AUGUSTINE
ASSET MANAGEMENT

July 2024

Dominance

MARKET SUMMARY

Equities

MSCI AC World	802
Price / Earnings	18.9x
Dividend Yield	2.0%
S&P 500	5460
Price / Earnings	22.6x
Dividend Yield	1.4%

US Interest Rates

2 Year Treasury	4.7%
10 Year Treasury	4.3%
30 Year Treasury	4.4%
Bloomberg US Agg.	5.0%

US Corporate Spreads

Investment Grade	1.3%
High Yield	3.3%

Equity Volatility

CBOE SPX Volatility	12.4

US Economic Figures

GDP Growth 1Q24	1.4%
Unemployment	4.1%
Inflation (core)	3.3%
Fed Funds Rate (mid)	5.4%
3 Month SOFR	5.3%

Commodities

Oil (Brent)	$84
Natural Gas	$2.60
Copper ($/lb.)	$4.39
Gold ($/oz.)	$2327

Foreign Exchange

Euro	$/€	1.07
Japanese Yen	¥/$	161
Chinese Yuan	元/$	7.30

Market summary data as of:
June 30, 2024

Vigorous. Striving. Surging. In 2024, when over 80 countries representing half of the world's population have a national election, it's been a rare day to not hear these and similar words describing campaigns and politicos. Days when the same words have not been used to describe financial markets have been equally rare.

Stocks have had a strong first half with the MSCI All Country World Index returning 11.3% since the beginning of the year. Bonds, the more defensive asset class, were less than flat, with the Bloomberg US Aggregate returning -0.7%.

Enthusiasm for artificial intelligence has propelled stock market indices over the last eighteen months and continues unabated, with the AI standard bearer, NVIDIA, recently becoming the world's most valuable company. It leads a cohort of mega capitalized technology companies viewed as the biggest beneficiaries of artificial intelligence spending. AI is certainly a catalyst for capital investment and subsequent productivity, and the holdings of Microsoft, Taiwan Semi, and Apple in Augustine Global Equity are beneficiaries. It's striking, however, that very

few companies are responsible for most of the stock market's gains since the AI boom began. So far this year, the ten largest AI-themed stocks contributed about two-thirds of the market index's unusually strong return while, in contrast, the average stock is slightly down.

Market dominance by a few stocks isn't, in and of itself, evidence of bubble conditions and imminent downside. However, it does point toward the market's reliance on a narrative that demands fundamental backing and, to the extent that market leadership trades at unusually high valuations, the need to manage risk by having multiple modestly correlated ideas across the portfolio. Our positions in Japanese and Indian stocks are examples of such that we expect will contribute to returns while providing risk mitigating diversification.

Japanese industrials and banks represent 12% of our global equity strategy and are beneficiaries of improving corporate governance in an economy that has emerged from deflation with a competitive currency. Improvement in corporate governance, led by the Tokyo Stock Exchange, is a structural theme that can spur greater interest among foreign investors who have been able to ignore Japan for several so-called "lost decades". Reduced cross shareholdings and increased management attention to share prices, balance sheet efficiency, and cost of capital will take time but suggest that the Japanese stock market may be at the beginning of positive long-term change.

The 8% exposure to Indian financials and healthcare provides exposure to one of the world's fastest growing large economies that has strong long-term prospects based on demographics, consumption growth, and capital formation. Reforms to help economic growth and investment by reducing bureaucratic red tape and a competitive workforce with skills in science, technology, engineering, and mathematics support the case for strong long-term growth in India.

With global stock valuations relative to earnings and cash flow high by historical standards, selective exposure in parts of the market that offer attractive relative value helps manage downside risk if expectations for and the pricing of technological advancements have raced ahead of fundamentals.

Exhibit 1: Global Equity Forward Price/Earnings Valuations

	All Country World	USA	Europe	Japan	Emerging
Current	18.9	22.9	14.2	16.5	13.2
Percentile	88	91	45	77	71
15 Year Average	16.0	18.0	14.5	15.9	12.5

The US bond market's current state of flux reveals the uncertainties about and the countervailing effects of near-term momentum of the economy and longer-term drivers of inflation and interest rates. Global growth is moderating from a strong 2023 to a slower but still positive level this year. While pockets of softness have emerged in US consumer spending and in some key economies like China, the breadth of growth has improved with global manufacturing firming in recent months. As such, the near-term economic outlook is decent and imminent recession risk appears low. Inflation is moderating, though it remains above the Fed's target, and its progress to target has been inconsistent. All said, current core inflation of 3.3% has improved enough for the Fed to begin cutting the short-term policy rate from the current 5.25% - 5.50% in the next few months. Employment and inflation data will be important for when and by how much policy is changed.

Policy moves by the Fed are felt more at the short and, to a lesser extent, the medium maturities of the yield curve. Longer-term yields are normally set by market forces. While super-sized central bank balance sheets have distorted medium- and long-term yields in the last fifteen years, we see the market dynamic having a prospectively stronger hand as structural issues of rising importance are priced.

Prior letters introduced factors that portend a higher non-cyclical level of inflation compared with that seen between 2000 and 2020 -- economic nationalism (dirigiste industrial policies, de-globalization of supply chains, and immigration restriction) and a forced pace of the green energy transition. We recently included fiscal dominance, under which spending, deficits, and government indebtedness can reach a point where the market demands a credit and inflation risk premium.

Congressional Budget Office forecasts suggest that possibility. Legislatively mandated spending is set to rise to almost 25% of GDP by 2034 compared with 21% over the last 50 years. Although tax revenue to GDP is also expected to rise, it isn't expected to keep pace. The primary deficit and interest expense are projected to grow faster, resulting in a federal deficit of 6.9% of GDP in 2034, a shortfall far exceeding the 3.7% average deficit over the last 50 years. Federal debt held by the public is consequently projected to rise from 99% of GDP today to 122% by 2034. This challenging scenario is probably optimistic, as it does not include fiscal stimulus that will likely be used during recessions.

Exhibit 2: Federal Outlays & Revenues % of GDP

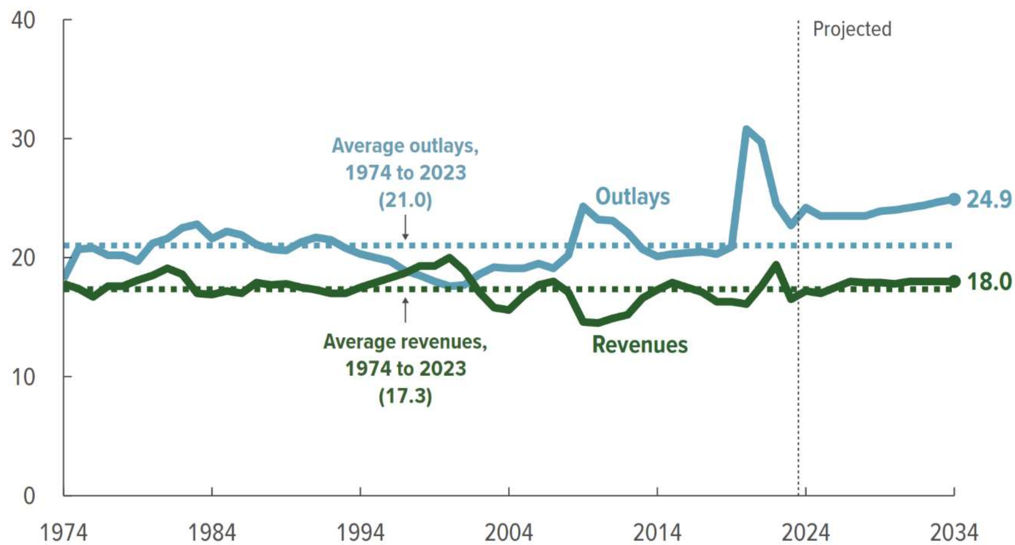


Exhibit 3: Federal Deficit % of GDP

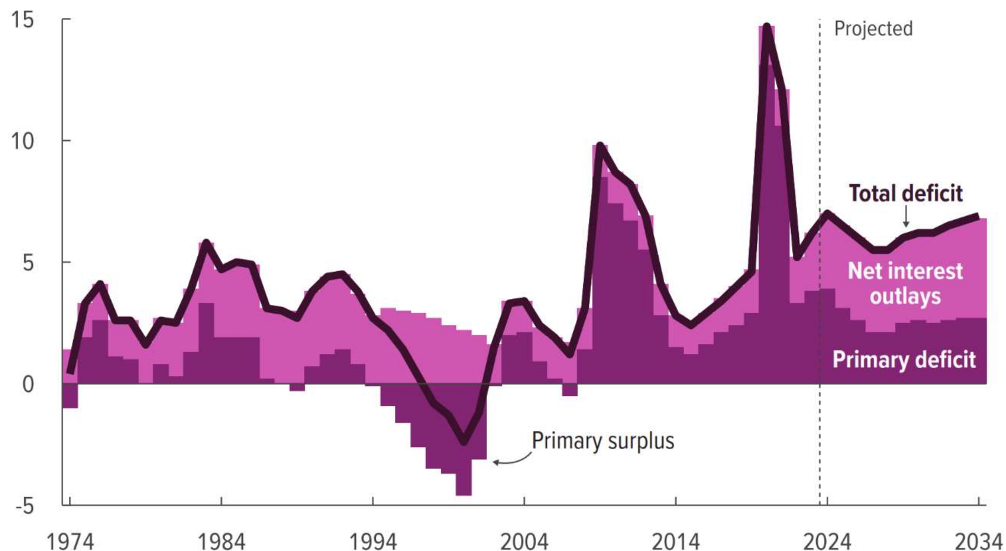
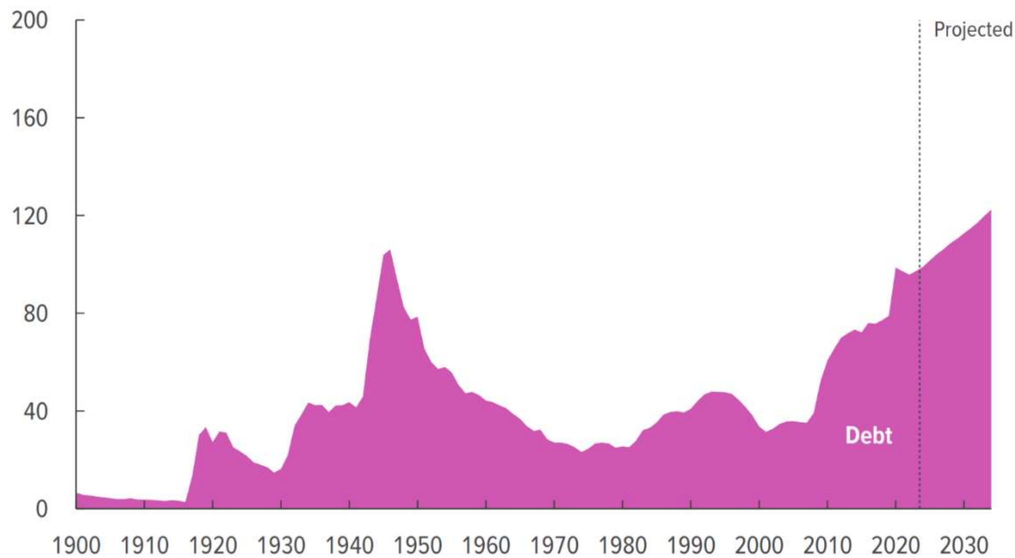


Exhibit 4: Federal Debt Held by the Public % of GDP



With a structurally worsening fiscal profile that is politically very difficult to address, we think long-term yields may not move down in tandem with short-term yields as the Fed pursues cyclically driven easing. Augustine Core Plus Fixed Income and Short-Term Fixed Income strategies are positioned to benefit from lower short- and medium-term rates, a return of positive term premium across the yield curve, and contained credit risk in an economy that is slowing but not recessionary.

Should the risk of structurally higher inflation and government indebtedness be reflected in sticky or possibly higher long-term rates, the positioning in our global equity strategy that favors securities trading at fair rather than stretched valuations versus earnings and cash flow and the positioning in our fixed income strategies, that is defensive versus long-term interest rate risk, should support favorable risk adjusted returns.

We hope this review of investment strategy, the economy, and capital markets helps to inform about our investment outlook and how we have positioned client assets to achieve returns while managing risk.

With best regards and appreciation for the opportunity to work on your behalf,

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Sources: Illustration: Microsoft Designer AI image generator. Exhibit 1: MSCI. Exhibits 2, 3, & 4: Congressional Budget Office June 2024 Update.