DIAMOND HILL

INVESTED IN THE LONG RUN

Let the (Political) Games Begin

Jul 2024

Markets notched a positive month in July, seemingly shrugging off globally ratcheting political and geopolitical upheaval. Developed markets were broadly positive, while emerging markets were flatter, with some — notably, China — in the red. In USD terms, the MSCI ACWI Index rose 1.6% as inflation finally showed some signs of easing, and global central banks seemed to get closer to interest rate cuts.

Just after the month ended, the Bank of England announced a 25-basis point (bps) rate cut — its first since 2020 — taking the benchmark rate down to 5.0%. However, the Monetary Policy Committee was sharply divided over the decision, which passed by a slim 5-4 margin. Accordingly, BoE Governor Andrew Bailey signaled ample caution around further rate cuts in the near term. Meanwhile, the US Federal Reserve held rates in July — though Fed chief Jerome Powell has indicated there may be room for a cut in September, ahead of the US election. The European Central Bank also held in July after cutting in June, and with July's inflation edging up again, it may rethink whether a cut is on the table in September.

At the other end of the monetary policy spectrum remains Japan, which announced a 25-bps interest rate hike to 0.25% as July concluded. The Bank of Japan also announced plans to halve its monthly bond purchases — moves that come against the backdrop of a notably weak yen. However, consumer-driven inflation in Japan remains modest, prompting some concerns the BoJ is raising rates in the face of an already weak economy and may jeopardize nascent signs of exiting its long malaise.

China also remains in a different — and challenging — position, with the People's Bank of China cutting rates in July by 0.1 percentage point to 3.35%, a move it hopes will spur economic activity. The surprise decision followed the Communist party's policy meeting, at the end of which it announced its intention to find ways to boost demand — a shift from the government's prior emphasis on spurring producers and helping bolster the country's flagging property market.

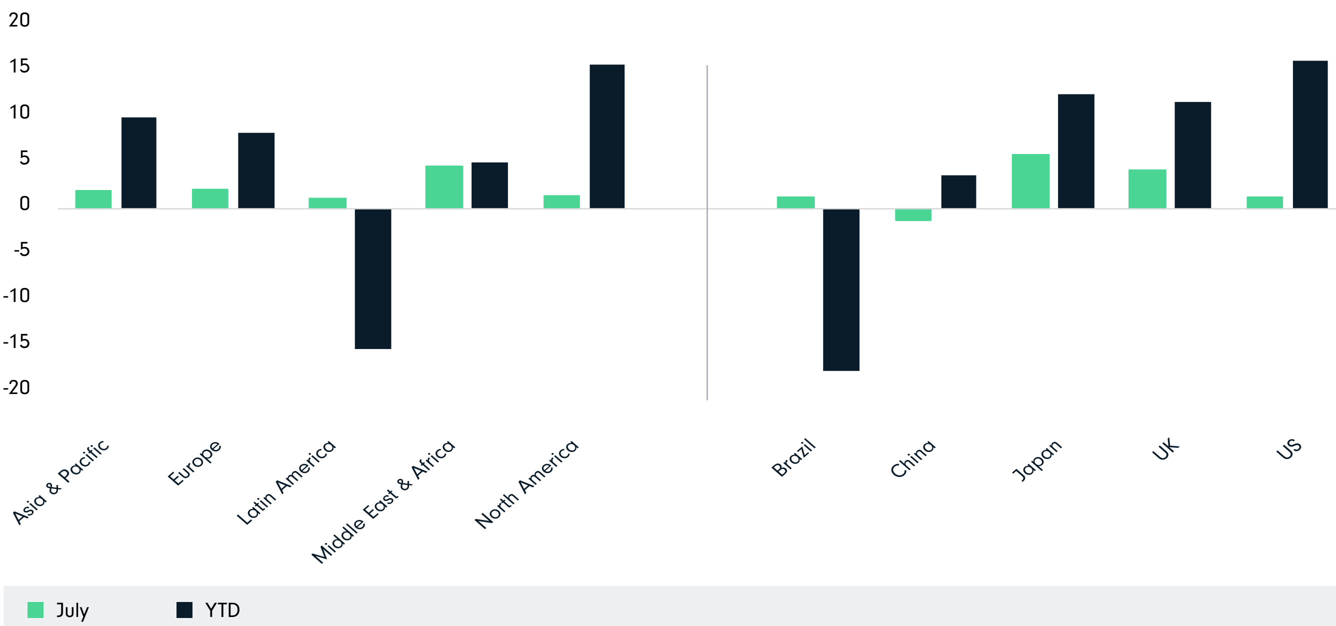
These economic and monetary policy developments occurred as domestic and international politics heated up meaningfully in July: After an assassination attempt on US presidential candidate Donald Trump, President Joe Biden announced he wouldn't seek another term and endorsed his current vice president, Kamala Harris. The UK voted the Labour Party into office in a landslide victory, ending the party's 14-year stint as the opposition party. And following French President Emmanuel Macron's surprise decision to call a snap election, the French government is gridlocked. In Latin America, Venezuela's population is threatening to revolt against President Nicolás Maduro, whom many claim stole the election from opposition candidate Edmundo González. On the geopolitical front, war continues between Russia and Ukraine, and hostilities in the Middle East seem to be escalating as Israel faces (and is responding to) a growing number of attacks from Hezbollah, in addition to pursuing its ongoing war against Hamas forces.

Regionally, stocks in the Middle East led the way, up 4.5% and led by strong performances from the United Arab Emirates (+6.8%), Egypt (+6.1%) and South Africa (+5.2%). Europe delivered the next best returns, rising 2.1% in July. At the individual country level, Ireland was the stand-out performer, gaining 10.5%, followed by Greece (+9.8%) and Belgium (+6.9%), Switzerland (+4.8%) and the United Kingdom (+4.2%). France delivered a more modest return (+2.4%), as did economic leader Germany (+1.9%). Meanwhile, the Netherlands (-4.9%), Poland (-4.3%), and Denmark (-4.1%) were all in the red.

The Asia & Pacific region also rose nearly +2.0%, tied to strength in Thailand (+5.8%), Japan (+5.8%), Malaysia (+4.2%), the Philippines (+4.4%), and India (+4.0%). However, Taiwan gave back some of its significant YTD gains, declining -4.3% in July, while China fell -1.3% and Korea was down -0.5%. North America rose 1.4% in July, with the US up +1.2% and Canada up +4.9%.

Latin America was the world's weakest region, though it also managed gains in July, rising +1.0%. Peru led the way (+2.8%), followed by Colombia (+2.3%) and Brazil (+1.3%). Mexico rose a more modest +0.7%, while Chile was the sole individual country in the red, down -0.5%.

Exhibit 1 — July Returns for Major Markets (USD) (%)



Source: FactSet, as of 31 July 2024.

At the sector level, utilities (+5.5%), real estate (+5.0%), and health care (+5.0%) rose the most, followed by financials (+4.5%), consumer staples (+3.8%) and industrials (+3.4%). Materials (+1.6%) and communication services (+1.5%) saw more modest increases, while consumer discretionary (+0.1%) and energy (+0.5%) notched the smallest gains. Conversely, the information technology sector was the lone decliner in July, falling -2.5%.

The macroeconomic backdrop seemed relatively benign in July: Inflation in some countries moderated but didn't fall precipitously. GDP growth was tepid in most places. The known challenges remain: In Japan, unwinding decades of ultra-loose monetary policy without killing off the nascent economic rebound; in China, bolstering demand in the wake of a significant property sector slowdown while facing growing trade tensions with major developed world partners; in much of the developed world, deciding when to begin lowering interest rates without risking an inflationary resurgence. And as noted earlier, many countries face heightened domestic and international political challenges, whether hot war or contentious domestic elections. Despite all this, markets have marched along, seemingly propelled by a combination of priced-in expectations and new technologies, like artificial intelligence, which are (at least for now) changing the face of sectors like technology, communication services, and even utilities.

Against such a confusing backdrop, we remain convinced what's needed most is a fundamentally oriented, bottom-up approach that takes a sufficiently long-term view to see through as much of the noise as possible. Investors willing and able to do the research necessary to identify investment candidates with the highest likelihood of delivering solid returns over a five-year time horizon should benefit in the long run, even as the near term can rattle nerves. As such, we will remain focused on executing our process and communicating what we learn in the months ahead.

MSCI ACWI Index measures the performance of large- and mid-cap stocks in developed and emerging markets. **MSCI ACWI ex USA Index** measures the performance of large- and mid-cap stocks in developed (excluding the US) and emerging markets. The indexes are unmanaged, market capitalization weighted, include net reinvested dividends, do not reflect fees or expenses (which would lower the return) and are not available for direct investment. Index data source: MSCI, Inc. See diamond-hill.com/disclosures for a full copy of the disclaimer.