



Melville Douglas Focused Quarterly Commentary

/ Q4 2024

As we step into 2025, the Melville Douglas team hope that you and your families had a joyous and restful festive season. As always, the new year brings fresh investment opportunities and challenges, and we remain fully committed to navigating them successfully with you. Thank you for your continued trust and partnership with us and we wish you a happy, safe, and prosperous year ahead.



Bernard Drotchie
/ Chief Investment Officer

Staying the Course: Another Prosperous Year for Investors

Led by US indices, global equity markets soared during 2024, fuelled by a confluence of favourable economic factors. Lower inflation has eased cost pressures, allowing businesses to operate more efficiently whilst also boosting consumer purchasing power. Simultaneously, a synchronised global interest rate cutting cycle has lowered borrowing costs, encouraging investment and spending across various sectors. This monetary easing has been particularly impactful in fostering a positive outlook for corporate earnings growth, as companies benefit from reduced financial burdens and increased demand for their products and services.



Donald Trump's recent US Presidential victory has significantly contributed to the outperformance of US assets relative to the rest of the world

MSCI ALL COUNTRY WORLD INDEX (USD) – TOTAL RETURN



Source: FactSet

The impressive performance of the US economy has played a pivotal role in this upward trend. Robust job growth, rising wages, and resilient consumer confidence supported by the positive wealth effect have underpinned economic stability and expansion. This has not only bolstered domestic US markets but also had a ripple effect globally, enhancing investor sentiment and market performance worldwide. Consequently, the combination of these elements has created a fertile environment for equity markets, driving them to new highs and reflecting the strengthened economic fundamentals and optimistic prospects for businesses around the globe for the year ahead.

Adding to this momentum, Donald Trump's recent US Presidential victory has significantly contributed to the outperformance of US assets relative to the rest of the world. His policies of lower taxes, fiscal expansion, import tariffs, reduced regulation, and a softer stance towards Environmental, Social and Governance (ESG) integration are aimed at boosting the economy as well as business and consumer confidence. With a clean sweep across the House of Representatives and the Senate, it is viewed that Trump will have the necessary support from Congress to implement many of his stated policies. This political backing is expected to further stimulate economic growth, enhance corporate profitability, and sustain the positive trajectory of the equity markets.

US EQUITIES VS REST OF THE WORLD EQUITIES



Source: FactSet

Make America Great Again – 2.0

While 2024 will be remembered as the year of elections, with more than 100 countries accounting for nearly half of the global population voting, the outcome of the US election was perhaps the most closely followed by market participants due to the sheer size of the country's economy and the US market's dominance in global financial markets. Biden's unexpected and late exit from the presidential race opened the door for Trump and the Republican party to secure a convincing victory over the Democrats. Trump's policies are expected to benefit US corporations and taxpayers at the expense of their trading partners. However, the enforcement of import tariffs on global goods and restrictions on immigration could result in unintended consequences such as stickier or even an unwanted lift in inflation, significantly higher government debt, a slowdown in capital formation by the private sector, a deterioration in global trade, and supply disruptions of goods and services.

It is important for investors not to overreact to the potential outcomes of Trump's stated policies, as the actual results are highly likely to differ significantly or be more moderate than what was communicated during the election period. Trump is an astute negotiator and is known for his transactional approach.

In its simplest form, newly elected President Donald Trump's economic strategy aims to run the US economy like a business by implementing several key policies:

1. Gaining Competitive Advantage: Trump seeks to boost American industries by imposing import tariffs, particularly on Chinese goods. This is intended to make imported goods more expensive, thereby encouraging consumers to buy American-made products. Additionally, he aims to lower the value of the dollar to make US exports cheaper and more competitive on the global market.

2. Reducing Costs: A significant part of Trump's economic policy is to lower the corporate tax rate. The Tax Cuts and Jobs Act of 2017 reduces the corporate tax rate from 35% to 21%, aiming to increase corporate profits and stimulate investment in the US economy. Trump also pressures the Federal Reserve to lower interest rates, which would reduce borrowing costs for businesses and consumers, theoretically spurring economic growth.

3. Reducing Frictions: Trump focuses on deregulation, including rolling back environmental regulations, to reduce the compliance burden on businesses. This is intended to lower operational costs and increase efficiency, allowing businesses to operate more freely and profitably.

4. Leveraging Up: By increasing the budget deficit, Trump aims to stimulate economic growth through increased government spending. This approach, often referred to as fiscal stimulus, involves borrowing more to fund infrastructure projects, defence spending, and other initiatives that could boost economic activity.

5. Cutting Unnecessary Expenditures: Trump advocates for reducing US contributions to international organizations like NATO, arguing that the US is bearing an unfair share of the financial burden. By cutting these expenditures, he aims to reallocate funds to domestic priorities.

These policies reflect a business-oriented approach to governance, focusing on competitiveness, cost reduction, deregulation, fiscal stimulus, and prioritising domestic over international spending.

At Melville Douglas, our investment approach remains firmly rooted to the fundamentals that determine the returns from carefully selected assets. However, we also find it insightful to examine how election outcomes can influence market dynamics. For instance, the US equity markets (S&P 500) demonstrated robust performance during both Trump's first tenure as president and Biden's tenure. This suggests that while the outcome of an election and the incumbent's policies are significant, they may not be the sole driver of equity returns. Over the long term, equity returns are more heavily influenced by factors such as profit growth and the discount rate applied to future cash flows. In other words, variables such as monetary policy, inflation, risk appetite, and valuations play a crucial role in shaping market performance. These elements can often have a more substantial impact on equity returns than the political landscape alone. As we navigate the complexities of the market, we remain committed to our fundamental approach, ensuring that our investment strategies are well-positioned to capitalise on opportunities and manage risks effectively.

Conclusion

The global economic outlook remains positive, driven by monetary easing, credit growth, real wage growth, and productivity gains from AI. The divergence in growth and inflation between the US and the rest of the world is expected to persist, resulting in less aggressive monetary easing in the US compared to Europe, where growth has been lacklustre. Emerging markets look set to face challenges from a strong US dollar, higher for longer global bond yields, a weak Chinese economy, and uncertainties related to a new US administration.

President Trump's policies, such as lower taxes, import tariffs, and the deportation of undocumented immigrants, could add inflationary pressures to an already buoyant US economy. The lack of detailed information and the ultimate implementation of these policies pose several risks to economic growth, likely leading to periods of volatility in global financial markets. If Trump succeeds, global trade could be significantly hampered given that the impact from his stated import tariffs is expected to be five times larger in US dollars than what was implemented in 2018/2019, and this does not incorporate the effects from retaliation and the effect on business confidence. However, given his reputation as a negotiator, we expect a more moderate implementation. What benefits the US may not necessarily benefit the rest of the world, so bouts of uncertainty and volatility should be anticipated. Federal Reserve Chair Jerome Powell recently highlighted this uncertainty regarding the impact on inflation and future interest rates, saying, "It's not unlike driving on a foggy night or walking into a dark room full of furniture."

We will continue to monitor developments as they unfold but will maintain our fundamental approach of investing in quality assets that offer significant upside and attractive returns for our clients over the long term. With equity valuations becoming less supportive we are dialling back our overweight equity positioning to neutral.



Our decision to deploy an overweight equity weighting added value

Investment Performance

In the absence of a US recession materialising during 2024 multi-asset and equity biased client portfolios enjoyed another year of favourable absolute returns. These strategies remain ahead of peer group over the medium/long-term but behind their reference benchmarks this year largely due to the extreme narrowness of market, sector and stock returns (US market, technology/communications sectors and Magnificent 7 stocks) which is challenging for active managers such as ourselves to fully participate in as we, prudently, prefer to deploy higher levels of diversification for our clients. Fixed income portfolios remain in-line or ahead of peer group and benchmark. Our decision to deploy an overweight equity weighting in multi-asset portfolios for most of 2024 added value, particularly in USD strategies, whilst our neutral fixed income positioning proved sensible given our no recession and 'higher for longer' interest rate outlook as a result of sticky inflation and now the potentially inflationary consequences of Trump 2.0.

Asset Classes

Equities	Overweight (Moving to Neutral)
Fixed Income	Neutral
Cash Plus	Underweight (Moving to Neutral)



Bernard Drotchie
/ Chief Investment Officer

Global Asset Allocation

Global Equity - Overweight (Moving to Neutral)

Equity markets have shown impressive performance over the past two years. Investors needed patience to participate in this rally amid significant volatility. A year ago, there was considerable uncertainty about the global economic outlook following one of the most aggressive interest rate hiking cycles in recent memory. Simultaneously, the war in Ukraine continued unabated, and a new conflict emerged in the Middle East after Hezbollah attacked Israel.

Earnings growth is expected to broaden out

MSCI WORLD CONSENSUS EPS GROWTH PROJECTIONS

Market	MSCI WORLD			
	2023	2024e	2025e	2026e
Market	1.1%	8.2%	12.6%	10.8%
Energy	-25.4%	-6.2%	7.6%	3.4%
Materials	-31.1%	1.7%	13.4%	7.3%
Industrials	7.1%	6.9%	12.9%	11.8%
Discretionary	34.1%	9.1%	12.9%	12.8%
Staples	1.9%	4.6%	8.6%	7.9%
Healthcare	-14.1%	8.0%	17.6%	11.2%
Financials	13.1%	8.3%	9.0%	10.7%
IT	5.1%	16.2%	20.1%	14.6%
Com Services	21.7%	22.5%	12.8%	12.5%
Utilities	11.7%	5.7%	4.9%	5.9%
Real Estate	-6.1%	0.4%	7.5%	8.3%

 Magnificent Seven

Source: IBES

Until recently, earnings growth for global equity was primarily driven by rapid growth in Technology and the beneficiaries from Artificial Intelligence (AI). While we remain optimistic that the secular growth drivers for these industries will continue, it is encouraging to note earnings growth for the next year is expected to broaden out across a wider range of sectors, given favourable base effects, as the economic cycle gains momentum and the positive effects from lower interest rates emerge.

From a valuation perspective, global equity indices appear quite expensive. However, while we don't claim that developed market equities are cheap, we believe there are valid reasons for the elevated levels of some indices, particularly in the US, and that investors should remain generally supportive, but selective, of this asset class as corporate earnings revisions turn positive and interest rates continue their downward trend.

The composition of indices has changed notably, with technology-related stocks now comprising nearly 42% of the S&P 500 index in the US, up from 8% in 1994. These stocks have been the primary drivers of global earnings growth over the past decade, especially since the pandemic began. Beyond the discount rate (risk-free rate and equity risk premium) used for asset valuation, the rate of earnings growth and profitability are crucial determinants of equity



valuations. Sustained growth in earnings per share (EPS) and return on equity (ROE) justifies higher valuations. This is why investors are willing to pay a premium for sectors or stocks with strong balance sheets, competitive advantages, and secular growth drivers, enabling them to grow faster than the average company. This trend is evident in equity markets such as the US, where secular growth stocks, including those in Technology, Communication Services, and certain Healthcare sectors like Biopharma, trade at a premium to their peers. The robust growth and improved profitability in these sectors have led to upward valuation adjustments across regions.

Additionally, when assessing valuations in regions outside the US, where Technology represents a smaller portion of equity indices, valuations align closely with long-term averages.

PRICE TO EARNINGS: MSCI AC WORLD EX USA



Therefore, while there are understandable reasons for some equities to trade at lofty levels at the start of the next earnings cycle upswing across a broader range of sectors, we anticipate that near-term returns from this asset class will now be driven mainly by earnings growth and dividends, as opposed to further earnings multiple expansion. We are cognisant that much of the positive expectations are already reflected in current valuations leaving investors with lower margins of safety at current prices. As Warren Buffet wisely said, "Price is what you pay; value is what you get."

Although we remain constructive on global equities, with valuations becoming less supportive we are dialling back our overweight equity positioning to neutral and will continue to invest in companies that offer an attractive "margin of safety" at the time of investment, aiming to generate appealing real, risk-adjusted returns for patient long-term investors.

Sector views

Consumer Discretionary	Overweight
Consumer Staples	Underweight
Energy	Underweight
Financials	Overweight
Healthcare	Overweight
Industrials	Underweight
Information Technology	Neutral
Materials	Neutral
Communications Services	Neutral
Utilities	Underweight
Real Estate	Underweight



Justin Maloney
/ Head: Global Equities



Derinia Mathura
/ Fund Manager

Global Fixed Income – Neutral

G7 Government	Underweight
Investment Grade - Supranational	Overweight
Investment Grade - Corporate	Neutral
High Yield - Corporate	Overweight

The **US Federal Reserve** (Fed) initiated the easing cycle in September with an aggressive, and dovish, fifty basis point cut and have subsequently followed up with two additional twenty-five basis point reductions. A 1% reduction in interest rates was broadly expected in 2024 but the material change in the rate outlook for the year ahead was more unexpected, or at least it was until Trump regained his

seat in the Oval Office. The Fed's December interest rate cut was deemed 'hawkish' and marked the return of the 'higher for longer' mantra. Whilst Trump's victory brings with it upside risks to growth (tax cuts and deregulation) as well as downside risks (tariffs and policy uncertainty), the Fed's more immediate concerns are with the former, particularly as the inflation battle rages on. The Fed has raised its 2025 growth and inflation forecasts and lowered the outlook for unemployment, something it could not do without amending the interest rate outlook. The Fed now sees interest rates ending 2025 only fifty basis points below current levels and the long-term neutral rate is now forecast to be higher at 3%. In essence, the Fed's 'immaculate disinflation' strategy is now less clear given the improved growth outlook and risks that proposed tariffs ignite a global trade war – an environment that could put a floor under government bond yields (higher for longer), at least over the medium term.

No 2025 recession in the US is virtually consensus now, indeed a reacceleration in economic activity is possible and this comes off an already strong base, with the economy growing in Q3 2024 at an annualised rate of 3.1% thanks again to robust consumer spending which remains supported by a strong and seemingly resilient employment market, real (after inflation) pay rises and household net wealth hitting record highs. There are myriads of outcomes to Trump's proposed tariffs but for now the market is focusing on the inflationary implications, and this comes at a time when prices (almost entirely in services) have entered another 'sticky' patch. Three-month annualised rates for both headline and core inflation have recently been moving in the wrong direction, a major issue for the Fed which correctly remains insistent on bringing inflation down to target levels. Weighing up these factors, it is not an environment that justifies materially lower bond yields, and as such we forecast longer-dated yields to be at or around current levels in a year's time, an outcome that would deliver a positive return. However, Trump 2.0 clearly poses risks to this view hence our reticence to materially extend the maturity profile of our US Dollar strategies just yet.

In stark contrast to the US Federal Reserve, the **UK Monetary Policy Committee** (MPC) left rates on hold with a vote of 6-3 in favour at their December meeting, closing the year with just 50 basis points of cuts, a far cry from the 150 basis points the market expected as we entered 2024. While there was no change, the decision was perceived as a dovish hold, with the MPC giving a relatively strong signal that its previous baseline of a gradual easing of 100 basis points through 2025 was indeed intact. This is at odds with the market which is currently pricing in two twenty-five

basis point cuts during 2025 as the disinflationary trend has ground to a halt with inflation rising in November and expectations that the fallout from Labour's recent budget could push it towards 3% by the third quarter of 2025. Recent data confirmed that wage growth remains elevated at 5.2%, which continues to fuel services inflation which is currently running at 5%, suggesting lingering price pressures. However, whilst inflationary pressures remain, weaker growth following recent disappointing economic activity has led the central bank to downgrade their forecast for the fourth quarter, now expecting flat growth which in turn raises fears of stagflation. The rise in UK government bond yields in 2024 has done much to factor in the ongoing inflationary uncertainty and, consequently, less interest rate cuts in the year ahead. At these elevated levels, we believe yields offer attractive medium to long-term value for investors even if, as we expect in the US, they continue to trend sideways until the MPC are confident that inflation is on a sustainable path to target levels.



Karl Holden
/ Head: International
Fixed Interest and
Currency Strategy

Cash Plus – Underweight

Cash and cash alternatives currently provide investors with favourable real yields and diversification. Having modestly revised our forecasts for inflation and interest rates higher, now expecting 'higher for longer' interest rates in the US, and with global equity valuations becoming less supportive we are upping the weighting to Cash plus in relevant client portfolios at the expense of equity.

Market performance / as at 31 December 2024

EQUITIES	DEC	Q4	2024
Global			
Bloomberg World Large & Mid Cap NR (Sterling)	-0.92%	6.03%	19.49%
Bloomberg World Large & Mid Cap NR (US dollar)	-2.36%	-0.97%	17.44%
UK			
Bloomberg UK Large, Mid & Small Cap NR	-1.34%	-0.13%	9.66%
US			
Bloomberg US Large Cap NR	-2.46%	2.71%	24.70%
Europe			
Bloomberg Europe DM ex UK Large & Mid Cap NR	-0.42%	-3.67%	6.81%

FIXED INCOME	DEC	Q4	2024
Bloomberg Barclays Series-E UK Govt 1-10 Yr Bond Index	-0.80%	-1.14%	0.25%
Bloomberg Barclays Series-E US Govt 1-10 Yr Bond Index	-0.57%	-1.70%	2.42%
Bloomberg Global Agg Treasuries TR Unhedged (GBP)	-1.04%	0.68%	-1.85%
Bloomberg Global Agg Treasuries TR Unhedged (USD)	-2.50%	-5.99%	-3.58%
Bloomberg Sterling Corporate TR Unhedged (GBP)	-0.57%	-0.32%	1.71%
Bloomberg US Corporate TR Unhedged (USD)	-1.94%	-3.04%	2.13%

CURRENCY vs. STERLING	DEC	Q4	2024
US Dollar	1.74%	6.86%	1.72%
Euro	-0.38%	-0.61%	-4.55%
Yen	-3.07%	-2.34%	-8.71%

CURRENCY vs. US DOLLAR	DEC	Q4	2024
Euro	-2.11%	-7.01%	-6.21%
Yen	-4.73%	-8.63%	-10.28%

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Neither Bloomberg nor Bloomberg's licensors approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.



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