COURTVILLE PARTNERS

Courtville Partners – Investment Outlook, October 2024

Summary of the key points in this quarter's Investment Outlook

- Stretched valuations, especially among the Magnificent 7, and nagging worries about the dollar's direction suggest greater caution towards US equities, though this is partly offset by a decisive change in the interest rate weather
- China's late-September stimulus package has surprised investors everywhere – and has certainly wrong-footed asset allocators, who long ago gave up on Chinese equities
- We prefer to stay overweight in the economies (and equity markets) that benefit from falling interest rates, looser fiscal policy and reliably low energy costs
- We are taking some profits in gold following its astonishing 45% rise over the last year

It is a commonplace in asset management that the impact of asset allocation far outweighs that of stock selection. How satisfactory to have invested $1,000 in Amazon shares at its IPO in 1997 – they would now be worth about $2.5 million. But who is blessed with such foresight? Not many of us. Trying to pick individual stocks can be intellectually stimulating – fun, even – but is almost impossible to do with consistent success.

Investors get better odds when they concentrate on the wider picture. For example, in the wake of 2007-08's Great Financial Crisis, an investor expecting the US to enjoy an extended period of economic and technological dominance could have simply allocated assets to US equity index funds or ETFs. From the 2009 market nadir to date, the S&P 500 Index has generated an astonishing total return of 744% – or nearly 15% p.a. on average. No stock-picking required: the index adjudicators took regular and automatic care of any rebalancing. Even more eye-popping, however, has been the extent to which the US has come to dominate the global aggregates: over the same period the US stock market as a proportion of the MSCI All Country World Index has inflated from 42% to a whopping 64% (which by the way dwarfs America's 26% share of global GDP).

Of the many reasons behind the US market's triumphal march, some are familiar, e.g. the rise and rise of Big Tech and the re-establishment of energy independence, not to mention fiscal and monetary incontinence. Others have been subtler – such as the new ways in which the US government has exploited its dollar-based imperial privilege. Whatever economic historians of the future decide were the most important factors, today's investors find themselves facing one overriding question: has the time finally come to reduce exposure to US equities? Was this summer's wobble among the so-called Magnificent 7 stocks a canary in the coalmine of asset allocation? Should it prompt us to allocate away from the US? And, if so, in favour of which markets?

To make the asset allocator's dilemma even more nerve-wracking, the answers to these questions come with the risk of whiplash. Very few global portfolio managers have had the guts to maintain a full US weighting over the last decade-and-a-half, let alone run an overweight position. Bad enough to have scoffed at Wall Street's remorseless rise – but even worse to get sucked in just as US exceptionalism begins to fade.

Meanwhile, across the Pacific Ocean, Chinese equities have been stuck at the other end of the performance spectrum. The Shanghai Shenzhen CSI 300 Index has underperformed the S&P 500 by all of 90% over the last five years. Just as the reasons for the US market's success have been plain to see, there is no mystery about China's malaise: tumbling growth rates, a vicious property crunch (plus associated banking woes), Taiwan jitters, politically driven interventions and arguably the world's most disastrous lockdown strategy (out of a strong field). Most foreign investors gave up on Chinese stocks a while ago. So too did domestic investors, weighed down by a collapse in consumer confidence.

Then, in the last week of September – and following an underwhelming Communist Party plenum – the Chinese authorities unveiled a raft of pro-growth measures, more or less out of the blue, including: interest rate cuts, looser fiscal policy, extra capital for banks and other measures to free up the ossified property market. For the first time in years the government managed to spring a positive surprise on markets. The CSI 300 Index duly jumped 27% in a week (though that still leaves it 30% below the February 2021 peak).

Back to the importance of asset allocation. Both the US and China are arguably approaching the end of 2024 armed with at least three crucial competitive advantages: easier monetary policy (i.e. lower interest rates), loose (or at least looser) fiscal policy and reliable cheap energy. The differences between the two economies – and their respective stock markets – may be legion, starting with their relative weights in the MSCI ACWI Index (64% and 2%, respectively). But the powerful twin forces of monetary and fiscal stimulus in both places may be hard for equity investors to resist, especially since few other countries are yet on the same rate-cutting tack. Indeed, in Japan interest rates are still on the way up, taking the Yen's exchange rate with them – itself an extra reflationary boost for the global economy.

In addition, the US and China are almost alone among first-rank industrial economies in sharing the superpower that is cheap energy, even though they derive it from very different sources (domestically fracked oil and gas for the US, coal-fired electricity for China). As we never tire of arguing, economies at the most fundamental level are energy transformed. And although the cost of energy is far from the only factor that determines economic success (or even economic advantage), cheap energy does exert a huge influence on a country's ability to compete. A case in point: governments everywhere are falling over themselves to host the enormous – and enormously power-hungry – datacentres that Big Tech must build to meet AI-driven demand for number-crunching. If you were running Microsoft, would you prefer to pay the equivalent of 7p/KWh in the US or 26p/KWh in the UK?

We are not entirely sanguine about US equities – and haven't been for some time. Only last quarter we observed that Nvidia's shares, up tenfold in just 18 months, seemed to be discounting improbable rates of growth in demand for the company's chips. Since then, the shares have endured a rocky three months, including a near-30% top-to-bottom drop. And at the macroeconomic level we still expect the dollar's decline against most major currencies to continue. The yawning US current account deficit points that way, as do the priorities of both presidential candidates. If we're right on this score, it may take some gloss of non-US investors' portfolios in the short term, though it should also continue to put wind in the sails of most emerging markets.

Should the Magnificent 7's bumpy summer or worries about the dollar – or anything else – prompt investors to allocate money away from the US market in general? Instead of allocating *away* from US equities in our Model Portfolio, we have opted to reallocate *within* the US market – more specifically, away from the mega-caps and towards the other 65% of the market's capitalisation not represented by the Magnificent 7. In early August we exchanged 5% of the Model Portfolio's *capitalisation*-weighted S&P 500 ETF for 5% in an *equal*-weighted version of the same S&P 500.

In this context, we think it worth noting the abrupt changes in relative sectoral performance during 3Q24. What MSCI labels "IT" and "Communication Services" were the two strongest sectors in the first six months of the year, rising 26% and 24%, respectively. But in the most recent quarter both were largely unchanged, leaving them near the foot of the performance tables. The winning sectors in 3Q24 were Utilities (+17%), Real Estate (+16%) and Industrials (+10%). Whisper it quietly, but there may be a bit of a shift in the investment winds away from growth and towards value – with one notable exception, Energy. The strong performance of Industrials hints at investor optimism about the economic outlook; but Energy is still an absolute laggard and fell another 3% in 3Q24. Our hunch is that better growth prospects in the US, China and Japan may not be compatible with Brent crude at $72. We've added 1% to the Model Portfolio's oil position, conscious also that it adds an extra hedge against war in the Middle East.

Has the Federal Reserve's bumper 0.5% rate cut proved us wrong about the persistence of inflation? Not necessarily. Instead, we get the clear impression that the Fed's policy priority is no longer to get back to 2% inflation, but rather to prop up both employment and asset prices (including the stock market). There is no talk of changing the official 2% target, at least for now; but it is perfectly possible that the Fed will now see this as a minimum level, not a maximum. If we're right, it's likely to be bad news for longer-dated US treasuries – and it also helps to explain the contrasting fortunes of the dollar and gold (down 7% and up 45%, respectively, over the last year).

The price of gold is normally expressed in dollars, of course. So dollar depreciation flatters gold's return. All the same, we can now say that the answer to the question we posed back in January ("Is gold having a moment?") is an unqualified yes. We count ourselves not so much as gold bugs (to use an old-fashioned term), but rather as gold bores; we have held gold in our Model Portfolio since the start almost 10 years ago; and we find ourselves extolling the precious metal's merits on a regular basis. But even we have been taken aback by gold's price performance of late. As far as we can tell, all the forces responsible for gold's surge this year are still in play – geopolitical tensions, fiscal profligacy, emerging market demand and the need to recycle China's gargantuan trade surpluses (now running at an almost unimaginable $70-80bn per month).

By contrast with gold, our bet on nuclear energy via the NUCG ETF was looking less clever for a while, but has rallied 24% since early August. There seems to be a lot of movement in the sector. At a basic level, the price of uranium itself has gone nowhere over the last year. But supply constraints are building: Kazatomprom, the world's largest producer of natural uranium, recently cut its output guidance for next year by almost a fifth; and the US has now banned the import of Russian uranium. As for power generation, we detect a growing recognition that, hydro aside, nuclear represents the only proven zero-carbon baseload technology.

The Czech government recently named Rolls-Royce as its preferred supplier of SMRs (small modular reactors); and Oracle is reported to be planning a datacentre with permits for three SMRs. Meanwhile, Microsoft has struck a 20-year deal with Constellation Energy to re-start the 835MW Unit 1 reactor at Three Mile Island in Pennsylvania (yes, *that* Three Mile Island). Finally, in deference to the follow-the-money theory, we should mention the marquee conference last month in New York that brought together many of the world's biggest banks to discuss options for lending to nuclear power projects. Commercial banks have long been wary of exposing their balance sheets to the nuclear industry because of the scary costs and even scarier risks. We don't want to come across as cynics; but what Microsoft, Oracle and the rest of Big Tech want (from their bankers), they are quite likely to get.

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Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	10	14.4
International Equities	54	46.9
Fixed Income	14	26.3
Alternatives	16	7.3
Commercial Property	1	0.1
Cash	5	5.0
Total	**100**	**100.0**

Model Portfolio	ETF	Weight (%)	Changes this quarter	Weighted OMC (%)
UK Equities		**10**	**0**	
UK	VUKE LN	8	0	0.09
UK	VMID LN	2	0	0.10
International Equities		**54**	**2**	
Global	IWQU LN	5	0	0.30
US	VUSA LN	11	-5	0.07
	XDPG LN	9	0	0.09
	EWSP LN	5	5	0.20
	IUVD LN	3	0	0.20
Euro	VERX LN	3	1	0.12
	EGRG LN	1	-1	0.29
Japan	VJPN LN	5	1	0.19
Asia ex-Japan	VAPX LN	4	0	0.22
Emerging Markets	VFEM LN	6	2	0.25
Emerging Markets ex-China	EXCS LN	2	0	0.18
Fixed Income		**14**	**-2**	
Government Bonds				
UK Inflation Linked	INXG LN	2	0	0.25
UK	IGLT LN	2	0	0.07
US	IDTM LN	3	-2	0.17
EM	SEML LN	3	0	0.50
China	CNYB NA	2	0	0.35
Corporate Bonds				
US	CORP LN	2	0	0.20
Alternatives		**15**	**0**	
Gold	PHAU LN	4	-1	0.39
Oil	WEL5 GY	3	1	0.18
Infrastructure	INFR LN	2	0	0.65
Uranium	NUCG LN	2	0	0.55
Water	IH20 LN	2	0	0.65
Carbon Allowances	CARB LN	2	0	0.35
Commercial Property		**1**	**0**	
Global	IWDP LN	1	0	0.59
Cash	XSTR LN	**6**	**0**	0.15
Total		**100**		**0.22%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2024 YTD	8.3%	7.9%	0.4%
Since inception(1/1/2015)	102.5%	93.4%	9.1%
CAGR	7.5%	7.0%	0.5%

The value of your investments can fall as well as rise. You may not get back all the money you invested