

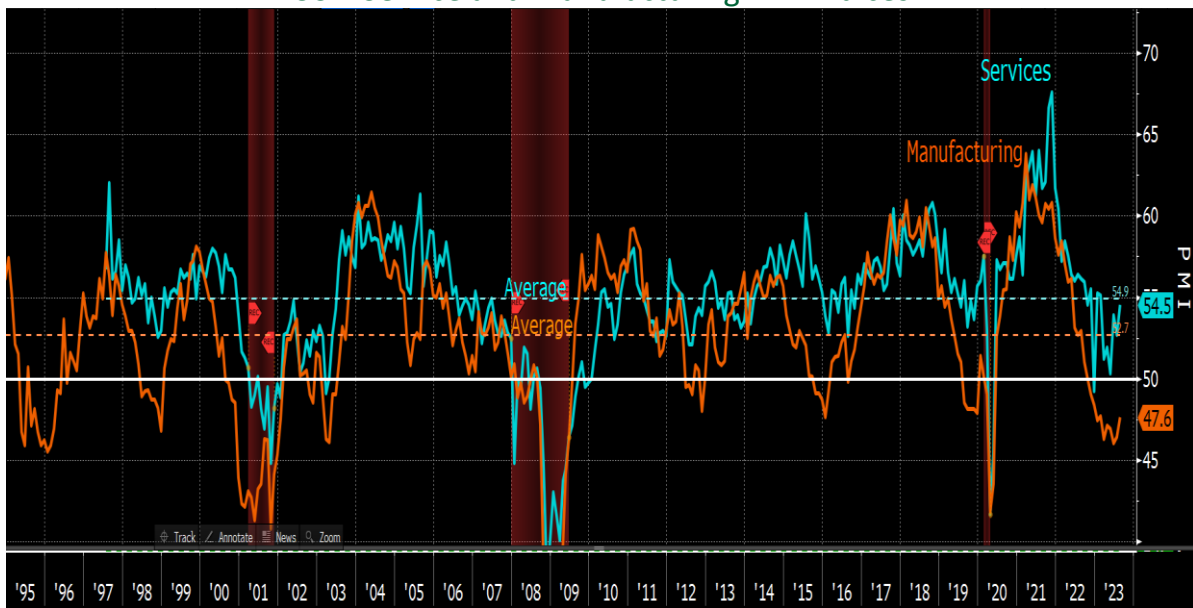
“There is no such thing as simple. Simple is hard.”

Martin Scorsese

1. US ECONOMY

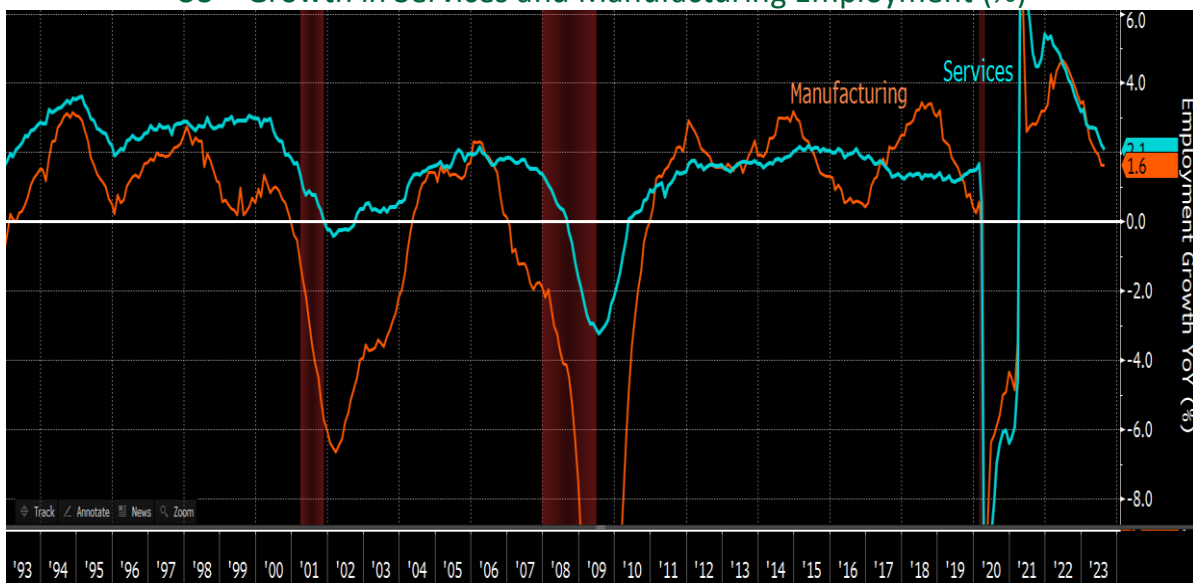
The US economy remains resilient despite the aggressive Federal Reserve tightening process:

US – Service and Manufacturing PMI Indices



The Services PMI is currently close to its long-term average, whilst the Manufacturing PMI seems to be in a bottoming out process off a low level. It is remarkable that the current 16-year record-high level of interest rates has not yet caused material damage to the economy.

US – Growth in Services and Manufacturing Employment (%)

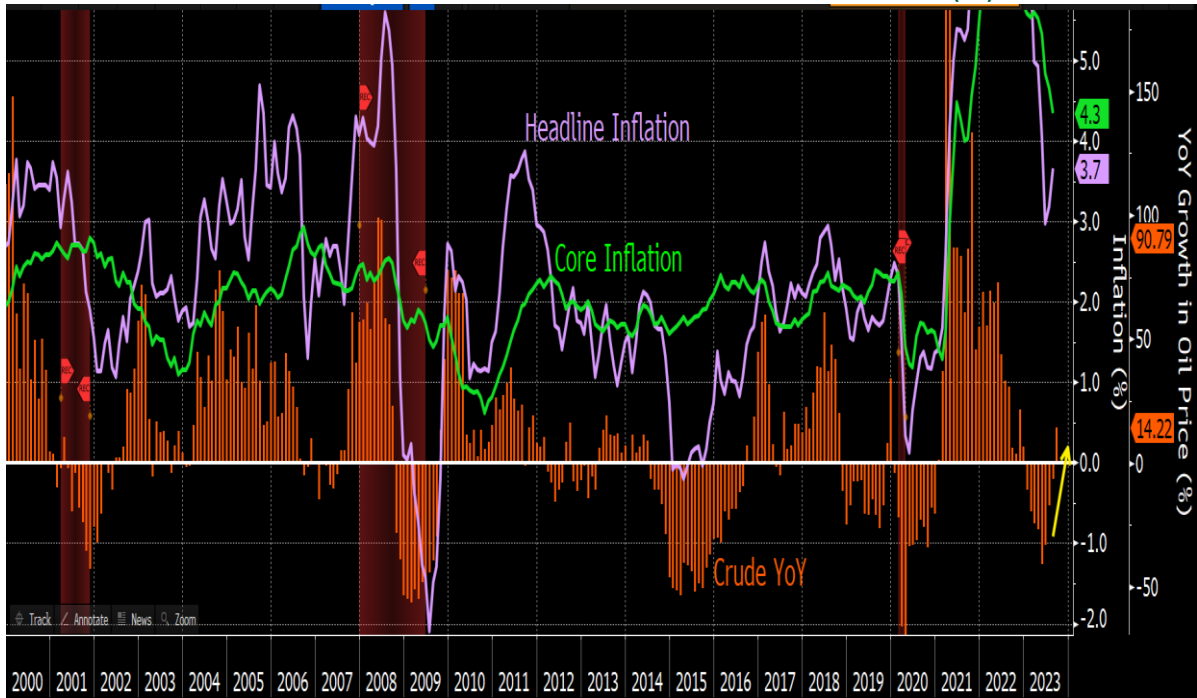


Continued strong employment supports the US economy. Employment growth of +2.1% in Services and +1.6% in Manufacturing, along with a 1.5 ratio of Job Openings to Unemployed, indicate a stable economy with, in our view, little risk of an imminent recession.

2. US INFLATION

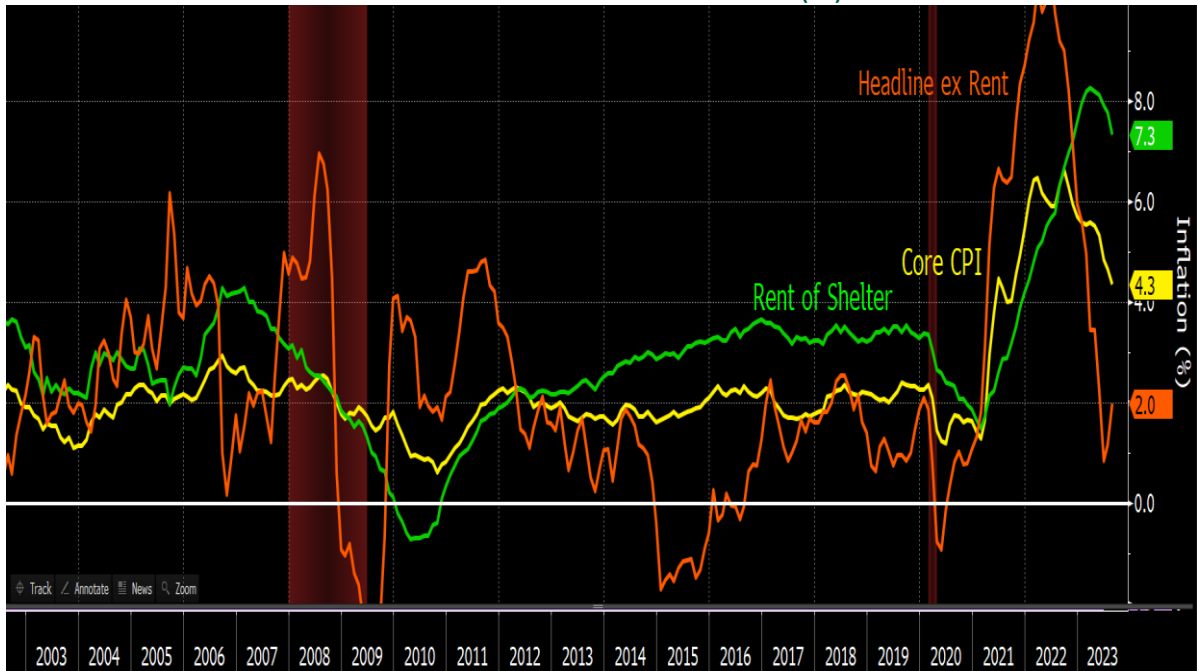
The recent two upticks in US inflation concern some investors.

US – Headline & Core Inflation vs Growth in Oil Price (%)



Headline inflation has increased from 3.0% to 3.7% (purple line), despite Core inflation (green line) and core personal consumption (not on the chart) continuing their downward trend. This increase is predominantly ascribed to the rise in energy prices (orange bars). It is striking that decisions by a few individuals in the oil industry have this effect at this particular time while the world yearns for a final tempering of inflation.

US – Headline vs Rent Inflation (%)



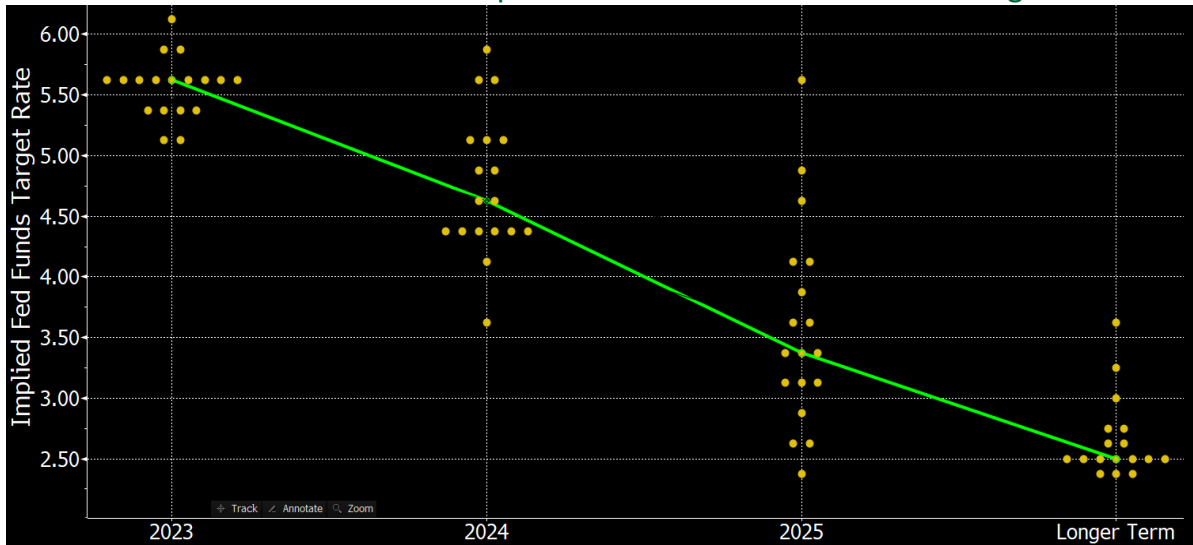
The cost of accommodation rent made up 65.7% of August's headline inflation. Whilst still at elevated levels, its current trend is downwards (the green line), shrinking core and headline inflation. It is striking that the latter is already at the Federal Reserve (Fed)'s 2% target when rent is excluded (orange line). No other category has a major impact on inflation levels currently. It, therefore, is clear that Rent and Energy are the main culprits, with the former showing promising signs. This also seems to indicate that there is little, if any, further work for the Fed to do on the tightening front.



3. US INTEREST RATES

Interest rates increased from 4.1% to 4.6% in September (ten-year Treasuries). The market reacted sharply on the Fed's message that, despite our preceding comment, they plan another hike this year, they plan to hold rates high for long and they remain committed to their 2% inflation target.

Federal Reserve Members' September 2023 Dot Plot Chart for Target Rate



It is clear from the above chart that most of the Federal Open Market Committee (FOMC) members believe another hike is necessary this year, taking the target rate to 5.75%, a 22-year record high level. Along with that, it is also clear how many members believe that the easing process next year should be a slow one, with some believing no cuts should be made at all.

The median FOMC member projections are as follows:

FOMC Members' Dot Plot Median Target rate					
Year End :	2023	2024	2025	2026	Longer Term
Sep-23	5.625%	5.125%	3.875%	2.875%	2.500%
Jun-23	5.625%	4.625%	3.375%		2.500%
Difference	0.000%	0.500%	0.500%		0.000%

The difference in opinions between the two most recent meetings of a target rate half a percent higher over the medium term caused a 4%+ capital loss in US bonds over September, with a similar loss in equities (along with the seasonal weakness).

US Longer Duration Bond Price & Technical Position



The bond bear market is in full swing, with the preceding comments taking bond prices to lows not seen for more than decade (on longer duration bonds, see the preceding chart).

As indicated on the chart, it seems the bond market is technically oversold. Ironically, though, it boils down to quite an extent to what happens to the oil price, given the Fed's obsession with their inflation target.

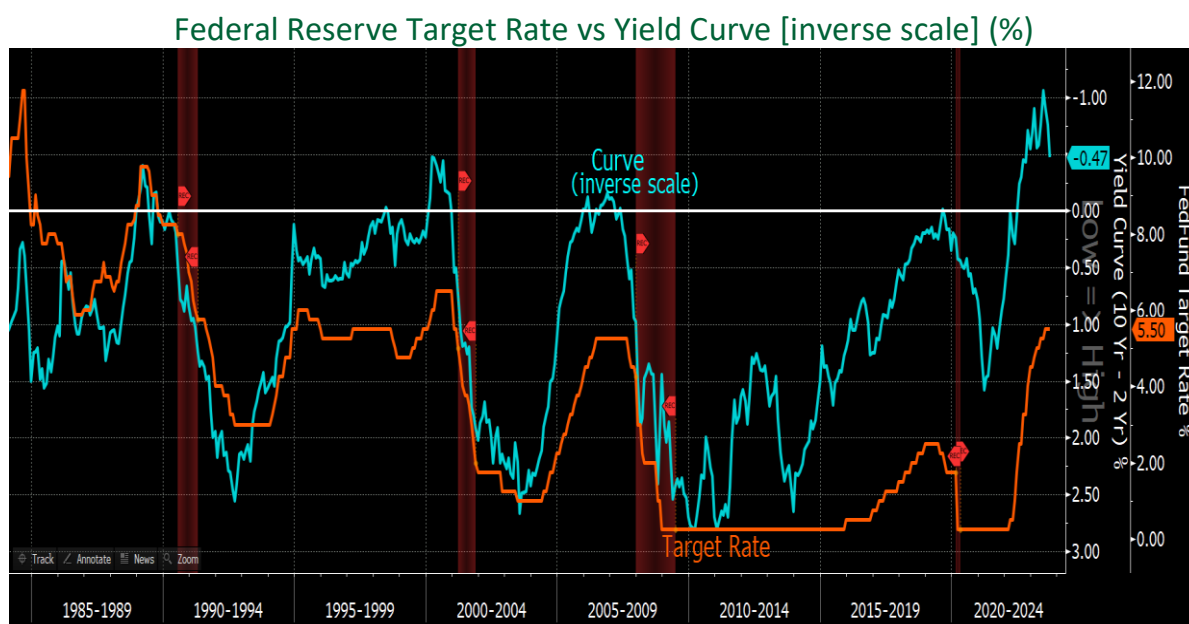
We believe that this backdrop places equity investors in the position that they must:

- Restrict themselves to strong franchises with very strong balance sheets
- Ensure their businesses' operational and earnings delivery is beyond doubt
- Ensure their valuations allow room for error

All said, the Fed has most probably gone as far as necessary to dampen enthusiasm and risk appetite, and with the attractive bond yields now in real territory, the bond market may well settle down and calm investor nerves.

4. TIGHT FED

The following Chart shows how conservative the Fed is currently:



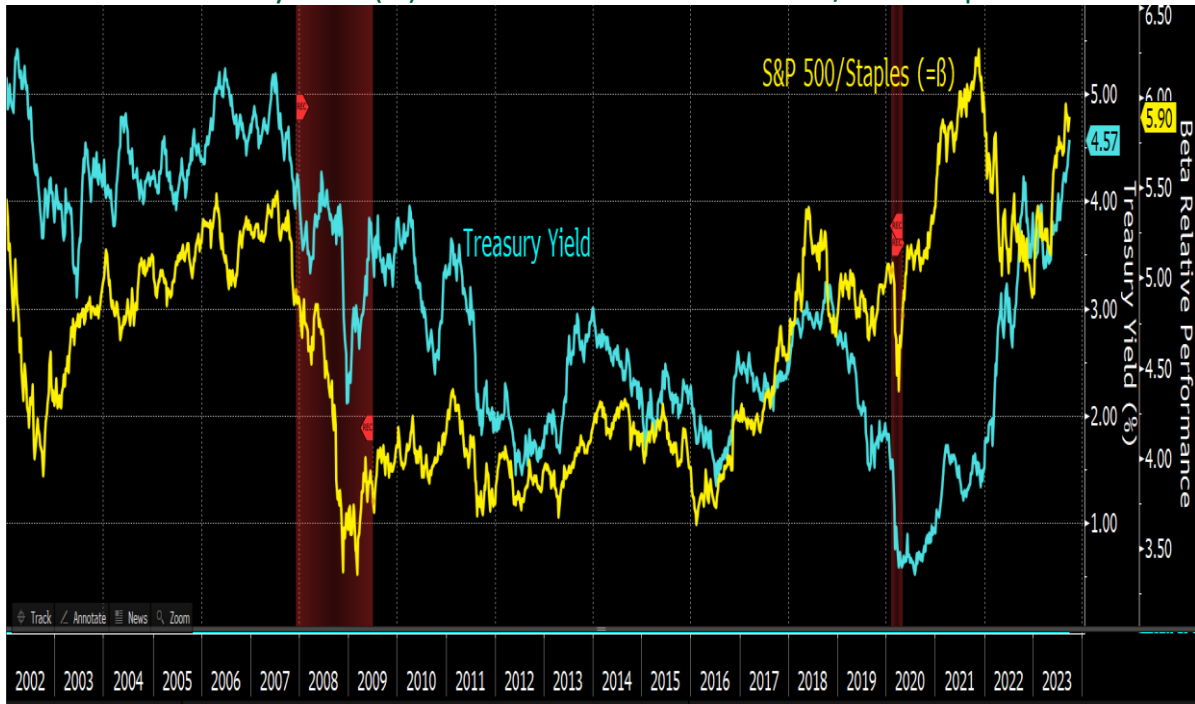
The US yield curve is currently in deep negative territory (blue line, inverse scale). Historically, the Fed has stopped tightening under such conditions. The more recent steepening of the curve (whilst still in deep negative territory), the sound economy and their firm commitment to keep rates high may well let them stay their indicated course.

5. STAPLES

The higher interest rates are having a detrimental effect on Staples' share prices. The chart on the next page of the relative ratio of S&P 500 / S&P Staples (in yellow) logically correlates closely with the Treasury Yield (in blue). It can be seen as a proxy for higher Beta (higher volatility) stocks. They have recently outperformed as interest rates increased, at the cost of Staples. On this basis, Staples needs lower interest rates to outperform, which is some time off according to the Fed.



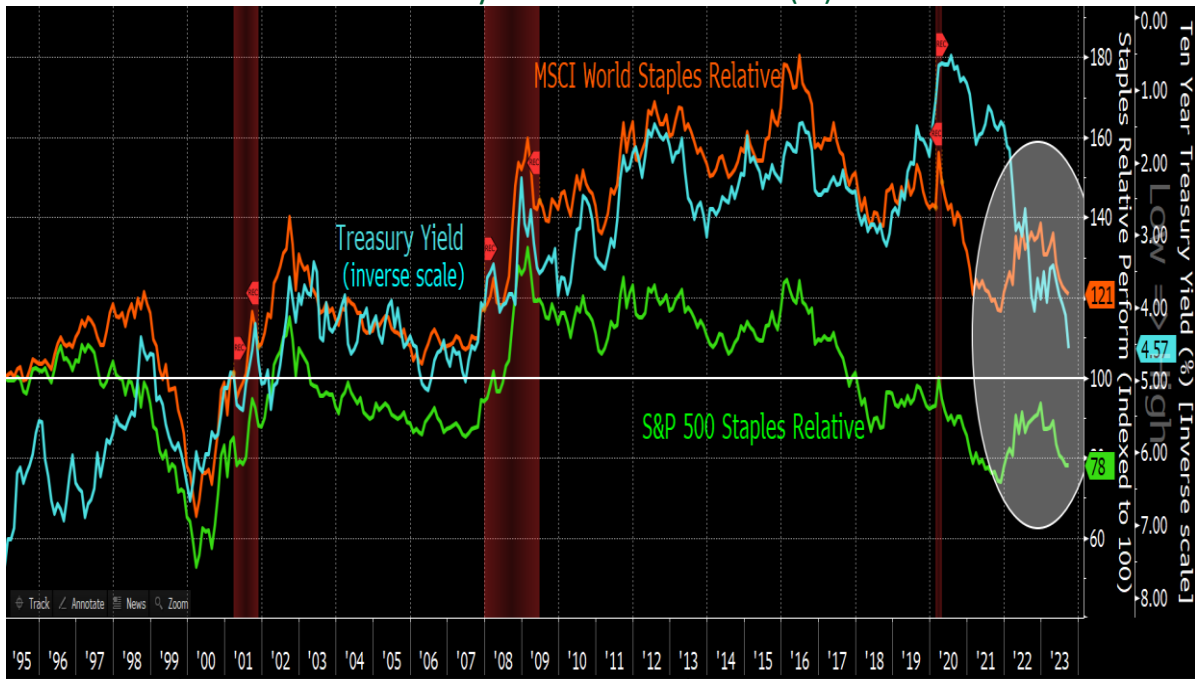
US – Treasury Yield (%) vs Relative Value of S&P 500 / S&P Staples Index



The chart below reflects both S&P Staples and MSCI World Staples relative to their respective overall stock market indexes. Both relative indices are indexed to 100 in 1995, and drawn along with the Treasury Yield (on an inverse scale). Again, there are clear correlations of the relative Staples' indices and interest rates.

We use this chart to consider the structural attractiveness of Staples as a sector.

S&P Staples / S&P 500 Index and MSCI Staples / MSCI World Index vs Ten Year Treasury Yield – inverse scale (%)

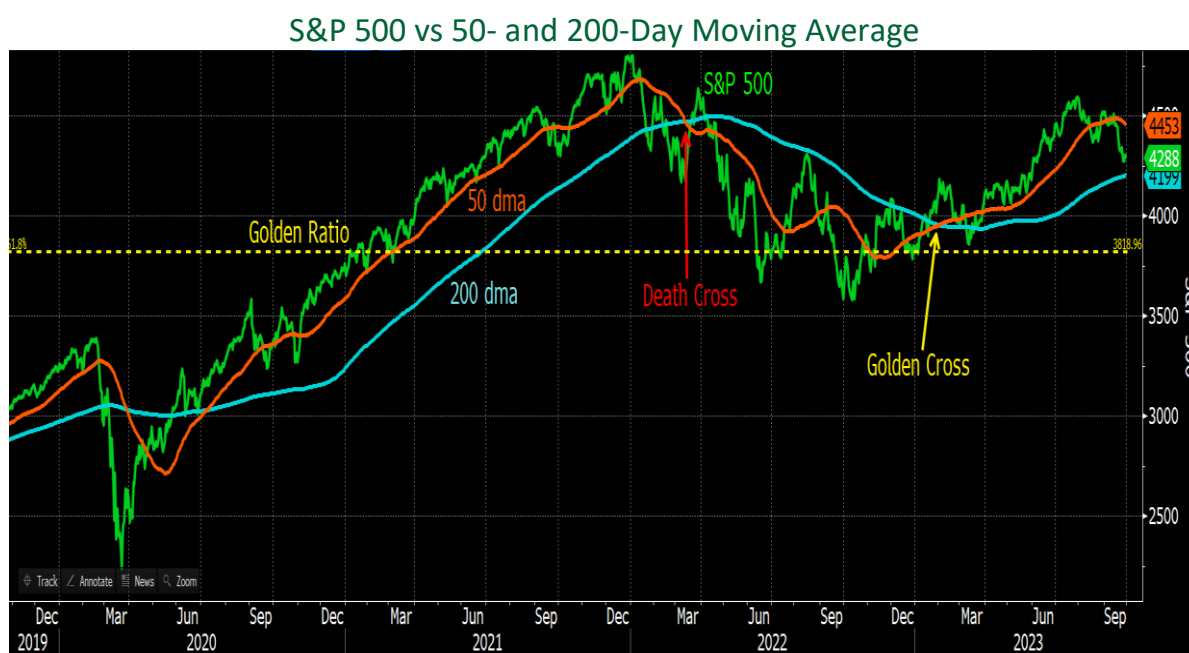


The following observations are to be taken cognisance of:

- Globally, Staples have been outperforming the World Index over the long term, but lost over 20% of its relative value against the S&P 500.
- Both S&P and MSCI Staples have been underperforming their main indices over the past seven years.
- In an environment of continuing higher interest rates, the merits of Staples can be questioned.
- The potential effects of obesity drugs on the Food and Alcohol sectors may hamper their stock market ratings and prevent re-ratings should interest rates drop later on.

Investors should make sure about their Staples holdings.

6. TECHNICAL PICTURE



Despite the weak September, the S&P 500's technical picture remains constructive. Cognisance should be taken that the 50-day moving average seems to be topping out, though. Other technical indicators reflect mildly oversold situations. The Put/Call and Bullishness/Bearishness ratios indicate further potential weakness. The upcoming earnings season may be quite determinant of the immediate stock market outlook.

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