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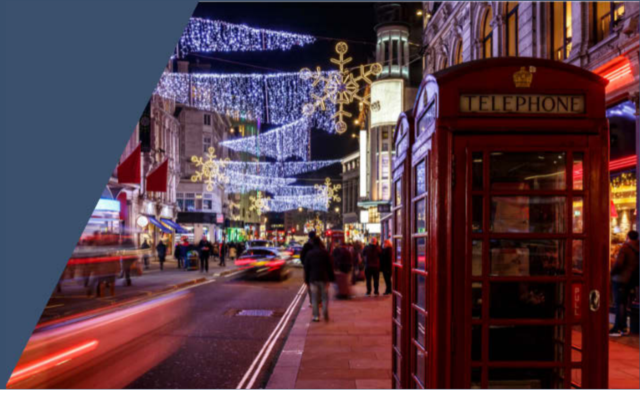
Investment Commentary
December 2024



Republican victory and market surge

The Republican Party's convincing win in the US election, returning Donald Trump to the White House, drove an advance in share prices across the entire market and, most significantly, in smaller companies. The index that covers all US companies, excluding the 500 largest, rose by almost 13% in sterling terms during November. The "Trump effect" was felt elsewhere, too; Elon Musk's support for the President-elect and subsequent reward of a role as head of an effort to cut wasteful government spending implied Musk's businesses would also curry favour. Tesla shares rose 44% over the week after election day.

Government spending and oversight

As an aside, it's worth underlining that this role is unlikely to be a sinecure. Cynical US citizens have for decades railed against profligate spending by government departments, particularly the military (~$900bn pa budget). The Roosevelt, Reagan and Clinton administrations made similar attempts to streamline government, but with limited success. In an infamous Congress oversight committee case, the chairman discovered that an Air Force "simulator repair kit" order costing $10,168 included a hammer invoiced at $400. He subsequently went to a hardware store and purchased the kit's identical items individually for $92. This new department will likely be popular at inception and gain Democrat support. The military's suppliers may not be so enraptured.

Tariff threats and policy contradictions

Mr Trump has doubled down on his tariff threats to include Canada and Mexico, who he feels have not done enough to stem the flow of illegal immigrants and drugs across their borders with the US. Those two countries account for 70% of US oil imports. At the same time, another Trump promise is to reduce the price of gasoline (petrol to you and me). The two initiatives would seem to be mutually exclusive.

US stock market performance

The US stock market has had a remarkable year. An investment into its six largest companies would be up 140% so far in 2024. The broad market index of 3,000 companies is up over 27%. By value, the US market now accounts for almost 70% of one primary global equity market index, double what it was at the end of the 1980s.

Sixteen of the world's 20 largest companies are American. The dollar is the world's reserve currency (i.e. where companies choose to store money earned from trade) because the US is considered a safer location than anywhere else.

Economic and market discrepancies

On the surface, this so-called "American exceptionalism" might be justified—the economy has been robust, growing by over 15% in the past four years. However, beneath this veneer of positivity, there are some concerns. The share price performances of only the ten largest companies account for 36% of the US market's total return and more than a quarter of the world's equity index performance. Conversely, the US share of global economic production is 27%—some way short of commensurate with its 70% market share.

Market capitalisation vs economic output

Intuitively, the market capitalisation of a country should (over time) align with its economic production. Gross Domestic Product (GDP) is the total market value of the final goods and services produced annually within a country's borders. Dividing the aggregate value of all the shares on a stock market by the value of what that country produces generates a number greater or less than 1 (i.e. 100%). Stock markets are forward-looking and anticipate future growth, so the long-term average ratio is usually a little over 100%. The benchmark, therefore, should be the long-term average.

By this measure, the US market value is the most expensive in its history. You'd need to spend $54 trillion to buy the entire US stock market. However, the whole US economy generated less than $30 trillion, a ratio of 206% versus its long-term average of 110%. Furthermore, those companies' total profits were less than $2 trillion. However, remember that expensive things can just get more expensive – markets aren't always rational.

Comparison with the UK market

Conversely, the UK has a ratio of 108%, slightly cheaper than usual. The leading UK index is up over 11% this year—a healthy real return over inflation—while medium-sized and small companies are also growing by 9% and 10%, respectively. The UK's quarter-point rate cut was a fillip, and despite an uptick in inflation, the Bank has signalled its aim to reduce rates by a full 1% by the end of 2025.

Bond market trends

On bond markets, despite cuts in November, UK and US interest rates remain relatively high, although not from a historical perspective. Being seen as inflationary (and hence a limitation on further rate cuts), Trump's proposed policies kept bond yields higher, thus depressing prices. Meanwhile, global bond prices are being influenced by the strong dollar—bond funds valued in sterling will have seen most of their November gains enhanced by currency movement.

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Looking ahead at 2025

Next month's commentary will briefly discuss the events of 2024, but we'll predominantly focus on the "known unknowns" that might significantly determine the markets' direction in 2025. Until then, have a delightful festive break, and we'll be back in January.

See you next month.

Graham Bentley

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