024 GDP showed a 0.3% q/q expansion, beating forecasts, while preliminary April consumer inflation held steady at 2.4% y/y, in line with estimates. While the region is often a mixed bag of relatively stronger and weaker national economies, the preliminary report reflects broader-based GDP growth amid normalising inflation—a welcome development following multiple quarters of pundits bracing for recession (Exhibit 18).

EXHIBIT 18: EUROZONE GDP BACK ABOVE PRE-PANDEMIC LEVELS



Source: Eurostat, data in EUR. Shows real GDP indexed to 100 at Q4 2019. Data shown quarterly from 01/01/2015 – 31/03/2024.

In Japan, data revisions erased its sequential GDP declines, but domestic demand declined three straight quarters through Q4. Exports primarily drove GDP growth in Q2 and Q4. While beneficial for Japan's multinationals—which largely comprise client portfolios' Japan exposure—it hinted at domestic weakness. But that is easing. After falling -5.6% annualised in Q2, business investment's decline slowed to -0.5% in Q3.[xxvi] In Q4, it flipped, surging 8.4% annualised.[xxvii] Machine tool orders, a volatile leading indicator, finished 2023 on a strong note. Businesses are starting to reinvest their healthy export revenues. As these upturns collide with resurgent US business investment, global growth and corporate earnings should keep beating expectations.

A LOOK AT BULLISH GLOBAL GRIDLOCK

Political tailwinds extend far outside the US, thanks to abundant gridlock, which keeps legislative risk low. It is perhaps most apparent in the eurozone, where multi-party coalitions have splintered parliaments across the bloc. Most member states have governments consisting of groups that don't much like and certainly don't agree with one another on key issues—or minority governments propped up by their ideological opposition. In both cases, only the absolutely necessary legislation, like budgets, tends to pass.

The latest example? Spain, where centre-left Socialist Party leader Pedro Sánchez heads a six-party coalition that hinges on support from Catalan separatists. That support depended on Parliament passing an amnesty bill allowing Catalan party members living as exiled fugitives following an illegal independence referendum to return home without facing charges. After multiple stalls and disagreements, the bill, which is deeply unpopular with Spanish voters, passed in March. This should have cleared the way for Parliament to focus on the budget legislation, which PM Sánchez pledged would make the currently temporary windfall profit taxes on banks and Energy firms permanent.

But this didn't happen. Instead, Catalonia's regional government called a snap local election, seemingly in hopes that the exiled leaders could soon return and head a new administration. In response, PM Sánchez canceled 2024 budget negotiations and rolled over 2023's funding agreement instead. Thus, the windfall taxes remain temporary, with their long-term status pushed to 2025. Will they pass then? Will the government even last that long? Unknowable now, and as we write, PM Sánchez briefly considered resigning as the courts began a preliminary investigation into corruption allegations against his wife, which he deems a politicised quest. In our view, this is one more symptom of the deep gridlock at work.

Portugal and the Netherlands are set for similar gridlock after their own recent inconclusive elections. In the Netherlands, right-wing populist leader Geert Wilders spent months trying to cobble together a coalition after his Party for Freedom won a plurality in November's election. He conceded the effort to become Prime Minister in March, citing irreconcilable differences with potential coalition partners. Now, those would-be partners are pursuing their own "extra-parliamentary" government, with an independent mediator overseeing coalition negotiations. In practice, this means a technocratic administration with several cabinet ministers coming from outside the political realm, supported by Wilders' Party for Freedom as well as the centrist People's Party for Freedom and Democracy, the Farmer-Citizen Movement and the upstart centre-right New Social Contract. Given the parties had too many disagreements to form a coalition, it seems unlikely they will pass much in the proposed arrangement. The mediator has indicated as much, noting the government formation agreement would likely be light on specific policies, with legislation up to individual members of parliament. This is a recipe for squabbling and inaction.

xxvi .... Source: FactSet, as of 24/04/2024.

xxvii .... Source: FactSet, as of 24/04/2024.

As for Portugal, the centre-right alliance headed by Luis Montenegro won a plurality in March's election, barely edging out the incumbent centre-left Socialist Party with 80 seats to 78. To form a majority government in the 230-seat National Assembly, they would have had to partner with the upstart right-wing Chega, which won 50 seats. But PM Montenegro ruled that out and instead formed a minority government, which was sworn in on 2 April.

The path there wasn't smooth, and few expect that administration to last long. Chega is still pushing for a full right-wing coalition and blocked the government's candidate for speaker, seemingly in hopes of forcing its way in. Instead, PM Montenegro leaned on the Socialists for support, signing a deal whereby each party gets to select a speaker for a two-year term. The new cabinet also has a technocratic flair, with several ministers from outside politics, including Finance Minister Joaquim Miranda Sarmento, an economist by trade.

PM Montenegro still rules out working with Chega on legislation, so bills will likely depend on Socialist support. Party leader Pedro Nuno Santos has said he will play ball where there is common ground, which appears minimal. He has already said the 2025 budget will likely be a breaking point.

People don't like gridlock, but markets do. It keeps legislative risk low and preserves a status quo equities know how to deal with. Spain and Portugal passed a number of reforms a decade or so to improve their economic competitiveness during the eurozone's debt crisis. When left-wing administrations took power years later, investors feared those reforms would bite the dust. But gridlock prevented that then and likely does so now.

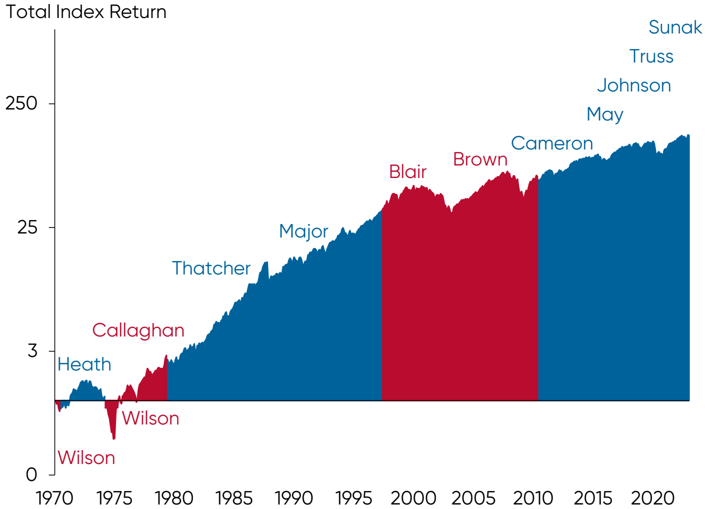
PEEKING AT THE UK'S ELECTION

On paper, the UK is an exception to Europe's political shift away from the centre. In the House of Commons, seats are awarded by constituency, not each party's share of the national vote. This system, like America's, supports the old two-party system and makes it challenging for third parties to break through. There are occasional exceptions. The centrist Liberal Democrats (one of the two dominant UK parties before 1922) were junior partners in former Conservative Prime Minister David Cameron's first government. But they were wiped into near-nonexistence at the next election. Since then, gridlock comes from intraparty divides.

The next UK election is due by January 2025. Prime Minister Rishi Sunak has said it will happen this year, but it isn't scheduled yet. But the chatter and polling suggest the Conservatives could lose in a landslide, placing Labour in power under its leader, Keir Starmer. The wildcard here is the upstart Reform UK, a grassroots conservative effort spearheaded by former Brexit champion Nigel Farage. Its support is rising, and it has attracted Conservative Party members and lawmakers disillusioned by the Tories' abandoning most of their 2019 election manifesto. There isn't much chance of Reform making a splash in Parliament, but it could split the conservative vote enough to give Labour a thumping majority, echoing Tony Blair's huge win in 1997.

UK political biases tend to echo the US. People see Labour as anti-business and the Conservatives as pro and presume equities will suffer under a Labour administration. But also as in the US, reality doesn't support the fear (Exhibit 19 on next page). Both parties have passed legislation markets liked and disliked. And today, there isn't much of a difference between their economic policy agendas. Both pay lip service to trimming both the deficit and the tax burden, and their regulatory ideas overlap. This policy similarity is a big reason why the Tories have lost so much support to Reform. So it isn't clear that a big Labour majority would deviate from the status quo.

EXHIBIT 19: UK EQUITY RETURNS AND PRIME MINISTERS



Source: FactSet. MSCI United Kingdom Total Return Index, monthly readings from 31/12/1969 – 31/12/2023 in GBP. Indexed to 1 at start of period. Red shading indicates a Labour Prime Ministers while blue shading indicates a Conservative Prime Minister.

Then, too, Labour is divided internally, much as the Tories are. These divisions are less apparent in opposition, but governing is another matter. It wouldn't take much for one or two factions to stonewall a bill or sand it down.

Mind you, this is all too early to forecast. But it shows the potential for falling uncertainty to help UK equities later this year as the election comes into focus and investors gain more clarity on the underappreciated potential for gridlock.

EMERGING MARKETS **COMMENTARY**

CHINA

China dominated EM developments in Q1. Myriad headlines hype a range of highly publicised economic risks like slowing growth or real estate concerns. In January, yearslong worries over developer Evergrande were again featured, as a Hong Kong court ordered its liquidation following the company's earlier default. Many analysts claim this is the source of weakness in Chinese markets. But in our view, the key is political uncertainty toward business.

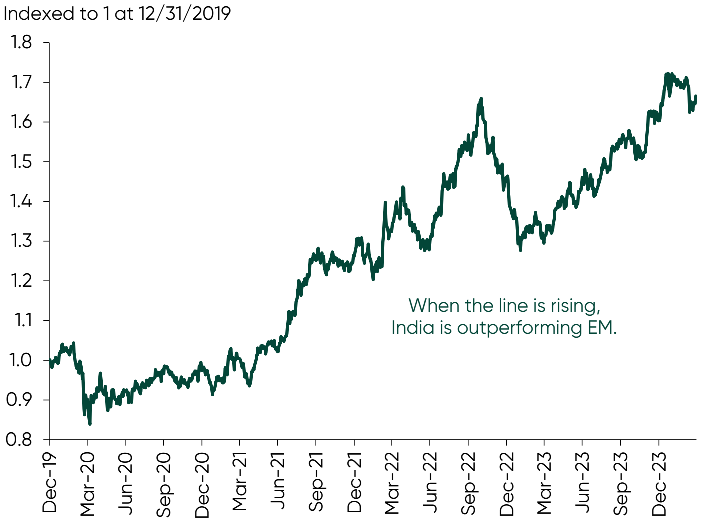
It is hard for us to see how Evergrande, already down more than -90% from highs, has much surprise power. However, authorities' response could rattle some nerves. Following the ruling, regulators unveiled new rules allowing real estate companies to use bank loans pledged against commercial properties for bond payments and operating expenses—an implicit backstop transferring bad debts to big banks' balance sheets, which many analysts see as a backdoor recapitalisation.

While economic uncertainty does exist, China has also seen continued growth to start the year, as Q1 GDP growth beat expectations. We believe Chinese economic activity likely continues contributing to global GDP growth despite fears otherwise—helping reality exceed expectations and propel equities further up the wall of worry.

INDIAN EXUBERANCE

Indian equities rose 6.1% in Q1, outperforming Emerging Markets and extending their overall run of strong relative returns since 2020.[xxviii] (Exhibit 20) While we think India's run partly reflects solid fundamentals, we think they have been largely priced at this point, making further outperformance harder to achieve. With sentiment toward India increasingly optimistic—and becoming excessively so, in our view—the risk of disappointment seems to be rising.

EXHIBIT 20: INDIA'S STRONG RUN SINCE 2020



Source: FactSet, as of 29/04/2024. MSCI India and MSCI EM with net dividends, in USD, 31/12/2019 – 31/03/2024. Indexed to 1 at 31/12/2019.

India's Q4 GDP is one way to see this. While headlines tout its booming growth as the fastest among major world economies, a look below the surface reveals a less torrid pace. Headline GDP's acceleration to 8.4% y/y from Q3's 8.1% generated triumphant coverage extrapolating how it will leap from the world's fifth to third-largest economy by 2027—and then overtake the US later this century.[xxix] Although this is possible, such far-flung forecasts often say more about sentiment than reality. And Q4's GDP growth was less than meets the eye, in our view.

India's GDP figures include net indirect taxes—taxes like India's goods and services tax less subsidies—that can introduce skew when there are big swings in the underlying components. So it was in Q4 2023: Subsidies plunged -54% y/y, largely due to falling fertiliser prices reducing the need for government assistance. Hence, net indirect taxes jumped 32% in Q4, buoying GDP.[xxx]

Looking at India's main private sector demand components offers a clearer view of activity. While consumption expenditures rose 2.2% y/y, up from Q3's 1.4%, that seems rather pedestrian and incongruent with the eyepopping growth rates usually associated with fast-ascending EM.[xxxi] The same goes for fixed capital formation, i.e., business investment, which slowed to 3.4% y/y from 3.9%. Another way to see through the skew, India's gross value added (GVA) underlying its GDP, which measures only pure output, has been decelerating—from 8.2% y/y in Q2 2023 to 7.7% in Q3 and now Q4's 6.5%.[xxxii]

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xxviiiSource: FactSet, as of 26/04/2024. MSCI India return with net dividends, in USD, 31/12/2023 – 31/03/2024.

xxix ....Source: FactSet, as of 26/04/2024.

xxx "India's Blowout GDP Based on Data Distortion That Masks Slowdown," Ruchi Bhatia and Dan Strumpf, *Bloomberg*, 29/02/2024.

xxxi ....Source: FactSet, as of 26/04/2024.

xxxii ....Source: FactSet, as of 26/04/2024.

Now, mid-to-high-single-digit growth is perfectly fine—alongside the latest Q1 and Q2 data, which point to its continuing. For example, India's services and manufacturing purchasing managers' indexes are each hovering near record-high levels around 60 (with levels above 50 indicating expansion) through March, while bank loan growth has boomed at about 20% year-over-year rates for 10 straight months through April.[xxxiii] But with expectations getting ahead of reality, burgeoning optimism could set up disappointment.

Besides proliferating projections and think pieces on the coming "Indian Century"—taking the baton from China demographically and economically—we see other signs sentiment is becoming rich. The number of IPOs is the most eye catching. From 150 in 2022 to 234 last year.[xxxiv] Four months into 2024, 111 have gone public. In Q1, Indian companies raised $2.3 billion, which may not seem particularly striking, but that is up over 1000% from Q1 2023.[xxxv] As retail interest has surged, this has caught the attention of Indian regulators concerned that novice investors are "buying into a bubble."[xxxvi] While we would hesitate to go that far, it does suggest a strong sense of enthusiasm for speculative firms in India.

We also see sentiment bordering on exuberance in election expectations. With Indian elections running from 19 April to 1 June—and the vote count 4 June—expected to deliver Prime Minister Narendra Modi a rare third term, many think the boom he has presided over will continue, with more reforms fostering openness and growth. Modi's Bharatiya Janata Party (BJP)—and broader National Democratic Alliance (NDA) coalition—are widely expected to win in a landslide with opposition parties in disarray. Currently, the NDA holds 332 of 543 (61%) seats in the Lok Sabha—India's lower, and more powerful, house of Parliament—while the opposition Congress party-led India National Development Inclusive Alliance (INDIA) coalition holds 142 (26%). 272 seats are required to form a government. Furthermore, bullishness around the election faces a simple problem: Markets move most on surprise—and we see little potential positive surprise from election outcomes. Hence, we think some caution is in order. Three main outcomes seem most likely: 1) the BJP achieves a single-party majority; 2) the BJP leads a coalition; and 3) the opposition INDIA alliance governs in a weak coalition. A BJP single-party majority is the one most investors view positively, given its history of reform and emphasis on fiscal prudence, infrastructure spending and increased investment. However, this scenario is widely expected—the BJP alone is projected to win 342 seats and the NDA 399.[xxxvii] This is currently priced into equities, in our view.

If the other two scenarios happen, current expectations of a BJP/NDA majority would likely be dashed, causing markets to reevaluate the likelihood reforms happen. Ditto for an opposition win. But even if the BJP/NDA wins a majority, there is a further consideration: Many see overwhelming victory by the BJP/NDA as positive and ushering in more economic reforms and continued strong growth. But the government already picked most of the low-hanging fruit in Modi's first two terms, and there isn't much economic reform on their current agenda. Reform expectations may be overwrought, in our view. With India's political and economic fundamentals increasingly well-known—and priced—reality falling short of them is more likely to shock, which suggests tempering enthusiasm.

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xxxiii Source: FactSet, as of 26/04/2024.

xxxiv "IPO Reports List," Staff, Chittorgarh, 26/04/2024.

xxxv "India Sizzles in Global Equity Capital Markets Amid Asia Deals Drought," Scott Murdoch, *Reuters*, 28/03/2024.

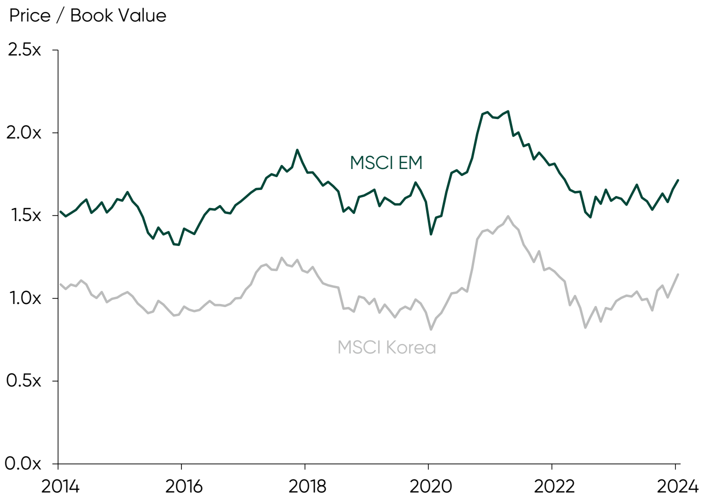
xxxvi "Quick 300% Gains on India IPOs Evaporate After Crackdown," Preeti Singh, Chiranjivi Chakraborty, Saikat Das, and Filipe Pacheco, *Bloomberg*, 03/27/2024.

xxxvii "Modi Could Sweep Away Congress in Indian Election, Says Survey," Krishna N. Das, Reuters, 03/04/2024.

KOREAN REFORMS

Investors have long observed an apparent disconnect between South Korea's advanced economy and Emerging Markets status—a gap many analysts blame largely on corporate governance-related issues. Many analysts also argue this underpins the long-running "Korea Discount," in which the country's equities often trade below book value (Exhibit 21) and global peers' valuations relative to cash flow and earnings. President Yoon Suk Yeol has seized on this, making it a policy goal for South Korea to become officially recognised as a developed market and close the valuation gap. Some suggest his plan could aid the relative performance of Korean equities.

EXHIBIT 21: KOREAN DISCOUNT TO EM



Source: FactSet. MSCI Korea and MSCI Emerging Markets Price to Book Value, in USD, 31/03/2014 – 31/03/2024.

President Yoon's real goal likely has less to do with returns and more to do with courting the rising voting bloc of investors to swing to his conservative People Power Party (PPP). But the idea itself does make sense and is worth monitoring, much like Japan's version unveiled last year. But rather than being a driver of relative returns, we see this as an evolution in the structural backdrop behind Korean equities. The developments—which we will detail—could be welcome. But that is if such a move can come to fruition and overcome entrenched interests, and it seemingly faces hurdles after April's legislative elections.

Many analysts see the Korea discount as resulting partly from the ever-simmering tensions with North Korea. But mostly the discount stems from perceptions of poor corporate governance. This is a long-running problem inherent in the largest South Korean companies' structure, which entails cross-shareholding ownership systems that give founding families control over Korean conglomerates (*chaebol*) at outside and minority shareholders' expense. The *chaebol* structure has much in common with Japan's old *zaibatsu* structure, which reigned before the *keiretsu* system retained cross-shareholdings but curbed family control.

To take on the *chaebols*' governance issues and improve competition, South Korea's Financial Services Commission (FSC) largely echoed Japan's corporate reform playbook introduced last year, which aimed to improve its corporations' capital efficiency. In a highly anticipated announcement, the FSC unveiled its "Corporate Value-Up Program" on 26 February. As expected, it seeks to reduce equities' discount through *voluntary* corporate efforts to prioritise shareholder return and encourages companies to disclose plans enhancing mid- to long-term corporate value. This would include the creation of a "Korea Value-Up Index," scheduled to launch in Q3, and an ETF to follow in Q4—mirroring Japan's JPX Prime 150 Index. The FSC will hold a second seminar in May after a feedback period, and guidelines will likely be formalised in the second half of 2024.

With details still vague—and subject to change—the high-level roadmap suggests the programme will be incentive-based (e.g., tax benefits for participating companies) and focused on strengthening governance, not on punitive measures (like delisting or penalties). An update by the FSC in March seemed to confirm this approach, but it went only as far as to note the government was "actively considering tax support measures."[xxxviii]

xxxviii "South Korea Will Look at Bolstering Corporate Reform After Criticism," Jihoon Lee, Reuters, 14/03/2024.

While these steps could prove positive, they aren't a certainty. In our view, as the programme moves from idea to implementation, the road ahead becomes more challenging—and positive surprise more difficult to achieve. This is because—as is often the case with promising policies—the incentives (i.e., in taxes and commercial laws) need legislative approval. This opens them up to execution risks—and the potential for disappointment. With no draft law even publicly released yet, many questions remain unanswered—and that is before one considers the presumed opposition and lobbying from the *chaebol*.

Looming over Korea's Corporate Value-Up Program is the current administration's flagging popularity, which contributed to the PPP's defeat in 10 April's midterm legislative elections. While the presidency wasn't up for a vote, President Yoon saw the shareholder value initiative as the centrepiece of his policy priorities to win over Korea's 14 million retail investors. But it apparently wasn't enough. Election results indicate gridlock likely reigns, stymieing President Yoon's domestic agenda.

The PPP and a minor allied party took only 108 seats in Korea's 300-member unicameral National Assembly, down from 119 before the vote. Meanwhile, the progressive opposition bloc led by the Democratic Party (DP) secured 192 seats, increasing its majority from 169. The PPP's failure to take control of the National Assembly could determine corporate reform efforts' success or failure. The DP has also championed *chaebol* reform, but with different priorities, likely making it tough to find intraparty backing for the PPP's reform agenda. And the opposition lacks the 200-seat supermajority needed to advance legislation on its own.

While such reforms could be positive for Korea, we don't think they dictate whether the country under- or outperforms. Although shareholder value and corporate governance reforms would be welcome, sector makeup, economic and political drivers—and how those relate to sentiment—are a far larger influence than slow-moving reforms that try to address longstanding structural issues. With all the attention paid to South Korea's initial reform efforts, nascent plans are already known and priced, likely limiting the effects—if those plans even become a reality.

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