General Update

JANUARY 2024

We build and maintain portfolios for clients which address their specific needs

Baggot is a Central bank regulated investment manager. We specialize in designing and monitoring investment strategies that are built using global investment products and assets. Where almost all financial advisors and brokers would simply refer your business to a large external manager, in return for a commission, we use in-house expertise to actively manage your assets.

We offer Investment strategies across various risk profiles. In many cases, we build portfolios in-line with our client's specific needs (CGT focus, Income focus, etc.).

As a principle at Baggot, we do not charge upfront fees or expose our clients to lock-up periods. You can add or withdraw funds at any time and switch between strategies at no extra cost.

If you would like a review of your current investment strategy or to discuss future investment opportunities please contact us.

Call 01-699 1590

Peter Brown
Managing Director

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01.

Portfolio Performance

Before getting into our product returns it should be noted that return numbers include all charges, which is not the case for our peers. Our peers show you returns before taking account of all charges. If we reported our returns before accounting for all charges, our returns look significantly higher than our reported numbers.

BMA 4, our medium risk multi-asset product posted a return of 2.49% including all charges, in Q4 and 9.39% for 2023. The benchmark Irish Life MAPS 4 posted a gain of 4.92% in Q4 and 9.97% for 2023. BMA 4 underperformed the benchmark by - 2.43% in Q4 and – 0.58% in 2023. Looking further back, BMA 4 beat the benchmark by about 9.5% between January 2020 and the end of 2023. A four year period. Conservatively taking account of all charges and costs in the way we do at Baggot, BMA 4 would likely be somewhere in the ballpark of 16% outperformance during the prior four year period. An astonishing level of outperformance for a medium-risk portfolio strategy.

BMA 5, our multi-asset product with a medium-high risk profile posted 0.94% returns in Q4 and 11.19% for 2023. The benchmark Irish Life MAPS 5 posted a gain of 6% in Q4 and 11.19% for 2023. BMA 5 underperformed the benchmark by 5.06% in Q4 while returns for the year were in-line.

BMA 6, our multi-asset product with a high-risk profile, posted a 2.16% return in Q4, bringing returns for 2023 to 16.53%. The benchmark Irish Life MAPS 6 posted a return of 6.53% in Q4 and 13.73% in 2023. BMA 6 underperformed the benchmark Irish Life MAPS 6 by 4.37% in Q4 but outperformed it by 2.8% for the full year. Since the start of 2022, BMA 6 has beaten the benchmark by 23.05%! That is not a typo.

BEI, our global equity income focused product (medium-high risk profile) gained 4.4% in Q4, bringing YTD returns to 5.53%. The benchmark Setanta Equity Dividend Fund gained 3.55% in Q4 and 5.75% in 2023. BEI outperformed the benchmark by 0.85% in Q4 but underperformed the benchmark by – 0.22% in 2023.

BME, our higher risk profile equity focused product posted a gain of 7.01% in Q4, bringing returns for the full year to 12.62%. The benchmark MSCI World gained 6.8% in Q4 bringing YTD returns for 2023 to 19.24%. BME outperformed the benchmark by 0.21% in Q4% and underperformed by – 6.62% in 2023. From a manager's perspective, if you want beat your benchmark on an annualised basis, you have to be willing to deviate strongly from it when you have conviction in your view. Keep in mind that BME has outperformed the benchmark by 7.03% over the last 2 years.

Before I move on, I'd just say that the five portfolios mentioned would be our more popular investment portfolios but we do have others that have been tailored more to the specific needs of some clients. For any further information contact pbrown@baggot.ie.

02.

Market Returns Summary

Q4 Asset Class Returns

AAsset class return numbers noted below are all based in Euro denominated terms. Data taken from unhedged (currency) European UCITs ETFs, which include costs as well as dividend payments.

For perspective when comparing returns, the EURUSD gained 4.5% in value in Q4 and 2.23% in 2023.

Equity Returns (Euro denominated returns)

Q4 Leaders

Q4 Leaders: MSCI Latin America, NASDAQ 100, German DAX.

Q4 Laggards

Q4 Laggards: MSCI China A Shares, FTSE 100, Vanguard FTSE EM.

Q4/YTD Equities Performance (Euro denominated returns)

S&P 500

7.0% / 21.5%

NASDAQ 100

9.8% / 49.5%

Euro Stoxx

8.6% / 22.8%

German DAX

8.8% / 19.5%

Stoxx Europe 600

6.7% / 16.0%

FTSE 100

1.7% / 9.8%

MSCI EM Asia

2.3% / 3.7%

Vanguard FTSE EM

1.7% / 4.1%

MSCI China A Shares

-8.3% / -14.9%

MSCI Japan

3.3% / 15.6%

MSCI Word

6.8% / 19.2%

MSCI Latin America

12.5% / 27.8%

MSCI India

6.9% / 15.6%

MSCI Asia Pacific ex-Japan

3.2% / 3.0%

Bond Returns (Euro denominated returns)

Q4 Leaders

Q4 Leaders: EM Bonds, European Inflation Linked Bonds and European Investment Grade Ultrashort dated Bonds.

Q4 Laggards

Q4 Laggards: Global Aggregate Bonds, 10+ Year Treasury Bonds and US Inflation Protected Bonds.

Q4/YTD Bonds Performance (Euro denominated returns)

US 10+ Year Treasury Bond ETF

8.2% / -0.7%

German 10+ Year Bund ETF

12.6% / 7.3%

EM Bond ETF

5.0% / 6.6%

Europe Aggregate Bond ETF

6.5% / 7.0%

US Inflation Protected Bonds

0.4% / 0.2%

Global Aggregate Bond ETF

3.6% / 2.1%

Europe Inflation Linked Bonds

5.3% / 5.9%

Europe Investment Grade Ultrashort dated Bond ETF

1.1% / 3.4%

Q4 Precious Metals (Euro denominated returns): Q4/YTD

Gold

6.4% / 9.5%

Silver

1.4% / -4.7%

03.

Central Banks, Inflation and Interest Rate Policy

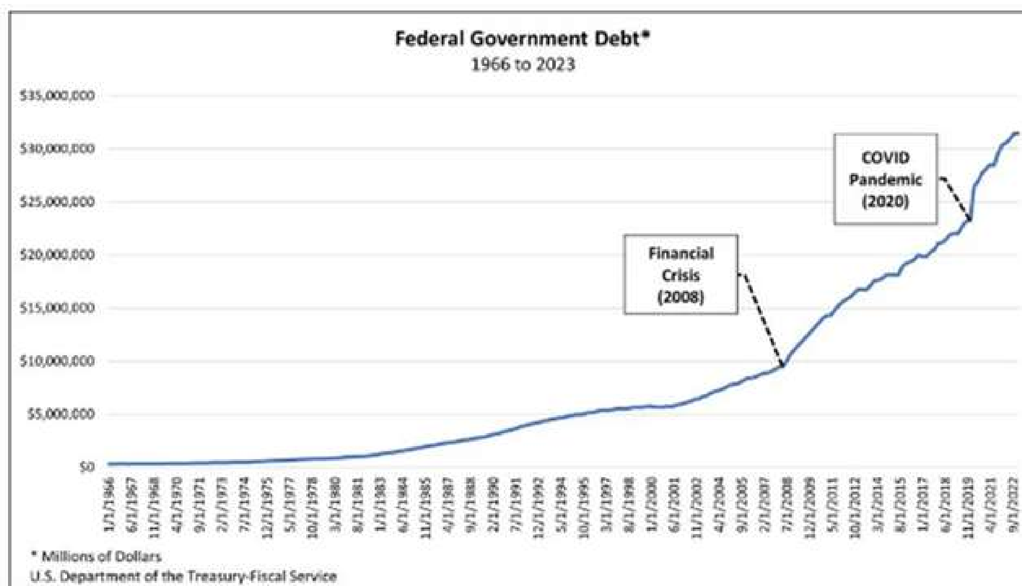
We're always more focused on the US than other western world economies because we are global investors and the dollar is the reserve currency of the world, so US inflation and interest rate policy (almost always) has the largest impact on the global economy. Also, we have maintained for quite some time now, that the US was the first major developed country/region into the interest rate hiking cycle and that we believed they would be first out of the cycle. In our last quarterly report we noted that the US Federal Reserve (The Fed) had recently paused their rate hiking cycle but that we felt there was no indication they would change course or begin cutting interest rates because inflation had not returned to their target of 2%. As recently as late September the Fed were continuously making statements which included the term "higher for longer", meaning US interest rates would stay higher for longer.

On December 1, everything changed. Chairman Powell gave a speech which made it abundantly clear that the Fed were signalling that they are finished hiking interest rates. At that time US equities and bonds exploded to the upside and the US Dollar sold off. Since then, markets have discounted the first interest rate cut in March of this year and a total of 5.5 interest rate cuts in 2024! We are somewhat puzzled by the very quick shift in their stance because inflation is still well above their stated 2% target, currently 3.4%. Also, since July of last year the rate of inflation is no longer trending down, and last but not least, the rate of inflation has surprised (relative to consensus) in the upside in 3 of the last 5 months. See the image below of the US Consumer Price Index over the last year.

Release Date	Time	Actual	Forecast	Previous
Jan 11, 2024 (Dec)	08:30	3.4%	3.2%	3.1%
Dec 12, 2023 (Nov)	08:30	3.1%	3.1%	3.2%
Nov 14, 2023 (Oct)	08:30	3.2%	3.3%	3.7%
Oct 12, 2023 (Sep)	07:30	3.7%	3.6%	3.7%
Sep 13, 2023 (Aug)	07:30	3.7%	3.6%	3.2%
Aug 10, 2023 (Jul)	07:30	3.2%	3.3%	3.0%
Jul 12, 2023 (Jun)	07:30	3.0%	3.1%	4.0%
Jun 13, 2023 (May)	07:30	4.0%	4.1%	4.9%
May 10, 2023 (Apr)	07:30	4.9%	5.0%	5.0%
Apr 12, 2023 (Mar)	07:30	5.0%	5.2%	6.0%
Mar 14, 2023 (Feb)	07:30	6.0%	6.0%	6.4%
Feb 14, 2023 (Jan)	08:30	6.4%	6.2%	6.5%

Just because the market is pricing in interest rate cuts this year, does not mean it will happen and we do not see how that could be possible given the current economic landscape. Employment is strong and the economy is currently in decent shape. Usually interest rate cuts happen when the economic data is poor and we don't see how economies can weaken dramatically with all of the fiscal stimulus around (not just in the US, but also in Europe).

I don't usually care about why central banks do what they do, I only care how their actions affect our clients' portfolios. The most important lesson I have learned in my 30 year career is that you should never fight the central bank in your investing framework. If they want to tighten financial conditions, invest according to that playbook and if they want to ease financial conditions, invest according to that playbook. Ultimately I think it is pretty clear that if the Fed want to back off now with an election coming, inflation so far above their stated target and the economy in great shape, what they are telling us is - that if there is no recession (the one people have been calling for, for the last 18 months, which has not happened) they will not hike interest rates.....and if there is a recession, they will cut interest rates a lot. So what does that mean? It should be a negative for the US Dollar, it should benefit US companies that have been hurt by the higher interest rate environment over the last 2 years (small and mid-cap companies), it should benefit commodities and it should be very supportive of emerging markets. A weak US Dollar could also be a trigger for foreign capital to leave the US for other developed markets (the most obvious candidate is Japan). I cannot see how it can be supportive of longer dated US government bonds, given the size of the deficit.



Especially not with inflation around 3.4% and US long duration bonds currently yielding 4.1%. Subtract the rate of inflation from the yield and your real yield is 0.7% annually. In fairness, that's a much better proposition than it was two years ago when your real yield on US long duration bonds was – 5.5%, but it is no bargain.

Reported inflation in Europe is 2.9% now, off a low of 2.4%, which has given the ECB an excuse to halt interest rate hikes. Lagarde signalled this week in a Bloomberg interview that the 2% inflation target is within range and that interest rate cuts could be possible by summer, but that the ECB is "data- dependant and that there is still a level of uncertainty and some indicators that are not anchored at the level where we would like to see them."
Will there be a recession in the US and or Europe, or not? Who cares? Answering that question is not going to make you any money. The big question that matters is whether we will have an inflationary future or not. Everything already pointed to an inflationary future before you brought war-time spending into the mix. Last quarter I was highlighting that every time I look at the news, Biden (and his European pals) are writing another $100 Billion cheque for war. I highlighted this article;

"WASHINGTON, Oct 17 (Reuters) - U.S. President Joe Biden may consider a supplemental request of about $100 billion that would include defense aid for Israel, Ukraine and Taiwan, multiple sources familiar with the request told Reuters on Tuesday."
Source: https://www.reuters.com/world/biden-considering-100-bln-funding-request-that-includes-israel-ukraine-aid-2023-10-17/

Now there is a new reason for the west to burn cash in the Red Sea. See this snippet from Politico; "The standoff between Houthis and Western navies reflects a new type of warfare that is not sustainable in the long run, with sailors having to deploy ultra-expensive missiles to knock out cheap drones. "The cost offset is not on our side," one official from the U.S. Department of Defense said last month."
"For example, the French Languedoc frigate last month used €1 million Aster 15 surface-to-air missiles to shoot down Iran-made Shahed-type drones, likely used by the Houthis that cost about €20,000 at most, creating a growing budgetary impact for those trying to keep the peace."
Source: https://www.politico.eu/article/red-sea-crisis-means-practice-cost-expensive-fuel-missile-yemen-houthi-israel-hamas/#

Sounds like an excuse to do more fiscal spending doesn't it?

Here's another headline;

"UK Has Run Out of Weapons to Send to Ukraine: Senior Official"

Source: https://www.telegraph.co.uk/world-news/2023/10/02/britain-run-out-of-arms-send-to-ukraine-says-military-chief/

Sounds like an excuse for the UK to replenish their stockpiles? Another country that has an excuse to do more fiscal spending.

All these countries need to borrow money in order to generate the funds necessary to do the spending. That's inflationary.

I'm only talking about military spending as well.

04.

The World Changed in 2020

A lot of what I've written in this next section comes from a recent Forward Guidance Podcast with Kevin Muir, publisher of The Macro Tourist newsletter, which is excellent. I haven't quoted him word for word and a lot of my own thoughts are added into what is written but its close enough to what you will hear in a portion of the podcast link below to make it clear. I want to give credit where credit is due. I've put this paragraph in italics so that it is clear what part of this update came from the podcast.
https://open.spotify.com/episode/2nWbTboYdUX4TvSeCwGd6q

The world changed in 2020. Every time we had an economic contraction or crisis of some kind, governments tried to fix them with lower interest rates. In 1982 interest rates were cut from what, something like 15% down to 7%, then the next cycle rates rise to something like 10%, then in the next cycle they cut interest rates down to 4%. It was this series of lower highs and lows for interest rates. They were using monetary stimulus to fix the economy, but it was taking lower and lower interest rates with each successive economic contraction/crisis to have the same impact. It comes to 2008 and we get to 0% interest rates and we find out monetary stimulus doesn't work like we think it does.

We find 0% interest rates aren't low enough to generate recovery, so they come up with these ways to synthetically create the effect of having interest rates below zero (Quantitative Easing) and they don't work as well as everyone expects they will. Weird things happen, like long duration government bonds trading at interest rates that are below 0%, meaning investors are now paying government borrowers to lend to them. It also has this effect of penalizing savers and rewarding reckless borrowers. It forces people to take more risk to get a return on their money which pushes valuations in the few sectors of the economy that do benefit from that environment, up to insane levels.

So then covid comes along and all of the sudden we rediscover fiscal stimulus and we go absolutely bonkers with it and do so much of it. In Europe we print money and give it out to people who cannot work due to lockdowns. We give businesses special loans with freshly printed money. In the US they just print money and hand it out to everyone. The US prints Trillions for the Inflation Reduction Act (the name is a big fat lie, it should be called the Inflation Creation Act). Clearly that fiscal stimulus is way more powerful than people expect and it has more of a lasting effect than everyone previously thought it could have. So when you see that interest rates are so much higher than they were few years ago and you wonder why western economies are doing so well, this is why. As long as governments don't care about deficits, they can just print money and spend it in the economy. Always remember that when the government issues debt, which is what the deficit is (a big pile of IOUs), yes that is a government liability, but it is also a credit for the economy. It's easy to forget that. I think this is why western economies are doing so well in spite of significantly higher interest rates and that can continue as long as the political will is there to continue down that path and interest rates are lower than the rate of economic growth is.

Back to my own thoughts; I'm not endorsing this behaviour, I don't really care, I just want to protect our investor's capital and generate returns for them in excess of what they can get elsewhere. This is just the way the world works now and it is an inflationary one. If you are operating on the basis that the world is the same as it was between 1982 and 2020 and these last few years are just a blip on the radar before interest rates go back to zero, that's a different investing template than one that will flourish in the world we live in today. Longer duration Bonds did very well in that environment; whenever the economy contracted during that era and equities went down, long duration Bonds saved your portfolio, they went up in value. Today long duration Bonds are the enemy. If you disagree with me, let me ask you how your 60% Equities/40% Bond portfolio has done for you over the last two years? 2022 was the worst year in history for 60/40s! What worked between 1982 and 2020 is not going to work in the current environment which looks much more like the period that existed between 1968 and 1982. In an inflationary environment where governments are willing to run large deficits in order to do fiscal spending, portfolios more focused on Value Equities, Commodities and Equities in that space, Cyclicals, Industrials, those are the things that work. And where you have to hold Bonds, you want to be focused on ultra-short duration Bonds/T-Bills because they track inflation better over time for the investor. I'll give you an example. If you buy a 1 month T-Bill with a 5% interest rate. In one month you get your money back with interest.

If the interest rate rises between now and next month to 5.25%, you can buy another one month T-Bill and earn the higher interest rate. Compare that to someone who buys a 10 Year Bond with an interest rate of 5%. Let's say interest rates go up to 10% in five years. You're still only getting 5% interest, while the one month T-Bill owner is getting 10%. Sure, it sounds crazy, interest rates going to 10% in five years, but if I told you in 2007 that interest rates would eventually go to zero, that would've sounded pretty crazy too. The world has changed and if you don't invest accordingly, your returns will be poor.

05.

Weaponized of the Dollar (and the Euro)

Let's not forget that there is another inflationary factor here which we have been highlighting for some time now. All this fiscal stimulus is funded by debt that is denominated in Dollars and Euros which has been weaponised. I'm not making a political statement here and I'm not standing up for Putin or Russia. I'm just stating important facts which affect the financial wellbeing of our clients....So Russia invades Ukraine and the West decides that they can confiscate Russian assets that are sitting in Western banks. Not only Russian government assets but it went further than that, they confiscated private Russian assets as well. The rest of the world took notice. The Chinese, the Saudis, India, etc, are thinking – what do you mean you can confiscate my assets if you don't like what I am doing? I mean today it might be Russian assets you are confiscating because they went into the Ukraine, but tomorrow it could be another country (or citizens of that country) whose assets you seize because they aren't woke enough or because they don't have the same moral code as you.

The US weaponised the reserve currency of the world. America consume many more goods and services from these countries than they export to them and consequently the US runs large trade deficits. Historically you buy stuff from China or Oil from Saudi Arabia (everyone needed Dollars to buy Oil, not just Americans), etc and they would take those Dollars and buy safe US assets (mostly US Treasury Bonds) with that money, thereby funding the US deficit. This ensured that there would always be demand for US debt. That game is ending. These countries are now setting up deals to exchange their goods and services to each other in their own currencies. This is really good for Emerging Markets (EM). Let's say you are India and you sell steel to Brazil in return for Brazilian Real. What do you do with the Brazilian Reals? You probably buy Brazilian Government Bonds. Now that is a very simplified example, but the point is, that these countries have taken notice. They do not like the weaponisation of western currencies and they are doing trade deals to cut Dollars (and other western currencies) out of the mix. I cannot stress enough how important of a change that is or how inflationary that is for the western world! Markets have been taking notice as well.

Just look at the difference in performance between Emerging Market Government Bonds and Western Government Bonds last year. It is staggering! Generic EM Government Bond ETFs have dramatically outperformed US & European Government Bond ETFs of similar maturities over the last 2 years. My favourite EM Government Bond Fund, the T Rowe Price Emerging Markets Bond Fund (Euro share class) has an average maturity of roughly 10 years, so very similar to US 10 Year Treasuries or German Bunds in terms of maturity. This fund gained 13.7% last year. What's even more interesting is that this fund has a risk profile of 3.

Risk Rating	Volatility Ranges	
	Equal to or above	Less than
1	0%	0.5%
2	0.5%	2%
3	2%	5%
4	5%	10%
5	10%	15%
6	15%	25%
7	25%+	

US 10 Year Treasuries used to have a risk profile of 2. Now because volatility has increased so much in the last 2 years, the risk profile in US Treasuries is more like a risk profile of 5.

People forget that central banks only control the interest rate at the front of the yield curve. They do not control interest rates in longer durations. The market dictates interest rates in longer durations. The US and some other western nations are running huge deficits and have bitten the hand that finances them (via bond purchases) by weaponising their currencies. Now these buyers are not showing up at Government Bond auctions like they used to. How does this get compensated for by the Bond market? Interest rates at the longer end of the interest rate curve will ultimately have to rise to a level that sufficiently compensates the holder for taking the risk. That's how.

06.

All Roads Lead to Inflation

Now add into this tinder box the fact that Western governments are spending money they do not have, like crazy, during a time when we are not even remotely close to recession type conditions. If they are spending money like that now, what do you think they will do if we actually do have a recession? They'll spend twice as much money, they'll run even crazier deficits and if there is nobody to buy the bonds they'll issue to fund all this spending, they'll just ramp up the printing presses again. They'll do Quantitative Easing again – print money to buy their own bonds, which keeps longer term financing rates down, but also trashes the purchasing power of money. In our humble opinion, all roads in the west lead to inflation. In my view it is much riskier to have lots of cash than it is to own commodities and hard assets because you have this finite supply of assets that are valued in infinitely printable currency which is getting printed in ever increasing volumes.

It's not all bad though. Government issued debt is a government liability, but that liability is someone else's credit. Think about it; Biden does the Inflation Reduction Act (Should have been titled the Inflation Increasing Act because that is what it does – it increases inflation). The estimated cost of this bill is $1 Trillion Dollars. Much of this money goes to climate change initiatives, which ends up in the private sector. This act is very supportive of the hard assets/commodities that will be needed to decarbonise the US economy. Never mind that it is a bit of a farce. $4 Trillion has been spent in the last decade on Solar, Wind and other green initiatives. During that same period the world has gone from being 83% dependent on fossil fuels to 81% dependent on fossil fuels! This was during a period of mostly benign inflation as well. If they had spent that money on nuclear power (zero carbon emissions) instead, energy costs would be significantly lower now and the world would be far less dependent on fossil fuels. I digress.....The point is that government liability (debt issuance) is a public credit and this public credit makes its way into corporate balance sheets, wages, commodities, etc and this creates opportunity for savvy investors.

07.
Bonds

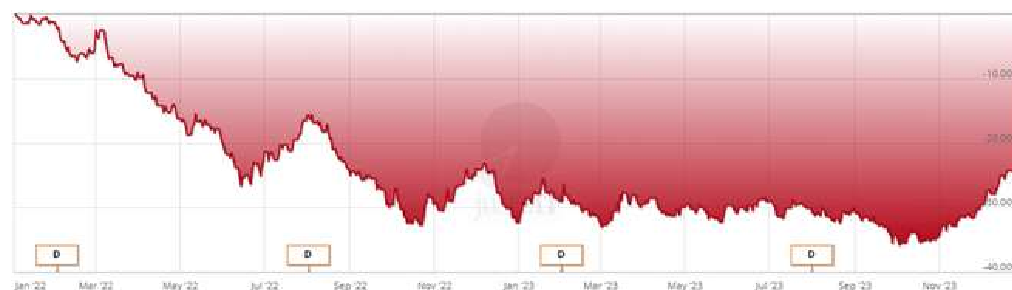
In our medium to low risk multi-asset products we have to hold euro denominated bonds in order to decrease the overall risk level of the investment product in question. In those investment products we have favoured investment grade, ultra-short duration bonds over long duration bonds, since before the rate hiking cycles began in the US and Europe. This is a stance that has served us very well. Our position gained 3.46% in 2023.

For perspective, let's take a look. Since 2022 was the worst year in modern history for western government bond markets, we'll look at total returns (%) from Jan 2022 through Dec 2023. The "D" at the bottom of the images shows where dividends have been paid. The % return does take account of these dividends in performance. Hence the term "total return".

Here's our position, the Ultra-short dated European Investment Grade (0 - 1 Yr fixed and 0 – 3 Yr floating rate);

For the period of 24 months, it has gained a total return of 3.10%. At the absolute worst point during the period, it was down - 0.93%. Performance bottomed right around the time the ECB began hiking interest rates in the autumn of 2022.

Here is the Bloomberg 10+ year European Government Bond ETF for the same period;



For the period of 24 months, it has had a total return of – 25.3%. At the absolute worst point during the period, it was down – 35.81. That's the steep price you pay for doing irrational things (like lending governments money at negative interest rates).

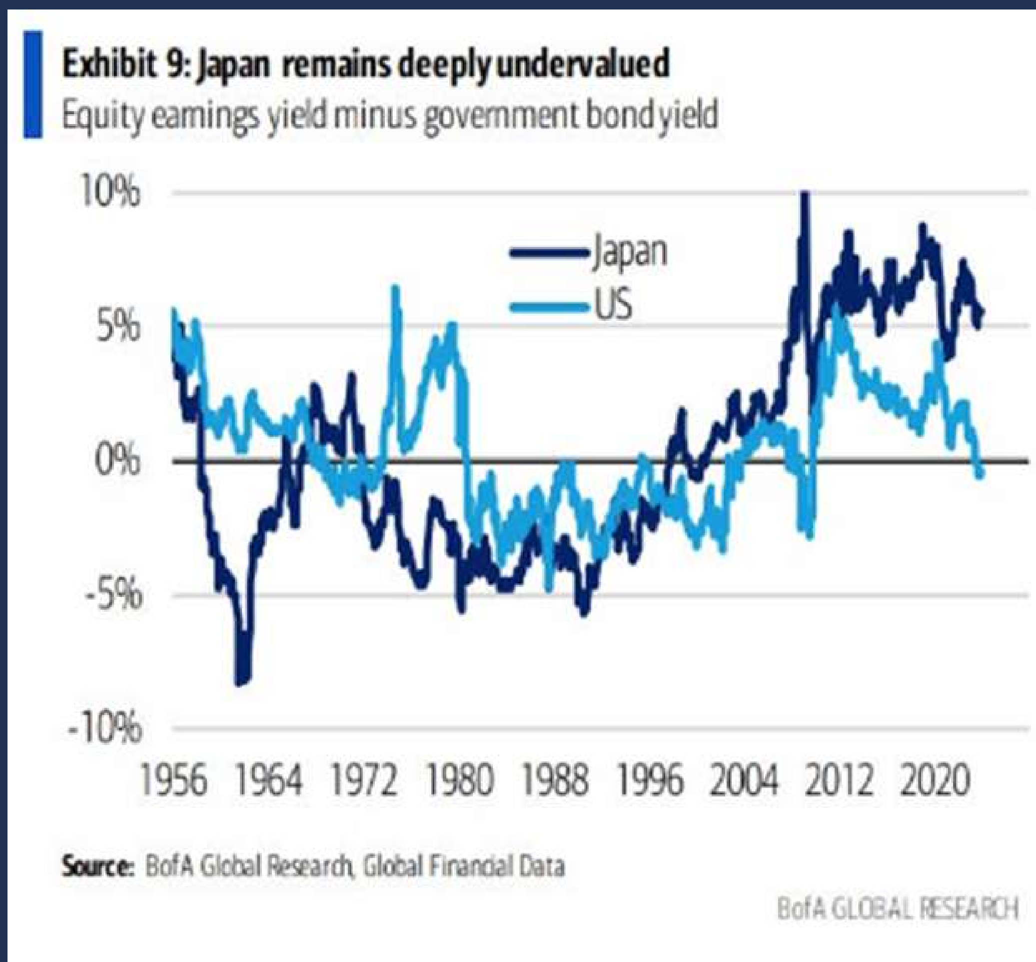
Here's our position for the full year 2023;

It gained 3.46% for the full year 2023. It isn't fully compensating us for inflation but our returns caught up with the rate of inflation faster than pretty much anything else you can own in the European Bond world, and it sure as heck beats sitting on deposit with an Irish Bank earning 0.5% (Don't confuse this with a fixed term deposit where you can get 3% to lock your money up for two years. Our position has no fixed term. We can exit tomorrow if we so choose). Keep in mind these bonds have a very low risk profile.

At some point long duration bonds will be investible again, when real rates (the difference between inflation and interest rates) are sufficiently positive again. Until then (contrary to what western governments would have you believe with their ex-food, ex-energy inflation reporting), in our view, there is absolutely zero incentive to take on the risk of lending money to governments or corporates on longer term time horizons. At this moment in time if we were going to move out the risk profile spectrum in the bond portion of our multi-asset portfolios, we would be looking at Emerging Market Bonds where real rates are high and inflation rates are generally coming down.

08.
Equities

From a longer term perspective we remain bullish on value equities. Particularly those with exposure to commodities. We continue to be bearish the Dollar and pretty much all other western world currencies, due to reckless fiscal policies and the weaponisation of the Dollar and other western currencies (which we've already spoken about in this piece). A weaker Dollar is usually good for global trade, so we continue to favour non-US equities, particularly Emerging Markets. Within Emerging Markets we find India and Latin America to be the greatest long term opportunities. Among Developed Markets, we like Japan a lot.



The group of stocks known as the “Magnificent 7” which includes Apple, Microsoft, Amazon, Nvidia, Alphabet (Google), Tesla and Meta (Facebook) makes up nearly 30% of the S&P 500 index. That group of stocks trades on an avg P/E ratio of 46! If you buy that group of stocks you are paying 46 years’ worth of current earnings for it today. Paying a high price for something isn’t always a bad thing. You have to look at the price of a company relative to its growth rate to see if there is any real value on offer or not. If you buy a company at 50x earnings but it is growing at 150% then it is cheap relative to its growth rate. If you pay 50x earnings for a company growing at 25% then it is expensive relative to its growth rate. India for instance, trades on a high valuation, but it’s worth it because it is growing rapidly (By 2027 the IMF predicts that India will be the world’s third largest economy). Most pensions and other passive general investment schemes have the largest equity exposure in these stocks for no good reason. US equity indices have the largest market cap in the world, so they get the highest allocation for that one reason alone. Price is what you pay, but value, (or lack thereof) is what you get. When you pay a lower price for something, there is a higher margin of safety built into the investment.

Let’s look at one example, of many. The MSCI Latin America trades on a P/E of 9.35 and pays a dividend yield of 5.75%, and let’s not forget that inside a pension wrapper that dividend income is tax free.

INDEX PERFORMANCE — GROSS RETURNS (%) (DEC 29, 2023)									FUNDAMENTALS (DEC 29, 2023)			
					ANNUALIZED							
	1 Mo	3 Mo	1 Yr	YTD	3 Yr	5 Yr	10 Yr	Since Dec 31, 1987	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI EM Latin America	8.38	17.76	33.54	33.54	10.50	6.58	2.51	13.42	5.75	9.35	9.24	1.73
MSCI Emerging Markets	3.95	7.93	10.27	10.27	-4.71	4.07	3.05	9.51	2.90	14.54	11.74	1.63
MSCI ACWI	4.84	11.15	22.81	22.81	6.25	12.27	8.48	8.10	2.03	19.81	16.57	2.82

Source: https://www.msci.com/documents/10199/5b537e9c-ab98-49e4-88b5-bf0aed926b9b

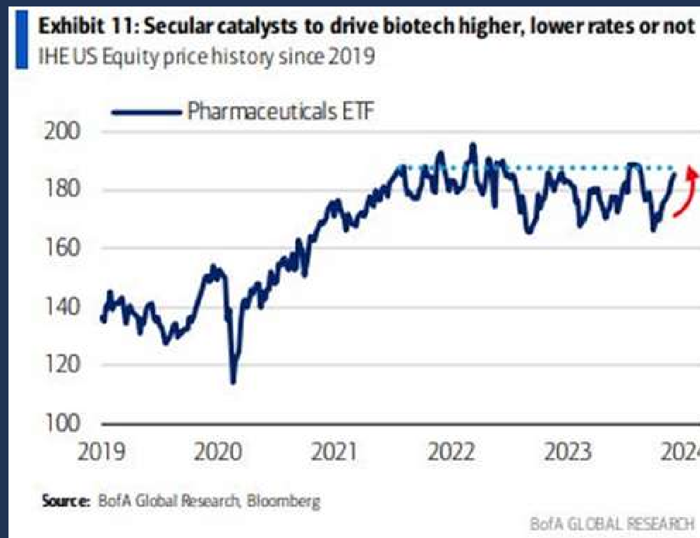
The MSCI USA Index trades on a P/E of 24.88 and pays a dividend yield of 1.44%. We would much rather have exposure to Latin America than we would the US right now.

INDEX PERFORMANCE — GROSS RETURNS (%) (DEC 29, 2023)									FUNDAMENTALS (DEC 29, 2023)			
					ANNUALIZED							
	1 Mo	3 Mo	1 Yr	YTD	3 Yr	5 Yr	10 Yr	Since Dec 31, 198[illegible]	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI USA	4.71	11.95	27.10	27.10	9.13	15.74	11.98	11.00	1.44	24.88	20.07	4.54
MSCI World	4.94	11.53	24.42	24.42	7.79	13.37	9.18	8.28	1.93	20.69	17.40	3.09
MSCI ACWI	4.84	11.15	22.81	22.81	6.25	12.27	8.48	8.10	2.03	19.81	16.57	2.82

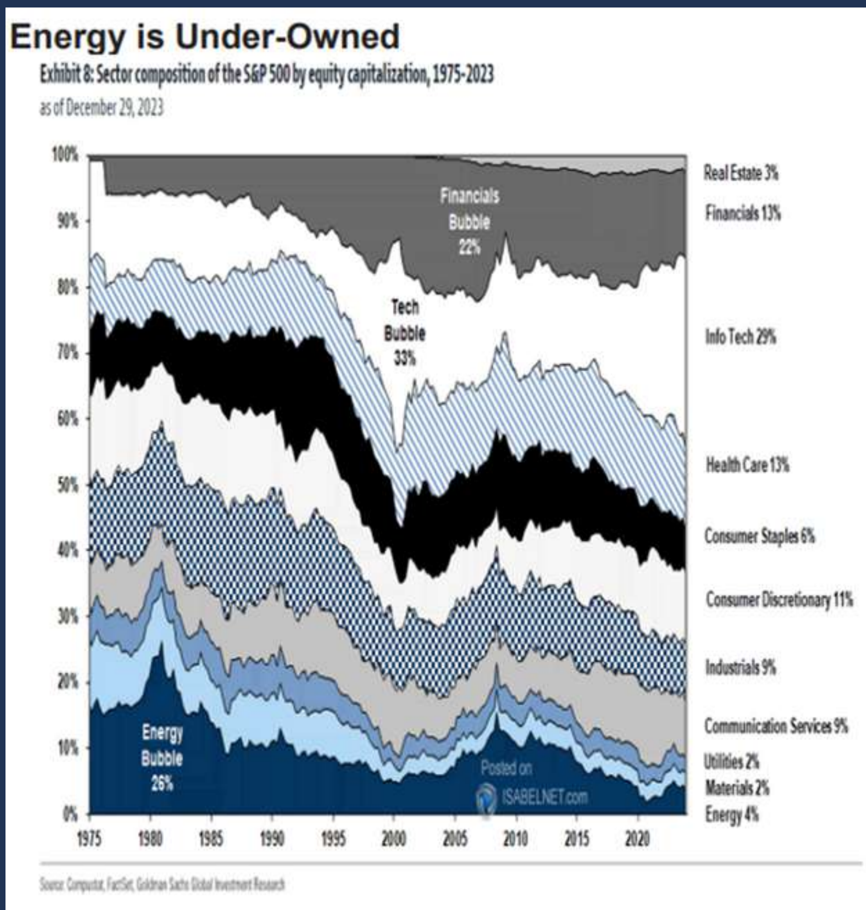
Source: https://www.msci.com/documents/10199/67a768a1-71d0-4bd0-8d7e-f7b53e8d0d9f

You basically get 2.7 units of the MSCI Latin America, for the price of one unit of the MSCI USA. There's also the added kicker that Latin America index has exposure to assets that tend to do well during inflationary environments. This is most certainly not the case for the big US indices.

At the sector level we find Biotech (Don't confuse Biotech with the Healthcare and Pharma sectors) and Energy very attractive. We see both sectors as Value plays.



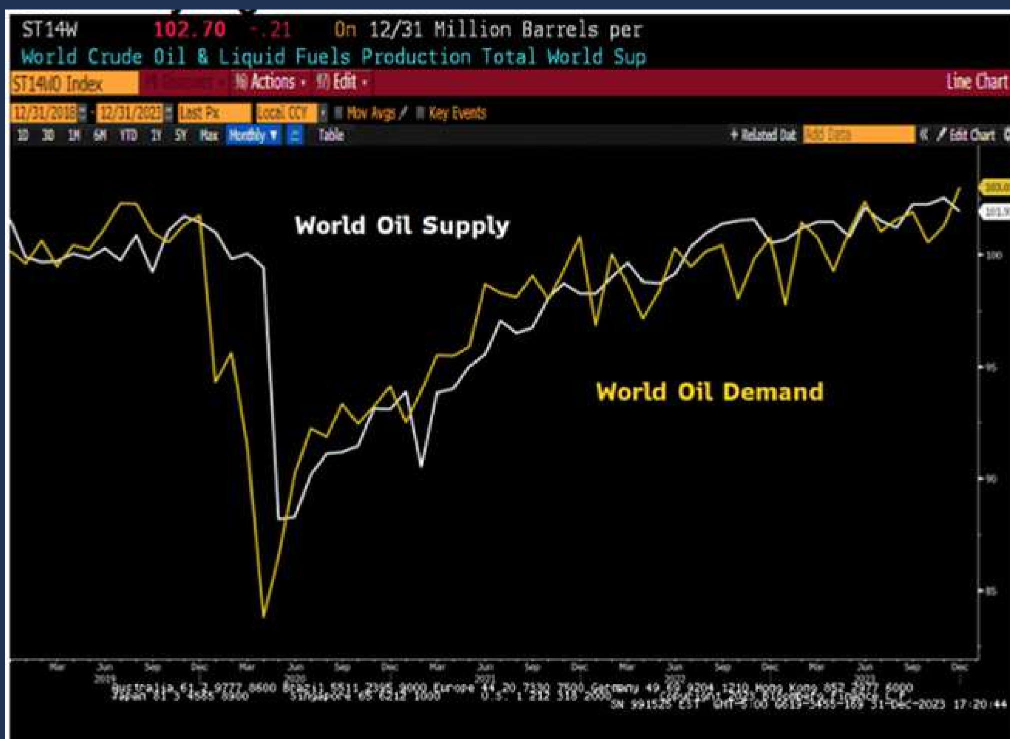
We find it incredible that the Energy sector is just 4% of the S&P 500 but it produces 10% of the S&P 500's profits.



Just so there's no confusion; Amazon, Google and Facebook (Meta) are not included in the Info Tech sector shown in the image above. They are in Consumer Discretionary and Communications Sectors. There is far too much Tech exposure in the S&P 500, which means there is far too much exposure to Tech in most standardized passively invested pensions and personal portfolios.

The Energy sector trades at around 10X earnings vs 22X earnings for the S&P 500, 28X earnings for Info Tech Sector and as noted above, 46X for the group known as the Magnificent 7.

We love the Energy sector. Global demand is at all-time highs;



The sector is generating record profits, using free cash flow to do buybacks (drives earnings per share higher) and it pays great dividends.

09.
Commodities

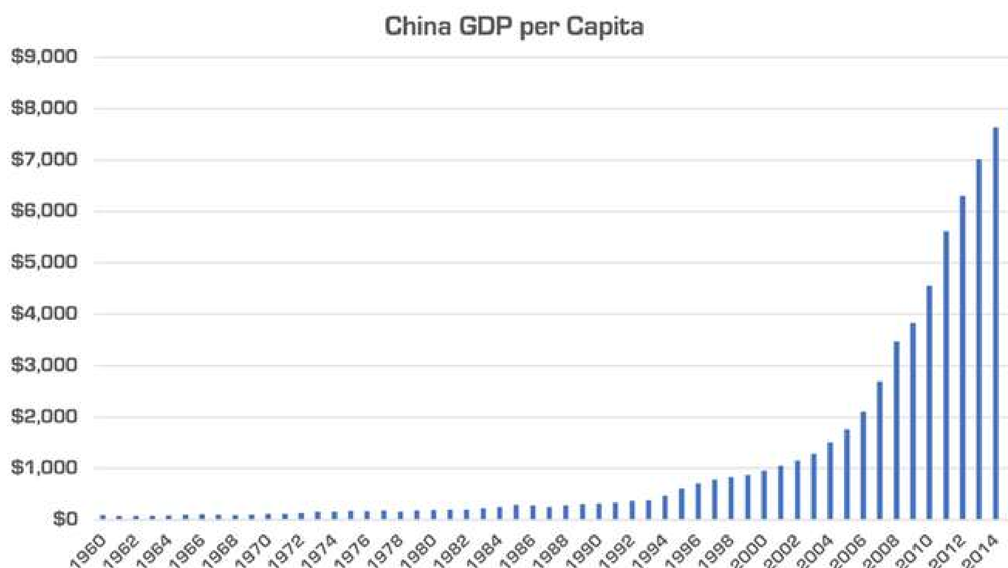
Regarding commodities we remain broadly very bullish from a longer term perspective for a few reasons. Firstly, almost all commodities are exceptionally cheap relative to Equities and Bonds. The image below plots the price of commodities as measured against the US stock market going back to 1900. When it is rising, commodities are outperforming equities and when it is falling equities are outperforming commodities. See this from Incrementum's once per year "In Gold We Trust" report (page 111 in the link posted under the image below);

"Now let's look at the performance of commodities relative to the stock market. Loyal readers know that the following chart has been by far the most-cited chart of the In Gold We Trust reports in recent years. It impressively shows that the relative valuation of commodities compared to equities remains historically extremely cheap and has just stabilized at this historically low level over the past few years. Compared to the S&P 500, the GSCI Commodity Index (TR) has barely recovered from its historical low of April 2020, and it has not yet been able to break out of the phase of extreme weakness since 2015. The ratio currently stands at 0.87, which is miles away from the highs and still well below the long-term median of 3.98."

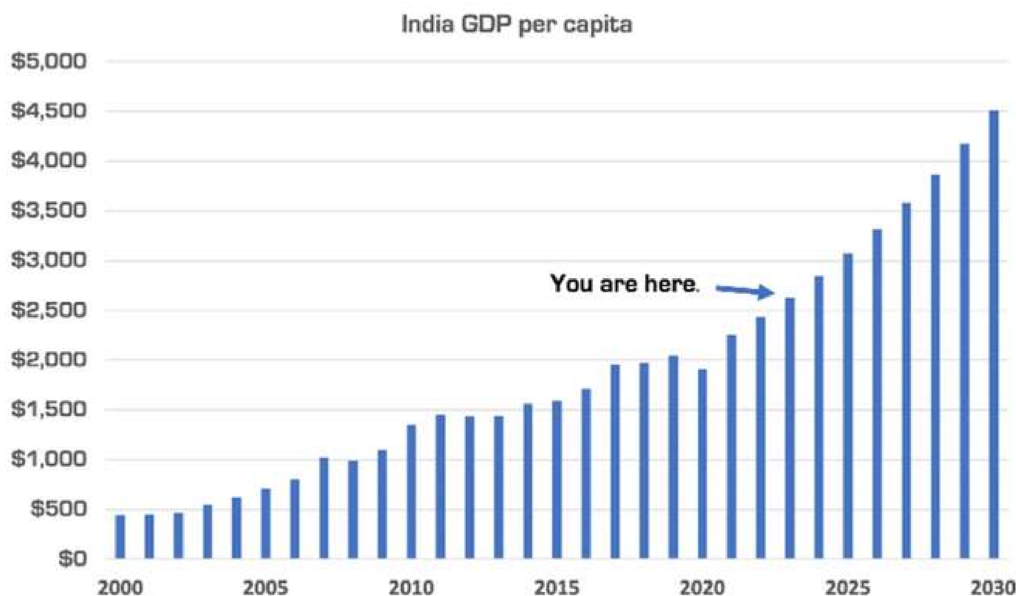
Source: https://ingoldwetrust.report/wp-content/uploads/2023/05/In-Gold-We-Trust-report-2023-english.pdf

Just because something is cheap does not mean it will rise in price but it does mean that you get a higher margin of safety built into the price. Also, the supply of a broad majority of commodities is constrained relative to longer term demand. Why? Because getting the stuff out of the ground is very capital intensive. Capital goes where it is treated best and before this interest rate hiking cycle began, nobody wanted to invest in capital intensive businesses when they could invest money in mega cap companies that could borrow money for nothing and use that money to buy back stock, synthetically driving stock prices higher. Before interest rates went up dramatically this phenomenon left many commodity companies out in the cold starved for capital. It takes years to turn a Copper, Cobalt, Nickel, Lithium, etc, deposit into a producing mine. You can't just press a button. There is a serious time lag. This virtually guarantees that there will be a shortage of supply of many commodities relative to demand in the coming years. Third, Dollar weakness is broadly supportive of commodities.

Another really important factor which we think will drive the commodity super cycle in a way that the world is unprepared for, is India. China drove the last commodity super cycle. As Chinese GDP per capita growth took off in the early 2000's, so too did demand for commodities. This makes total sense. As people become wealthier they consume more energy and commodities.



Around 2005, Chinese average GDP per capita had a big jump, crossing $2000 for the first time as 1.3 billion people joined the global economy. In inflation adjusted terms that equates to something around $3000 now.



Never in history has there been more people entering the energy intensive part of the economic development cycle. Fact! In the next couple years India will cross the Rubicon and 1.4 Billion consumers will join the global economy. We are going to see another commodity super cycle and the world is unprepared for it. The supply just does not exist because there hasn't been any capex. Commodities are very capital intensive, you can't just decide to build a Uranium, Copper, Lithium, Cement, etc, mine and expect new supply to come online in a year. It takes years to bring most of the commodities that all these new consumers will need to market. As you have seen with Uranium which we've had in portfolios for years now (it has doubled in price since our last bullish update in August), when you have little supply of something and huge demand for it, the only way the market can incentivize new supply to come to market is via dramatically higher prices.

10.

Conclusion

To conclude, we remain confident in the way our portfolios are constructed. Our multi-asset portfolios provide true diversification when you really need it, in an uncertain world.

Please do let us know if you wish to discuss your portfolio at any time.
We appreciate your faith and trust in us.

Kind Regards,
David Flynn
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