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INVESTMENT MEMORANDUM

Overall, there has been little change in Q2 2024 international equity markets but H1 returns are usefully higher. The market has shrugged off the geopolitical uncertainties and disappointment about the prospect, perhaps dwindling, for interest rate reductions this year. This is in contrast to the fixed interest market which has endured a more difficult quarter. As our review sets out, political considerations are becoming more important for investors.

The tables below detail relevant movements in markets :

International Equities 29.03.24 - 28.06.24

Total Return Performances (%)				
Country	Local Currency	£	US\$	€
Australia	-0.7	+1.6	+1.7	+2.4
Finland	+4.4	+3.6	+3.6	+4.4
France	-6.1	-6.9	-6.9	-6.1
Germany	+0.2	-0.7	-0.6	+0.2
Hong Kong	+1.1	+1.3	+1.4	+2.2
Italy	-1.4	-2.2	-2.2	-1.4
Japan	+1.4	-4.6	-4.6	-3.8
Netherlands	+4.9	+4.0	+4.1	+4.9
Spain	+0.1	-0.7	-0.7	+0.1
Switzerland	+1.4	+3.4	+3.5	+4.3
UK	+3.0	+3.0	+3.1	+3.9
USA	+4.1	+4.1	+4.1	+4.9
All World Europe ex UK	+0.8	+0.3	+0.3	+1.1
All World Asia Pacific ex Japan	+6.3	+6.1	+6.2	+7.0
All World Asia Pacific	+4.5	+2.2	+2.3	+3.0
All World Latin America	-3.9	-12.4	-12.3	-11.6
All World All Emerging Markets	+6.9	+5.8	+5.8	+6.7
All World	+3.5	+2.9	+2.9	+3.7

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : -0.9%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	29.03.24	28.06.24
Sterling	3.93	4.17
US Dollar	4.20	4.40
Yen	0.72	1.04
Germany (Euro)	2.30	2.49

Sterling's performance during the quarter ending 28.06.24 (%)

Currency	Quarter Ending 28.06.24
US Dollar	+0.1
Canadian Dollar	+1.2
Yen	+6.5
Euro	+0.9
Swiss Franc	-0.2
Australian Dollar	-2.1

Other currency movements during the quarter ending 28.06.24 (%)

Currency	Quarter Ending 28.06.24
US Dollar / Canadian Dollar	+1.0
US Dollar / Yen	+6.3
US Dollar / Euro	+0.7
Swiss Franc / Euro	+0.9
Euro / Yen	+5.5

Significant Commodities (US dollar terms) 29.03.24 - 28.06.24 (%)

Currency	Quarter Ending 28.06.24
Oil	-2.2
Gold	+4.9

MARKETS

It has been a quarter of consolidation for international equity markets meaning that, for the first six months of 2024, international equity investors have seen some further improvement in the value of their portfolios from the end of 2023.

In sterling terms for the quarter, the FTSE All World Index showed a total return of +2.9%, in US dollar terms +2.9%, in euro terms +3.7% and in local currency terms +3.5%. Looking at local currency returns firstly, the best performance came from the FTSE All World Emerging Markets Index, +6.9%, whilst there was also a strong performance from the FTSE All World Asia Pacific ex Japan Index, +6.3%. The FTSE USA Index, +4.1%, slightly outperformed. On the negative side were the FTSE All World Latin America Index, -3.9%, and FTSE Australia Index, -0.7%. There was also an underperformance from the FTSE All World Europe ex UK Index, +0.8%. Turning to sterling adjusted returns, the FTSE All World Asia Pacific ex Japan Index, +6.1%, and the FTSE All World Emerging Markets Index, +5.8%, and the FTSE USA Index, +4.1%, showed useful outperformance, whilst strength in the Australian dollar turned the FTSE Australia Index positive at +1.6%. The weakness of the yen pushed the FTSE Japan Index into quite significant negative territory, -4.6%. The FTSE All World Europe ex UK Index showed only a very small return, +0.3%.

For bonds, the story was not so good as they continued to underperform equities. Taking ten year government bond benchmark yields, the gross redemption yield on the UK government bond rose by 24 basis points to 4.17%, on the US Treasury bond by 20 basis points to 4.40%, on the Japanese Government Bond by 32 basis points to 1.04% and on the German Bund by 19 basis points to 2.49%.

In the foreign exchange market, the notable mover was the yen against which sterling rose by 6.5%. Sterling also rose by 1.2% against the Canadian dollar, by 0.9% against the euro and by 0.1% against the US dollar. On the other hand, it fell by 2.1% against the Australian dollar and by 0.2% against the Swiss Franc.

In the commodity markets, oil, as measured by Brent crude, fell by 2.2%, but gold continued its rise, +4.9%, on the back, it is believed, of central bank buying, notably, it is thought, by China.

ECONOMICS

As often repeated in these memoranda over the years, politics can be as important as economics in determining an investor's portfolio asset allocation and strategy and, certainly, it is at the forefront of our thinking when we set our investment policy. The balance between the two may change in emphasis, for example during and after Covid when economics was the more important influence, at least in our thinking, but we think the balance has shifted with political influences the more important one at present although these, of course, lead on to economic ones.

There are, we are told, 40 elections this year, some more consequential than others and, amongst these 40, are the big ones, the US Presidential and Congressional elections next November. However, we have already had some important elections and it is possible to see their influence on markets at this early stage.

But before doing this, it is important to make two points. The first one is that in giving our views on the implications of governments' policies on markets, we are not expressing an opinion on whether we agree or disagree with them, merely the likely effects on markets and, therefore, our investors. Quite often, but not always, the implications are fairly obvious, at least in the short term. The second point is particularly pertinent in US election year and that is that investors should look at what politicians do rather than what they say and not to be distracted by strong personal feelings towards a particular candidate. So, for example, both US Presidential candidates elicit strong feelings from voters, one more than the other, but we will be looking more closely at what happens to the results of the elections for the Senate and the House of Representatives which are likely to be more meaningful for investors, at least in economic terms.

So, what can we say about some of the elections which we have had so far in 2024? The first one which could, and may still, have consequences was in Taiwan in January when the Presidential and legislative elections took place. This is clearly one of the most sensitive issues around as far as China is concerned and, from an investor's point of view, the implications were not negative. We need hastily to qualify this statement. The risk of a Chinese invasion of Taiwan remains very alive as can be seen from all the military and diplomatic pressure being exerted by China. But the electorate of Taiwan gave an ambiguous message. Whilst Lai Ching-te, the Democratic Progressive Party (DPP) candidate, won the Presidential election, he did not gain a majority of the votes and the DPP lost its majority in the legislative election. The DPP is the more hawkish of the two main parties on China but will be restrained by the DPP's weakened position overall. Whilst China was not pleased with the result of the Presidential election, of itself it did not increase the chances of conflict from the present level. That chance, however, is certainly non trivial. As these elections were at the beginning of the year, we do have some evidence of the effect of the two results on markets. For the Taiwan equity market, there appeared to be nothing in the outcome which made sentiment worse. The Taiwan equity index is up around 33% so far this year, helped by the rise in the semiconductor manufacturing giant, TSMC, which is up around 74%. On the other hand, the Taiwan currency is down 5.5% against the US dollar but this is not of note when measured against the performance of some other Asian currencies. So, notwithstanding the enormity of the crisis which would unfold if China were to invade Taiwan, the message of the two Taiwanese elections on the stock market and currency is that they have not made the situation more difficult.

A second election with the potential for significant investment implications was the May one in South Africa. The South African economy has been in a very poor state for a long time, with high unemployment, unreliable power supplies and acknowledged corruption which has weakened vital areas of the economy such as the power supplies and transport systems. With the ANC losing its parliamentary majority, it had to make a choice between allying with two breakaway parties, which would generally be considered extreme and unpalatable to investors, or forming some kind of arrangement with the pro business Democratic Alliance (DA) which it has done. Not surprisingly, even though it is very early days and there has been haggling over the number of ministries which will go to the DA, investors have interpreted the election result positively with this being reflected in the stock market and currency.

As the most populous country in the world and one with increasing economic might, an Indian election is always going to be important for investors, particularly for a country which has become a market favourite in recent years. Mr Modi's Bharatiya Janata Party (BJP) was expected to be returned with an overall majority, perhaps a large one as he himself appeared to expect, but, in the event, the BJP lost seats and now has to govern with two coalition partners to maintain a majority. Investors liked the idea of the BJP continuing to be the governing party because it was perceived as pro business and pro reform. In the immediate aftermath of the surprise result, the stock market and currency were affected because the relatively poor result for the BJP had not been discounted and investors feared that the reforming agenda could be derailed because the Prime Minister might have to compromise with his coalition colleagues in parliament. But, after an initial dip, the stock market has recovered and is up about 10.6% for the year to date whilst the currency has remained stable and has been one

of the best performing Asian currencies this year with only a fractional fall against the US dollar. Of course, the election has only recently taken place and early indications may be unreliable, but the view which investors seem to have taken at this stage is that there will be no policy changes which will upset the positive sentiment towards India.

An election in another very important country, Mexico, has also just taken place and the current President's protégé, Claudia Sheinbaum, won a landslide majority for the Morena party. Investors had some concern that the ruling party would obtain a super majority which would have enabled it to change the constitution but it fell just short in the Senate. The fears for investors surround the current President, known as Amlo, with his radical policies and that they will be passed on to Claudia Sheinbaum, emboldened by her large majority. One major concern is the state of public finances. Although he followed radical and sometimes anti business policies, Amlo had been conservative financially but in the run up to the election the spending taps were turned on such that the budget deficit is expected to be around 5% of GDP this year. Investors will read the country's economic position negatively if action is not taken to stabilise the country's finances. The Mexican peso has been weak against the US dollar, down by nearly 6% so far this year although others have been worse and the equity market has been weak, down around 8%, with pronounced weakness after the election result.

In Europe, we have had elections in France and the UK and, as this is written, we now know the surprise result of the second round of the French election in which Marine Le Pen's National Rally (RN) fell back to third instead of first place as expected. For the moment, we will just concentrate on the French election because, in the short term, this is likely to be the more important one in terms of any consequences for investors. It is too early to draw any investment conclusions from the UK's election result and this will be discussed in future reviews. Firstly, however, some economic background. In June, the European Commission warned eight EU countries over their excessive budget deficits, one of which was France. The situation is serious in France with its budget deficit in 2023 standing at 5.5% of GDP, well above the EU's 3% limit. Furthermore, France's debt to GDP ratio is 112.3%, a very high level. The situation is made even more dangerous given that France is a member of a currency union with no ability to make currency adjustments independently. Although the country's credit rating is still high, Standard & Poors recently cut its rating to AA- from AA. The very large size of the budget deficit increases the pressure on the country's finances as investors become more particular about the rate of interest they are prepared to accept on the country's debt. At the moment, taking ten year government bond issues by members of the euro, France is having to pay about 65 basis points more than Germany, although the spread has been higher and about 6 basis points more than Portugal pays. With such a large budget deficit, the costs of servicing it create a vicious circle, leaving no room for fiscal relief and weighing on economic growth, the latter being the driver of tax revenues. As a result of his party's very poor showing in the recent European Parliament elections, President Macron decided to call for early legislative elections, seen by many as an enormous gamble. And, as this is written the day after the second round, it is difficult to find anything positive to say because there is no majority for any of the economic measures which need to be taken. A feature of European politics has been the rise of multi party politics. It took eight months for Netherlands to form a government and Pedro Sánchez in Spain rules with a coalition of seven parties.

In this second round, voters' change of allegiance seemed to be decided by which of the parties they disliked the least but, what is certain, is that there is no majority for anything which is necessary to address the economic problems of France, specifically its very high budget deficit and high overall public debt to GDP ratio. Whoever the President appoints as Prime Minister will have a thankless task in trying to find a way of addressing these budgetary problems. What did unite the various left and right forces opposed to President Macron was the desire to spend more and reverse reforms such as the rise in the retirement age. We can feel confident in saying that the outlook for France from an investment point of view has deteriorated as a result of the elections. We have sometimes said in the past in respect of the USA that a stalemate position where the President cannot enact measures he would like to because he does not control both arms of the legislature is a good result for investors

because it largely maintains the status quo and they therefore have a certain clarity of outlook. The stalemate in France is not in this category because urgent action is needed to address the state of French public finances and, at this stage, it is hard to see how this problem can possibly be addressed. To be clear, the USA's finances are in a serious state but, in terms of which country's borrowing problems are likely to come to the fore first, it is France.

Specifically for France, failure to address the state of public finances may lead to further credit downgrades and additional borrowing costs. But the problems of France cannot be isolated from those of the eurozone because, being part of a currency union, it cannot let its currency adjust to different economic circumstances. An important part of French sovereign debt, around 50%, is held by foreigners, not to mention the debt held by French banks and insurers. So, any loss of confidence is not only serious for France but, as its second largest member, the eurozone and the currency. France has always been very resistant to change but it is becoming increasingly urgent that the state of public finances is addressed and the results of the elections give no hope for necessary reforms. So, for us, the French election result is negative for investors with maybe further implications for the eurozone.

The most high profile elections of all, for the Presidency and Congress, occur in November in the USA. Paradoxically, because of the possible magnitude of what is happening in France, the French election may be more consequential. This is a heavily qualified comment but, going back to our earlier comment about stalemate in politics sometimes being good for investors, the rationale is that if nothing much can be done by the relevant legislature, there is more certainty for markets and there is nothing worse for markets than uncertainty. So with the US Congress currently split with the Republicans holding the House of Representatives and the Democrats controlling the Senate, President Biden's quite radical tax policies cannot be implemented. That is why the battle for the control of Congress in November will be so important because the tax policies of the two parties are quite different and therefore the implications for investors may also be quite different. At present, it is unclear how the results for the Presidential and Congressional elections will turn out. With Wall Street at around an all time high (though this statement must be qualified by the fact that market leadership is very narrow, centred as it is on the "Magnificent 7"), election issues do not appear to be having an influence at present. We will be commenting more on the implications of the US elections nearer the time when we may have more clarity.

In recent reviews, we have focused on the increasingly aggressive approach of anti trust regulators, apparent in the USA, UK and Europe with particular emphasis on the technology sector and the big companies in particular. The actions of regulators can have as much influence as those of politicians on markets although this may not always be apparent. If we look at the USA, whilst President Biden has not been able to get his tax measures through Congress, he has been able to appoint sympathetic people to the various agencies and this would appear to be having some effect as the authorities go after the big technology companies. Big tech divides opinion but, as far as market implications are concerned, brakes on M&A activity, attempts to break up companies and long running investigations which may slow up business progress for affected companies and regulators' attempts to bring Artificial Intelligence (AI) link ups into their investigations add to the uncertainty. The UK and Europe, of course, do not have these vast companies but regulators have been greatly exercised by them with the EU's Digital Markets Act acting as the firing gun for investigations into the US big tech companies. In the UK, one has sensed the frustration of some previous government ministers, keen to make the UK an attractive home for technology companies, about the attitude of the Competition and Markets Authority (CMA) towards technology companies, some of whom have shown their dismay at the regulatory climate in the UK. Regulatory activism will tend to be a negative factor for markets if it clamps down on M&A activity or has second order effects in encouraging companies to move to a more benign climate. However, for those concerned about the consequences for companies and markets of regulatory creep, the US does have some countervailing forces with recent Supreme Court rulings curtailing regulatory creep. This is not so much the case in the UK and Europe. Whether one agrees or not with the various regulatory or anti trust authorities, their actions can affect perceptions of various markets.

So, as we end the first half of 2024, political factors, in particular, seem the more important consideration for investors whilst increased regulatory activism should also be noted. As indicated above, the French election is the most immediate concern for investors as the opposition to changes necessary to put French public finances on to a sounder footing seems entrenched. However, politicians often have to temper their policies in the light of reality. We have, on several occasions in the past, referred to a comment by James Carville, President Clinton's political advisor. He said "I need to think that if there was reincarnation, I wanted to come back as the Pope or as a .400 baseball batter. But now I would like to come back as the bond market. You can intimidate everybody". And therein lies the problem for France. The bond market may give the warning but will politicians react? At present, it looks unlikely given the firmly entrenched views of left and right.

Turning to the economic influences on markets, our discussion on the political issues above leads neatly on to one of the issues which concerns us most at the moment and that is the level of government borrowing in many countries specifically discussed above in relation to France but widely relevant. As our clients will know from our economic reviews in recent years, we have been negative about the prospect for bond markets and, as a result where possible, have avoided holding bonds in client portfolios. Their recent performance against equities has been poor and it is not difficult to see why. The suppression of interest rates by central banks in recent years as part of an aggressive monetary policy to deal with the Global Financial Crisis back in 2008 and, more recently, the economic effects of Covid created major market and economic distortions. The failure of central banks to recognise that inflationary pressures were building up in 2021 and act accordingly to raise interest rates in a timely manner made the situation worse. Whilst, of course, the Russian invasion of Ukraine in 2022 could not have been anticipated and caused a sharp rise in inflation, the latter was made worse as a result of central banks being behind the curve beforehand and not acting to try to quell rising inflation. Fiscal policy, of necessity, had to be expansive as a way of keeping the world economy afloat but, now, as we look around the major economies, we see very high levels of budget deficits which we regard as problematic, especially for bond markets. If we look at the IMF's Fiscal Monitor detailing past levels of General Governments' Fiscal Balances and its forecasts beyond 2023, we see some disturbing figures, not least for the USA. Just to pick out some of its projections for 2024 and 2025 gives a flavour of the problem. If we take the USA, the IMF is looking at a deficit of 6.5% of GDP for this year and 7.1% in 2025 (the figures remain alarming as far ahead as one can see). If we take France, and these figures are almost certain to be updated, it forecasts a deficit of 4.9% for both years. If we look at Italy, a very heavily indebted country, it forecasts a deficit of 4.6% this year and 3.2% next year. For the UK, the respective figures are 4.6% and 3.7% respectively. The effect of this on years of deficits is shown in the figures for general government debt as a percentage of GDP in those four countries. Although it is a subject of argument amongst economists, and now subject to some revised thoughts, it was argued that if a country's public debt as a percentage of GDP went over 90%, it would reduce future growth prospects. The theory behind this is that the servicing costs of growing debt crowd out the private sector in terms of interest rates which the private sector may have to pay as they compete with the public sector. Secondly, increased debt servicing costs increase public expenditure giving finance ministers less room to follow an expansionary fiscal policy as they have to manage the rising budget deficit. And then there is the supply issue. It has been argued in the past that the level of supply of new government debt does not really matter and that it will be comfortably absorbed. Going back to the USA, the non partisan Congressional Budget Office foresees years of extremely high budget deficits. Now there is the argument put forward that the USA can be removed from normal market disciplines because the US dollar is the largest reserve currency and that US dollar assets will always be in demand. At these exceptionally high levels of borrowing, we see this differently. Very simplistically, likening the situation to an individual who makes a loan to another individual, that individual may decide what a reasonable rate of interest is but if the borrower comes back for more loans, the lender will, firstly, want to be rewarded for increased risk by charging a higher rate of interest and, secondly, the lender will be querying the borrower's

creditworthiness and decide not to extend the arrangement. Reverting to the country situation, the USA could start to pay a premium for borrowing so much and also see its creditworthiness questioned, resulting in a falling currency. It is never not going to be able to service its debt but at what price financially in terms of interest rates and the implications for the US dollar and at what level of creditworthiness as measured by debt rating agencies? This is why what happened in the French election is so important. The spreads on French government debt have widened and the implications for the eurozone of its second largest member facing a loss of investor confidence would be significant, as discussed above.

What this boils down to in our investment policy is that the risks to the bond market remain significant not only through interest rate pressures caused by the high levels of debt but also diminishing creditworthiness in some countries. Compared with the period of Covid and its aftermath when real interest rates were largely negative, the relationship between nominal yields and inflation is much more normal with many positive real returns. However, concerns about the supply of government bonds needed to fund these vast deficits as well as political developments offset the positives in our view.

The case for equities is rather stronger than because we don't favour their main alternative, bonds. We are not in a period of strong economic growth but neither are we in recession so profits overall should be able to grow modestly, especially as inflationary pressures have eased. There are divergences between the prospects for each sector and market leadership has been very skewed by the performance of the Magnificent Seven, charged up in some cases by the excitement surrounding AI. There are risks, of course. We have talked predominantly about the effect on investors arising from the elections we have had so far this year. In due course, we will need to consider any implications for investors arising from the UK election but, most particularly, as we move towards November, we will be looking at what happens on the political scene in the USA.

We have not touched upon the troubling amount of serious geopolitical events in the world, any of which could escalate even further. However, and this is not being complacent, markets seem to react more calmly than they have done previously when a serious unexpected shock occurs such as the Russian invasion of Ukraine, the Hamas attack on Israel and Covid. One feels it reflects not only the increasing regularity of such unexpected events but also how, over time, these reflect much smaller blips in the long term graph of equity performance. That attests to the validity of the argument that it is dangerous to react to short term shocks by abruptly changing one's strategy, for instance going liquid, and not returning to the market before it has recovered. That may incur a loss of profit which may never be recovered. None of this is to downplay the horror of these events. It is important to emphasise this when making the comments above about how markets have recently reacted to some of these awful events.

So, as we look back on the first half of 2024, which has again seen equities outperform bonds, we need to reflect that in the year of elections, it remains as important as ever to achieve meaningful geographical diversification in an investment portfolio as, undoubtedly, some of the election outcomes may not have good implications for investors. By being alive to the advantages of derisking through geographical diversification, portfolio performances should benefit. However, as always and after a positive performance H1 2024, though heavily skewed by AI excitement, we have to be realistic and not be surprised by some negative quarters. However, for the reasons given, we continue to prefer equities to bonds and we see no reason to take the risk of cashing in some profits only to suffer from an opportunity cost risk as equities continue to gain. The long term approach remains important.

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