July 2024

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Investment Report N°·81

Our aim is to protect investors' capital and increase its value over the long term.

Much ado about nothing?

As a politics graduate, I have a disproportionate interest in the subject. I also recognise the distraction that political outcomes pose to investors, often adding mere noise, to be ignored, if we are to succeed. Yet in the last decade that noise has become louder and its market impact, albeit modest for much of the time, has not always been inconsequential.

June and July are busy months for client and shareholder updates, combined with our annual Investment Trust seminar in London and the Personal Assets Trust AGM in Edinburgh. This provides plenty of opportunity to hear from our investors. The outcome of elections and their effect on markets is a current preoccupation.

The two most common questions that arose prior to the outcome of the general election on July 4th were;

1. Have you made any changes to the portfolio in expectation of a change of government in the UK and the prospect of a Labour landslide?

2. What are the implications of a second Trump presidency?

In the past we have generally dismissed such concerns. As long-term investors, we do not change the portfolio for specific outcomes that are unpredictable beyond the widely followed polls. Nor do we have prior knowledge as to how markets may react. We leave that to traders. In our experience, being reactive to news rarely adds value in the long run.

Why are we generally sanguine? To provide some wise counsel, I asked our oldest stockbroker and market contact (there are very few in their 60's these days) how he expected the market to respond to a Starmer landslide. Expecting him to say a relief rally for UK stocks and a firmer sterling, his response was typically matter of fact and rather more downbeat. "If the news is expected, it will be discounted." Thus, if the polls were correct, there should be little movement on the day after the election, once the result was known, and so it proved. Notwithstanding this preparation for a "*nothing-to-see-here*" response from markets, even I was moderately surprised by the FTSE 100 Index registering a fall of -0.5%, while Cable, the sterling/US dollar exchange rate, firmed by +0.4%. The more domestically focused FTSE 250 was similarly unexciting. The reaction of the indices was remarkably in line with their respective average daily volatility over the past year. The market simply shrugged off the result. Life goes on, and once again, masterly inactivity would have been better than hyperactivity. To our venerable broker's point, it is unexpected political outcomes and events that really move markets.

The past is a foreign country

A recent example of an unexpected political event was the Brexit referendum result in June 2016. After spiking to over $1.50 when the exit poll indicated the likelihood that the UK would remain a member of the EU, Cable subsequently fell to $1.32 before closing at $1.37, once it was clear we were out. This represented a fall of -7% on the previous close. Within two weeks of the referendum, sterling had fallen by -13% from its pre-Brexit levels. This unexpected outcome resulted in the FTSE falling -3% on the day after the referendum, but within three days UK stocks had recovered their losses, led by companies with significant overseas earnings that benefited from a weaker sterling. Troy's Multi-Asset strategy performed well due to our overseas exposure and minimal weightings in hard-hit domestic UK stocks. We do not try to second guess eventualities and never gamble on a particular outcome. The strategy's gains following the Brexit vote were an unexpected windfall.

Just when you least expect it, just what you least expect

So, what of Trump 2.0? Before giving any opinion on the market reaction of a second term in the White House, let's look at what occurred on Donald Trump's election in November 2016. The result was unexpected, as much for Mr Trump as for anyone else. Stock markets reacted rationally with an initial sell-off followed by a sharp rally. By the day after the election, the US stock market was up +1% and went on to perform strongly in Trump's first year in office, rising +26%. In contrast, bond prices were less kind to investors[1], with the US 10-year Treasury yield rising from 1.85% to 2.26% in a matter of days after the election.

Today, a Trump win is expected so the market reaction is likely to be muted. In contrast a Kamala Harris win and a 'blue wave' may initially be regarded negatively by markets, as tax increases would be anticipated. There is no lack of analysis and reportage about the potential response to the presidential election, but we remain unmoved by the ongoing speculation and talk of 'Trump trades'.

The more interesting question might be; what would have happened if the attempted assassination on 13th July had resulted in the death of Donald Trump? The best guess would be that it would *not* have been positive for financial markets as it is likely to have resulted in increased polarisation in an already politically divided United States. Our view is that commentators are focusing on the wrong threat to the market rally. Heightened geopolitical risk, not necessarily election results, is the biggest risk to financial markets today and it is also the hardest to price. Markets tend to ignore such events until they are staring them in the face.

Those looking for a repeat of 2016 in the US may be in for disappointment. The economic backdrop is different today. Inflation was subdued eight years ago, and interest rates were close to lows. US Government debt was admittedly high at 76% of GDP but the cost of that debt was minimal. Since then, debt has ballooned to 97% of GDP and annual interest costs will soon be measured in the trillions of dollars. Back then the budget deficit was relatively modest, but today it is 7% of GDP – a level only normally seen in deep recessions. As one savvy client asked me recently; where would the US economy be with a balanced budget? US government debt stock is $27tn. With Trump expected to extend his 2017 tax cuts, that will add an extra $3-5tn to the tally.

At some stage bond investors, concerned over growing interest costs and inflation, may turn on the US government. The experience of the Liz Truss administration shows bond vigilantes are alive and well and can cause trouble for reckless and imprudent governments. The US may overplay their reserve currency status. Other likely factors to characterise a Trump presidency are a faster rush into a cold war with China and protectionist tariffs, likely to boost inflation and damage growth. The US dollar may remain firm amid trade wars and with pressures on NATO, but if geopolitics begins to impact economically, politics will once again be important for investors.

Cool Britannia?

Following the surprise timing of the UK general election, the country looks set for a period of relative stability at a time when Europe appears to be going through a period of polarisation. The UK is unlikely to become "Singapore-on-Thames", but a relative safe-haven, nonetheless. A period of stability and competence will be welcomed by investors after the eight years of self-inflicted pain since the 2016 referendum.

The experience of the short-lived Truss government is instructive to this new Labour government. While other countries, including the United States, are showing a zeal to expand

1 Yield is a general term that relates to the return on the capital you invest in a bond. Price and yield are inversely related: As the price of a bond goes up, its yield goes down, and vice versa.

(unsustainable) budget deficits, the UK looks less likely to risk a collapse into a government debt vortex. With UK public sector debt-to-GDP at close to 100%, there is minimal room for manoeuvre. Labour's election landslide seems destined for a new era of Butskellism[2], defined by centre-left/right pragmatism, fiscal responsibility and a clear desire for higher nominal GDP growth.

If this outlook is not too pollyannaish, there is room for a reduction in the political and economic discount imposed on the UK in the post-Brexit years. Butskellism will not be all plain sailing for investors. With big government comes interference for companies. Regulatory risk is often underestimated by investors, which is why in our equity selection we are careful to avoid heavily regulated industries that are vulnerable to government interference. Another drawback of the big government of Butskellism is a higher level of inflation. Recent talk of higher public sector wages and a rise in the minimum wage, expected in the autumn, may lead to the anchoring of a higher level of inflation.

A narrow path

At Troy we have not spent our time tracking every electoral poll or political rumour and instead we focus on more predictable factors. Unaffected by politics, stock markets have risen to new highs in the first half of 2024. The gains are driven by the US, which now represents over 70% of global equity markets, and the excitement garnered by vast investments into Artificial Intelligence. More recently there are signs fatigue is setting in with some questioning the potential return on the billions invested into generative AI. Market returns remain very narrowly based, with Nvidia alone accounting for 30% of the +14.5% rally in the S&P500 during the first half of the year. By contrast the equally weighted S&P500 was up only +4%[3]. Coincidently, Troy's Multi-Asset Strategy returned +4% for the first half of 2024, which lagged equity indices, but was in excess of cash and inflation.

The narrowness of the US market's returns should not be viewed as healthy. On the contrary, this pattern often occurs late in a market cycle. Investors coalescing around a very short list of stocks (or one might even say one single stock) rarely ends well.

We wish you a restful summer.

Sebastian Lyon
Charlotte Yonge

July 2024

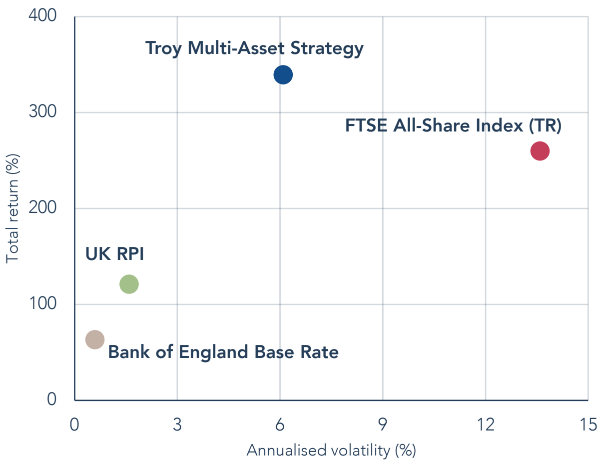
2 Butskellism refers to the post-war consensus politics established in the 1950s which identified with Rab Butler (Conservative) and Hugh Gaitskell (Labour).
3 Equal weighted indices have the same holding size in all companies in an index. They differ from the more common market capitalisation weighted indices that scale holding sizes relative to the value of the business.

TROY
ASSET MANAGEMENT

TROY MULTI-ASSET STRATEGY TRACK RECORD

Total Return 30 June 2024	Annualised Return*	31/05/01 Since launch	30/06/14 10 years	30/06/19 5 years	30/06/21 3 years	30/06/23 1 year	31/12/23 6 months
Troy Multi-Asset Strategy	+6.7%	+343.5%	+66.3%	+26.3%	+8.4%	+6.0%	+3.8%
Bank of England Base Rate	+2.2%	+63.7%	+12.6%	+9.9%	+9.2%	+5.4%	+2.6%
UK Retail Price Index	+3.5%	+121.8%	+50.8%	+33.4%	+27.1%	+2.7%	+2.0%
FTSE All-Share Index (TR)[+]	+5.6%	+255.4%	+77.8%	+30.9%	+23.9%	+13.0%	+7.4%

RETURN VS VOLATILITY SINCE LAUNCH (31/05/2001)

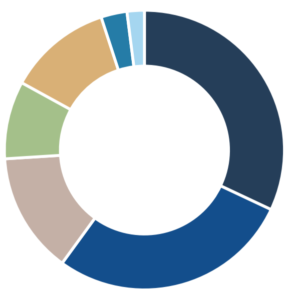


RISK ANALYSIS

Risk analysis since launch (31/05/01)	Troy Multi-Asset Strategy	FTSE All-Share Index (TR)
Total Return	+343.5%	+255.4%
Max Drawdown[1]	-13.7%	-45.6%
Best Month	+8.9%	+12.7%
Worst Month	-4.7%	-15.1%
Positive Months	+66.1%	+59.2%
Annualised Volatility[2]	6.1%	13.6%

[1] Measures the worst investment period
[2] Measured by standard deviation of annual returns

ASSET ALLOCATION



- US TIPS 32%
- Equities 28% (USA 14%, UK 8%, Swiss 3%, Europe 3%)
- Short-dated Gilts 14%
- Short-dated US Treasuries 9%
- Gold-related Investments 12%
- UK Index-linked 3%
- Cash 2%

Source: Factset. Asset Allocation is subject to change. Holdings subject to change.

Top 10 Holdings	
iShares Physical Gold	6.3%
Invesco Physical Gold	6.1%
Unilever	4.5%
Visa	3.1%
Nestlé	2.8%
Alphabet	2.6%
Microsoft	2.6%
Diageo	2.3%
Heineken	2.3%
American Express	1.4%
Total Top 10	33.9%
8 Other equity holdings	6.7%
US TIPS	31.9%
Short-dated Gilts	13.8%
Short-dated US Treasuries	8.6%
UK Inflation-linked	3.5%
Cash	1.6%

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Please refer to Troy's Glossary of Investment terms here.

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