Courtville Partners – Investment Outlook, July 2025

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

- There are several more or less obvious reasons behind the dollar's decline this year, which after all happens to be US Government policy. But the reordering of the world's economic blocks could prove to be the biggest headwind of all for the dollar.
- For two decades Asian countries have recycled excess dollar savings into US assets, especially treasury bonds. Burgeoning investment opportunities within Asia may undermine the incentives for such "dollar round-tripping".
- In general, we still don't see decent value in government bonds. Real yields on US treasuries may need to rise in order to offset weaker demand from the current account surplus countries in Asia.
- US equities overall should continue to benefit from the country's many competitive advantages – and should therefore still offer rewards for discerning investors. But we keep our Model Portfolio tilted towards Asia, Europe and Emerging Markets.

Only one of Courtville's partners read history at university. Even so, we often find ourselves rummaging through the economic annals as we try to make sense of the present. The infamous party slogan from *1984* – "Who controls the past controls the future" – doesn't apply to portfolio investment. But it seems to us axiomatic that an appreciation of historical context is likely to help investors identify both opportunities and threats. The apparent sea-change in the dollar's fortunes is a case in point – and strikes us as potentially momentous.

Some history, then. In August 1971 President Nixon sought to defuse a looming dollar crisis by suspending the currency's convertibility into gold at a fixed exchange rate of $35/oz. In doing so, he effectively killed off the Bretton Woods system of fixed exchange rates that had been in place since the War. Three months later US Treasury Secretary John Connally arrived at the G-10 meeting in Rome and in mellifluous Texan tones dropped his truth-bomb: "The dollar is our currency, but it's your problem". His present-day successor, Scott Bessent, comes across as a more diplomatic individual. Yet this Administration's desire for a weaker dollar, especially against Asian currencies, echoes the sentiments of 54 years ago. The dollar really *is* a problem for non-Americans, not least non-American investors. We live in a world that remains dollar-denominated and, in certain areas, dollar-dominated. So the 11% fall in the greenback's value since Inauguration Day matters. Translated to equities, it means that the 9% rise in the dollar version of the MSCI All World Index so far this year becomes a 1% fall when expressed in sterling.

We have always been wary of predicting exchange rate movements. That said, it remains a truism of macroeconomics that current account deficits (the most visible sign that a country is living beyond its means) eventually result in – and are resolved through – currency depreciation. This pre-condition for further dollar weakness certainly applies in the case of the US, where the current account deficit has accelerated materially in recent years and now stands at almost 4% of GDP. Even if this wasn't the case, there would be many other reasons to expect the dollar to carry on falling: the tariff brouhaha, the US Government's perceived hostility towards foreign investors, straightforward over-valuation on a purchasing power basis – and so on.

But perhaps the biggest – and most powerful – downward force on the dollar may come from across the Pacific. In retrospect, the combination of widespread devaluation of Asian currencies after the 1997 crisis and China's accession to the WTO in 2001 generated *inter alia* powerful tailwinds for global bonds, courtesy of both disinflation ("The Great Moderation") and Asian countries' appetite for US treasury bonds (the natural home for excess dollars earned by fulfilling the US consumer's vast appetites). Could these tailwinds soon become headwinds for Western government debt? And does a $250bn surge in dollar bank deposits in Hong Kong in just two years hint at a buyers' strike (of US assets by Chinese investors)?

We were recently introduced by research house Gavekal to the concept of the Valeriepieris circle – the smallest possible circle drawn on a map with more people inside than outside. If the map in question is of the whole world, the Valeriepieris circle extends from India in the west to the southern tip of Japan in the east and from Mongolia in the north to Indonesia in the south, but still covers only 10% of the Earth's surface. The circle's location shouldn't be a surprise: 16 of the world's 20 most populous cities are in Asia. But this Valeriepieris circle is about more than population. It also captures the $9trn or so of current account surpluses accumulated in the region since the Asian crisis of 1997, not to mention a vast pool of educated human talent (China and India produce more STEM graduates than the rest of the world put together).

Until now the missing ingredients for pan-Asian economic lift-off have been (i) easy access to raw materials, (ii) deep pools of capital and (ii) the simmering hostility between China and India (there are no direct flights between India and China). But war in Ukraine has brought Russia and China closer to each other than ever, while Russia and India have long been friends. On paper at least, a China/Russia/India axis (plus the ASEAN economies) looks like a near-perfect community of interest. So signs of incipient cooperation between China and India should make investors sit up – and, once sitting up, consider deploying their own capital in that part of the world.

If Asia does manage to mobilise financial capital, raw materials and its educated youth, the investment opportunities could be vast. More to the point, they could easily look more attractive than investing those excess dollar savings in US treasuries (or even Mag 7 stocks), which has been the pattern for many years. If Asia begins to disinvest from the US treasuries and stocks – or at least refrains from committing new capital in that direction – whither the dollar? Will real dollar interest rates have to rise in order to attract and retain bond investors? It seems likely.

The threat of foreign investors reducing their $31trn of aggregate investments in US securities is one reason why we remain cautious about government bonds in general and US treasuries in particular. (For context, US stock and treasury bond markets are capitalised at $52trn and $27trn, respectively.) Leaving aside nagging worries about post-DOGE fiscal policy, stubborn wage inflation and possible Asian disinvestment, the case for government bonds has been dented by their broad failure to act as decent hedges during recent periods of stock market volatility. Compare and contrast with gold, say (up 27% so far this year and up 70% over two years).

Although yields on US treasuries (and UK gilts) are far higher than they were for 15 years between the GFC and Covid, they are frankly quite low by historical standards. When treasury bond yields climbed from 5% to 8% in 1994, President Clinton, in partnership with a Republican-controlled Congress, tightened fiscal policy significantly, raising taxes and cutting spending. Bond yields were back at 4% by 1998. It is hard to imagine the political leaders of any major Western country doing such a thing now. As a result, the debt burdens of most OECD countries continue their seemingly unstoppable ascent to wartime levels. We struggle to see what might reverse this trend, barring a full-blown debt crisis. Sooner or later, though, the so-called bond vigilantes will have their day. (Note the dictionary definition of vigilante: "a person who tries in an unofficial way to prevent crime, or to catch and punish someone who has committed a crime".)

If this all sounds gloomy for US assets, we should repeat our expectation that the US will continue to enjoy crucial competitive advantages for many years to come (energy self-sufficiency, population growth, technological prowess, etc.), which ought still to make it fertile territory for discerning investors. Nor are we suggesting that the dollar will relinquish its role as the world's reserve currency any time soon. After all, there is no obvious replacement, however much China promotes renminbi-based trade.

On the other hand, countries are no longer forced to earn and hold dollars in order to buy energy and other commodities, all of them priced in dollars. Russia, for example, happily sells its oil in renminbi or rupees, among other currencies – a more or less direct consequence of the US decision to freeze Russia's $300bn of foreign exchange reserves in February 2022. It also seems clear that the US is no longer willing to bear all the costs of policing the world and its trade routes. "Fortress America", if you like – or perhaps a modern-day version of the Monroe Doctrine. Finally, the AI buzz that has helped propel certain US equities to exotic valuations may not turn out to be the source of supranormal profitability that its cheerleaders suggest. DeepSeek's arrival on the scene is a reminder that making money in direct competition with Chinese rivals is always hard. And, from a more philosophical angle, it is anyway possible that AI-fuelled "stochastic parrots" (as Prof Emily Bender memorably dubbed LLMs) fail to rise above the level of high-speed, but prejudice-prone, search engine.

A word about Japanese equities, which we have overweighted for a while in our Model Portfolio. After a rocky 1Q25, Tokyo has come storming back and is up a whopping 30% since "Liberation Day", leaving it modestly in credit year-to-date. The need to normalise monetary policy after so many years of abnormality ("yield curve control" in central bank jargon) makes some investors nervous. In essence, are higher stock prices compatible with rising inflation and bond yields? We would highlight at least two positive influences on Japanese stocks. First, revisions to earnings forecasts are the strongest of any major region. Second, in the space of a dozen years Tokyo has gone from a buyback-free market to one in which the pace of buybacks is accelerating sharply (to an annualised Yen 12trn from Yen 7trn only a year ago). Crucially, share buybacks are still earnings-accretive despite the rise in government bond yields – in contrast to the US, say. Buybacks and dividends *each* now generate a yield of 2.3% p.a.

We still have a relatively high cash position (8%) in our Model Portfolio. At the risk of being accused of cake-eating, we want a reserve with which to profit from any major market setback. Fred Hickey, a doyen among equity strategists, points out that bear markets often unfold only after one or more false starts. The dotcom monster-bust of 2000-02 included no fewer than five US stock market rallies before hopes were finally dashed that the internet *per se* would justify novel valuations. The snag, as ever, is timing. We have no idea when (or if) markets might crash. And the spasms following April's "Liberation Day" could be construed as a reminder that it (usually) pays to keep calm and stay (mostly) invested.

But where to invest? Notwithstanding a gazillion bytes of analysis of what US tariffs may or may not mean for economies, companies and share prices, we aren't much wiser about how US trade policy will shake down. We do, however, retain quite enough faith in the American entrepreneurial spirit to support a substantial weighting in US equities, albeit with a bias towards both currency-hedged and equal-weighted ETFs. Nevertheless, as we peer out towards our investment horizon, we do expect attractive returns from the economies inside the Valeriepieris circle. These existing tilts within our Model Portfolio – away from plain-vanilla US equities, towards Asia, Europe and Emerging Markets – have helped the portfolio beat its benchmark by 135bps in the second quarter. One quarter means nothing in the grand scheme of things, but does encourage us to stick to our guns.

Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	10	12.9
International Equities	56	50.2
Fixed Income	11	25.5
Alternatives	14	5.8
Commercial Property	1	0.1
Cash	8	5.5
Total	**100**	**100.0**

Courtville Partners 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		**56**	**0**	
Global	IWQU LN	2	0	0.30
US	VUSA LN	7	-2	0.07
	XDPG LN	9	2	0.09
	EWSP LN	9	0	0.20
	IUVD LN	3	0	0.20
Euro	VERX LN	5	0	0.12
	XDAX LN	2	0	0.09
Japan	VJPN LN	4	0	0.19
Asia ex-Japan	VAPX LN	4	0	0.22
Emerging Markets	VFEM LN	9	0	0.25
Emerging Markets ex-China	EXCS LN	2	0	0.18
Fixed Income		**11**	**0**	
UK	IGLT LN	3	1	0.07
US	IDTM LN	2	-2	0.17
EM	SEML LN	4	2	0.50
China	CNYB NA	1	0	0.35
US	CORP LN	1	-1	0.20
Alternatives		**14**	**12**	
Gold	PHAU LN	4	0	0.39
Oil	WEL5 GY	2	0	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	**8**	**0**	0.15
Total		**100**		**0.21%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2025 YTD	2.9%	2.0%	1.0%
Since inception(1/1/2015)	113.5%	103.7%	9.9%
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.