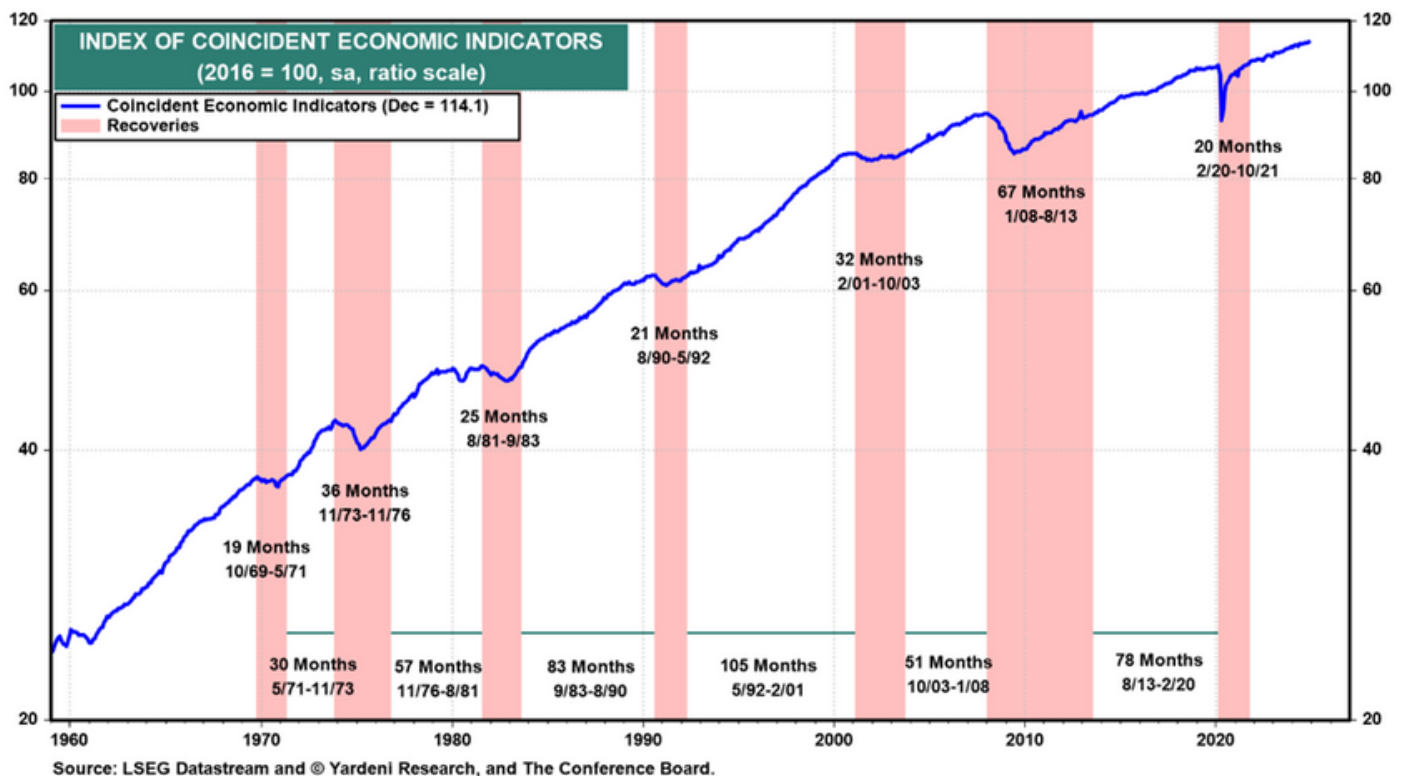


Market Matters - with Tom McGrath

Still feels like a Bull Market

There is a danger when you have to write a weekly overview of market matters that you can get myopically focussed on day-to-day market movements. Things shoot up, and you get tempted to profit take, or things sell-off, and they can look like a screaming buy. There are constant pressures to rebalance as market sentiment oscillates rapidly from bearish to bullish. After two stellar years, we have had a good start to 2025, and last week was another positive one for equity markets despite signs of inflation ticking up, leading me to think - is this not a good time to take some chips off the table? I am not alone in this thought as there is a growing sense of unease and questioning of valuations, as we have an unpredictable leader in the White House, and we could still be on the cusp of a global trade war, even as the President keeps delaying implementing tariffs. So, at times like these, it is worth pulling back and looking at the big picture and remembering the sage advice from great investors such as Charlie Munger, who said, 'The big money is not in the buying and selling but in the waiting'. So, with that in mind and before I summarise what happened last week, here is a big-picture view.

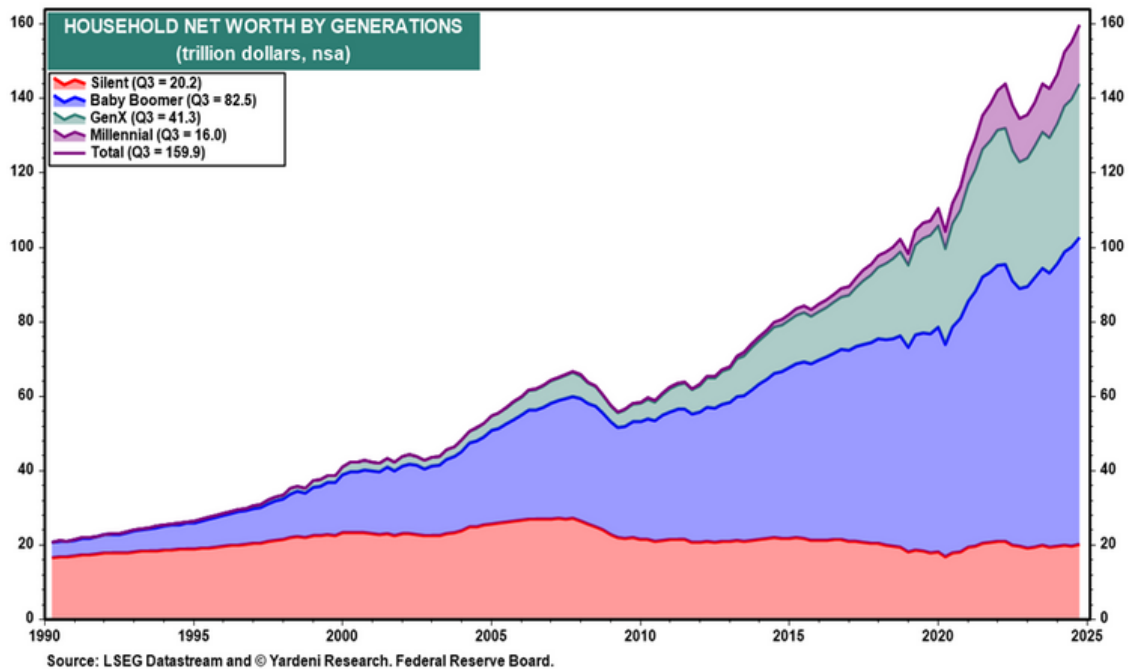
I remain convinced we are still in a bull market and are still nearer the start than the end. The resilience of the U.S. economy remains remarkable. Despite a period of aggressive monetary tightening, growth has continued, and the widely expected recession never arrived. Instead, the economy has expanded by 23.5% since mid-2020, with no obvious signs of slowing. If anything, this expansion could rival the long, steady boom of the 1990s and potentially extend well into the next decade. Remember, the most typical cause of a bear market is a recession.



For all the political noise in Washington, the U.S. economy has a way of pushing forward. Entrepreneurs continue to drive record levels of business formation, corporate America remains highly adaptive, and productivity gains through technology are compounding. The financial system is also far more robust than a decade ago. Since the Great Financial Crisis, markets have diversified, private capital has stepped in to absorb shocks, and the Federal Reserve has developed a playbook to contain crises before they spiral.

Technology remains a key driver of long-term growth. The AI revolution, far from being just another trend, is accelerating investment and reshaping how businesses operate. High-tech spending now accounts for half of all business capital expenditure, up from just 20% in the 1960s. Unlike previous cycles, this wave of technological change is happening against a backdrop of strong corporate balance sheets and access to deep pools of private and public capital.

Consumer resilience remains another defining feature of this expansion. Despite concerns about inflation and high interest rates, household wealth is at record levels, and interest income from savings is surging. The baby boomer generation, which holds nearly half of all household wealth, is set to spend down its assets in retirement, providing a steady tailwind for consumer demand. While not every segment of the economy is firing on all cylinders, the underlying trends suggest continued stability.

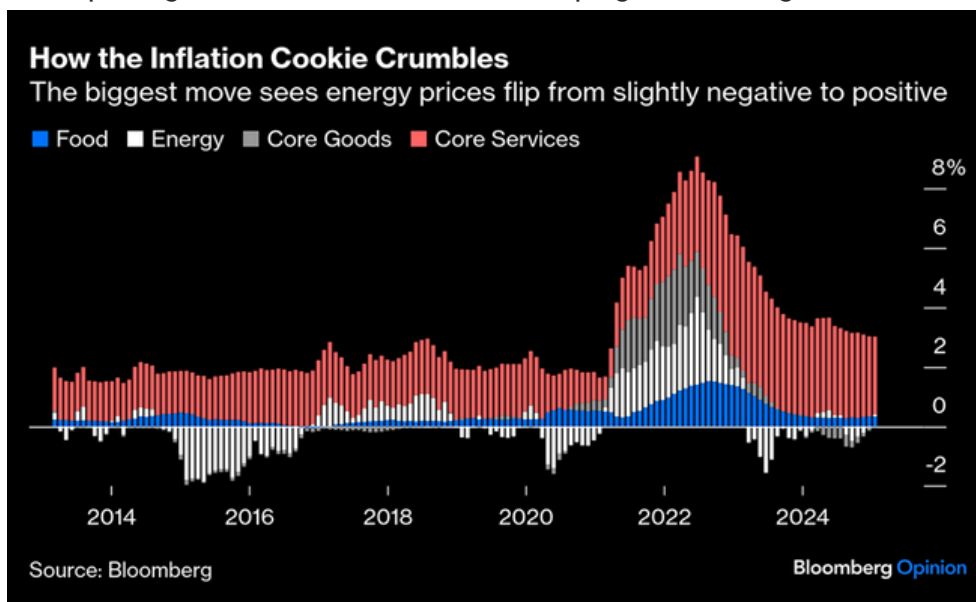


None of this means there aren't risks. Sticky inflation, policy missteps, and geopolitical developments could all challenge the current trajectory. However, the broader economic foundations remain sound. This is not a market running on euphoria but rather one underpinned by structural strength. The expansion still has momentum, and while volatility will come and go, the longer-term outlook remains positive. Stay patient and reap the rewards...

Last week...

Trump's press office must have been working overtime, flooding the wires with trade, geopolitics, and diplomacy in rapid succession. His latest 'reciprocal' tariffs plan remains a moving target—unclear in execution but clearly a shift toward bilateral deal-making. Meanwhile, Trump's ultimatum to Hamas appears to have worked, with the group now agreeing to release hostages. At the same time, Ukraine's Zelensky is meeting U.S. officials while Trump continues talks with Putin, underscoring the possibility of a broader deal taking shape. The sticking point could be over Ukraine's ability to join NATO at the end of the hostility, something Putin is unlikely to accept and one that Ukraine and Europe (including the UK) insist must happen. The U.S. believe it is a concession worth making to get the war ended. Over the coming weeks and months, this will undoubtedly become the big debate, and markets are twitching. However, looking at the move in Europe on news of Trump's call with Putin, they are twitching to move higher at the possibility of a 'peace dividend.'

U.S. inflation data took centre stage, with CPI coming in hotter than expected at 3% year-on-year, marking its highest level in six months and sparking renewed concerns that inflation progress is stalling.



The core CPI reading of 0.4% month-on-month was particularly concerning, driven by sticky shelter costs, healthcare, and a spike in prescription drug prices. Markets initially reacted with a sharp rise in Treasury yields and a reassessment of Fed rate cut expectations.

Looking past the initial shock, the latest inflation numbers don't look as alarming as the headlines suggest. Headline CPI nudged from 2.9% to 3.0%, while core inflation (stripping out food and energy) increased from 3.1% to 3.3%. Digging into the details, the main drivers were a shift in energy inflation from slightly negative to positive and a smaller-than-expected drop in core goods prices. Meanwhile, services inflation, the real trouble spot for the past couple of years, actually ticked down slightly. PPI inflation was also hotter than expected, but again it is more nuanced than that as key components that feed into the Fed's preferred PCE inflation measure, like healthcare and airline fares, were flat or lower. This suggested that pipeline inflation pressures aren't as severe as feared, helping bonds recover and easing immediate concerns about a more hawkish Fed.

However, we finished the week with expectations of only one Fed cut this year, and yet both the bond and equity markets seem to be relaxed about this significant change in the script. This makes me much more comfortable, as I thought the biggest threat to the US market this year would be the absence of rate cuts. I have argued for quite some time that the Fed has interest rates about where they should be. It remains to be seen if bond and equity markets would cope as well if they thought that there might be no rate cuts, or even (whisper it quietly) that the next move is going to be up, not down.

The UK economy continues to defy expectations, but not in a way that inspires much confidence. Last week's big surprise was that GDP actually grew by 0.1% in Q4 2024, narrowly avoiding a technical recession. That's a decent headline, but let's not get carried away. This is still a stagnation story rather than a turnaround. The Bank of England, which had already slashed its 2025 growth forecast to 0.75%, now looks a touch too pessimistic, but not by much.

The bigger issue for the UK remains its fiscal position. Chancellor Rachel Reeves is in a tight spot after the Office for Budget Responsibility (OBR) revised its growth forecasts, effectively wiping out the £9.9 billion in fiscal headroom she had in her October budget. That puts her cherished fiscal rules—balancing day-to-day spending with tax revenues—under serious pressure ahead of her budget statement on March 26. The options are unappealing: either make spending cuts or break her self-imposed rules, neither of which will play well politically.

Meanwhile, the Bank of England is walking a tightrope on monetary policy. Headline UK inflation has come down significantly, but the Bank clearly doesn't want to cut rates too soon. The unexpected growth in GDP may reinforce that view, keeping rates higher for longer. The 10-year Gilt yield has edged higher, reflecting the shifting market sentiment that rate cuts might not come as fast as expected. On the political front, the UK is watching the US closely, particularly on trade policy. Trump's talk of 'reciprocal' tariffs has yet to translate into anything concrete, but if the US moves toward a more protectionist stance, it could spell trouble for British exporters. In addition, there are ongoing concerns about weak consumer spending and a fragile housing market, and the UK economy still feels like it's trading water rather than building momentum.

Nevertheless, despite a dip at the end of the week, the FTSE 100 is still ahead of the S&P 500 year to date, but the European Bourses are actually leading the way. I have just come back from a Citywire Conference, and it was notable that the most prominent 'pitch / break out session' from the asset managers was from the European teams. The argument put best by the Alliance Bernstein team went something like this...

Europe

Attractive Valuations: European stocks are trading at more appealing valuations than U.S. equities. The Euro Stoxx 50, for instance, has a price-to-earnings (P/E) ratio of around 15, significantly lower than the S&P 500's P/E. This valuation gap suggests that European markets may offer better value for investors seeking growth at a reasonable price. The region is also significantly underweight in global portfolios, and there is a sign of money moving back into the region.

Robust Earnings Amid a Weaker Euro: The euro's depreciation has bolstered the competitiveness of European exporters, leading to stronger-than-expected earnings in the fourth quarter of 2024. Companies with significant international exposure have particularly benefited as their goods and services become more attractive on the global market. This trend has been a key driver behind the recent outperformance of European stocks.

Monetary Policy Tailwinds: The European Central Bank (ECB) has embarked on a series of interest rate cuts to stimulate economic activity. As of January 2025, the ECB has already reduced rates 5 times by (a total of 125 basis points), bringing the deposit rate down to 2.75% and heading lower. This accommodative monetary policy is expected to lower borrowing costs, encourage investment, and support corporate profitability across the eurozone.

Improving Economic Indicators: Recent data indicates a modest uptick in eurozone economic activity. The Purchasing Managers' Index (PMI), a key gauge of manufacturing and service sector health, has shown signs of expansion, suggesting that business confidence is rising. This improvement points to a potential stabilization of the European economy, which could further enhance investor sentiment.

Potential Peace Dividend from Ukraine Conflict Resolution: Ongoing peace negotiations between Russia and Ukraine, facilitated by international leaders, have raised the prospect of a resolution to the conflict. A successful peace agreement could reduce geopolitical tensions, lower energy prices, and improve consumer and business confidence throughout Europe. This "peace dividend" may serve as a catalyst for economic growth and provide additional support to European equity markets.

The quote, 'When the facts change, I change my mind. What do you do, sir?' is widely attributed to John Maynard Keynes, the famous British economist. Regardless of who said it, I think it is a fair point. Having been underweight Europe for most of 2024, we brought the European weight in our portfolios back up to around neutral at the end of last year and have just moved back to a Neutral fund selection stance. And we may well look to go overweight at the next rebalance.

U.S. Earnings Update: Earnings season is shaping up better than expected, with S&P 500 companies delivering stronger-than-anticipated results. So far, 77% of companies have reported, with 76% beating earnings estimates—right in line with historical averages. More importantly, the overall earnings growth rate for Q4 2024 has climbed to 16.9%, the best in three years, driven by strong performances in Financials, Consumer Discretionary, and Communication Services. Revenue growth is more muted, at 5.2%, but still marks 17 straight quarters of expansion. The market is still rewarding solid earnings, but as we all know, valuations remain elevated. The forward price-to-earnings ratio sits at 22.2, well above the 5- and 10-year averages. Forecast growth rates that analysts expect (year-over-year) are 8.1% and 9.9% for Q1 2025 and Q2 2025, respectively. For CY 2025, analysts are predicting (year-over-year) earnings growth of 12.7%.

Good earnings but not exceptional. I am still waiting to see the results of all the AI adoption and digital technology enhancements to show up in either the earnings or productivity numbers. Maybe I just have to be patient like Charlie Munger advised.

A Note on Charlie Munger: A Legendary Investor and Timeless Thinker

Charles Thomas Munger (1924–2023) was more than just an investor—he was a business philosopher, a sage of rational thinking, and a cornerstone of Berkshire Hathaway's success. As Warren Buffett's longtime business partner and vice chairman, Munger was instrumental in shaping the investment philosophy that turned the company into a global powerhouse. His wisdom extended far beyond finance, emphasizing the importance of multidisciplinary thinking, patience, and integrity.

While his early career was in law, his true passion was investing, leading him to build his own fortune before joining forces with Buffett in the 1970s. Together, they championed value investing, but Munger's influence nudged Buffett away from deep-value, cigar-butt stocks toward high-quality businesses with strong moats—companies that could compound wealth over time.

Munger's wit and wisdom became legendary in the investment world. His mental models, outlined in his famous speeches and the book *Poor Charlie's Almanack*, guided investors and thinkers across industries. His principles avoid stupidity rather than chasing brilliance, always be learning, and never underestimate the power of compounding have become essential lessons for those looking to build lasting success.

Though Munger lived in Buffett's shadow in the public eye, his impact on Berkshire Hathaway and the world of investing was profound. He was a man who valued clear thinking, honesty, and long-term vision over short-term speculation. His passing marks the end of an era, but his teachings will live on, continuing to inspire generations of investors, business leaders, and lifelong learners.

Rest in peace, Charlie Munger—one of the greatest minds the financial world has ever known.



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