A forward view of the global economy and financial markets

August 2023

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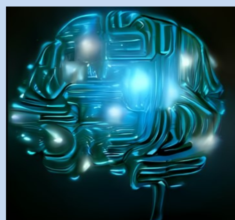
Nvidia and A.I.

"Artificial Intelligence will reach human levels by around 2029. Follow that out further to say, 2045, we will have multiplied the intelligence, the human biological machine intelligence of our civilization by a billion-fold."

Ray Kurzweil (US Computer scientist)



Source: Wikipedia

Nvidia was founded in 1993 by three very bright Information Technology engineers. The company has grown into the leader in Artificial Intelligence (A.I.) computing with a market cap of $114 trillion. The company reached this position by being the best provider of graphics cards for the gaming industry, which has exploded over the last two decades.

Along the way it has acquired rivals such as 3dfx Interactive. Inc. which was a pioneer in consumer 3D graphics technology. After completing this deal in 2002 it went on to buy Extuna, MediaQ, IReady, ULI Electronics and Hybrid Graphics. In 2006 it was investigated by the US Department of Justice regarding antitrust violations in the card industry. Nvidia and its main competitor AMD were already dominating this market but it did not stop Nvidia buying PortalPlayer Inc in 2007 and in 2008 it took over Ageia. Things were not entirely straightforward as the company took a $200 million write down as certain mobile chipsets and GPUs had abnormal failure rates. It then faced a class action lawsuit over defective chips that were being used by Apple, Dell and HP. In 2010 Nvidia reached a settlement and then in early January 2011 it signed a six-year, $1.5 billion cross-licensing agreement with Intel.

Nvidia was quick to understand that it made sense to buy up companies with new technology which would keep it ahead of all other competitors. This policy continued with the largest deals being the acquisition of Mellanox Technologies in 2019 for $6.9 billion and then in 2020 it bought Arm, the largest UK chipmaker, from Softbank for an eyewatering $40 billion.

It is no surprise that a company with 2,101 employees and revenues of $2,010m in 2005 is now an industry giant employing 26,000 people with revenues of $13.51b. Nvidia is now well placed to be a dominant force as the A.I. market expands rapidly. It has seen a huge increase in sales of its data centre chips and its top-tier GPUs are used to process complex A.I. tasks at data centres and all the top "generative A.I." platforms run on its chips.

Nvidia has no meaningful competitors in the data centre GPU market and it is going to be increasingly difficult for a new company to break into this market. The other worry for governments and companies alike is that Nvidia can afford to buy up potential competitors at an early stage.

Many commentators have spoken about the dangers of A.I. taking over from humans but maybe we should be more concerned by the dominance of Nvidia in the high end of the chip making technology. Microsoft is trying to develop its own chip but as far as we can see it is still someway off threatening Nvidia's dominance.

The use of A.I. is growing at a faster pace than was ever envisaged and it is still a relatively unregulated industry. Governments need to act quickly and regulators need to make sure that there is meaningful competition in the future.

Richard Harper
Head of Asset Allocation
GHC Capital Markets Limited

Asset Allocation

In which **Tim Harris**, the Chair of our Asset Allocation Committee, describes the factors influencing our latest Asset Allocation decisions

Dodging a G7 recession?

Financial markets fret that global growth might border on a mild recession. However, several data points from the US have brought comfort. A robust sector quarter GDP report and evidence of a rebound in industrial confidence led economists to upgrade their 2023 growth forecasts. Inflation is well off the highs of the last year, but remains problematic.

Although some data points have been better than expected, the aggregate global picture is of persistent inflation ahead of central bank targets. Inflation is moderating in most parts of the world, although core inflation remains higher than the central bankers would like. In most cases, they do not see inflation getting back to their targets until the back end of 2024. The Fed, ECB and Bank of Japan all tightened monetary policy through the course of July, much as the markets had expected. In the emerging markets there are hopes that some countries could be delivering their first rate cuts – Brazil and Chile come to mind.

The latest 25bps increase in the US Fed funds rate has still not pushed the real interest rate to a level that would typically be seen as restrictive. Monetary policy is working against very loose fiscal policy in the Fed's effort to slow US growth. JPMorgan estimates that spending is pushing the US government deficit from $950bn in fiscal year 2022 to $1.839 trillion in the current fiscal year ending September 30th. The Congressional Budget Office expects the US to run increasing budget deficits of around 6% of GDP over the next two years. Compare that with 2006/7, when the US last tried to rein in inflation, the budget deficit averaged 1.5% of GDP and was declining.

The US economy is outperforming the UK and Europe

Nonetheless, we expect the US to avoid recession this year, while bringing inflation further back to desired levels. Among the major economies, the US is the stand out, with economic data that is coming in ahead of market expectations. Meanwhile, the UK and Europe are stumbling through low growth / high inflation data points, which we expect will remain the case through the balance of summer. UK economic growth is projected to be flat for the rest of the year as tighter monetary policy slows expansion. The UK has exceeded modest expectations during the first half, amid lower-than expected natural gas prices, labour market resilience, strength in the services sector, and better-than-expected global expansion. While consumption is expected to be supported by improving consumer confidence, real labour income turning positive in the second half of the year and excess savings, Britain's economy will also have to contend with even tighter monetary policy that may stall expansion.

China slowdown

Asia is focussed upon China's dramatic slowdown on a fading boost from reopening, a shift from inventory building to destocking, a renewed slide in housing activity, and weak external demand. The growth impulse from reopening was more front-loaded than we had expected and appears to have largely played out in recent months. The third quarter is off to a soft start, with exports and imports weakening further in July, another major property developer missing a bond payment, and CPI inflation joining PPI in negative year-over-year territory, mostly due to food prices.

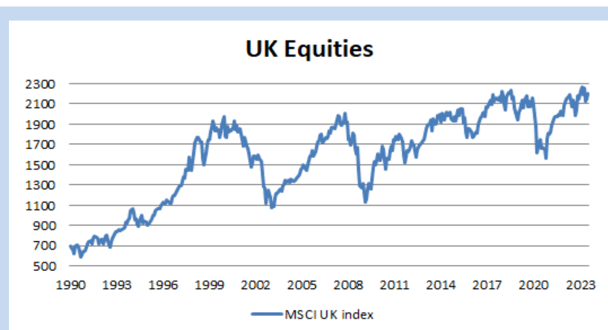
Exports and property, the two main engines of China's growth over the past few decades, are sputtering. Exports are challenged by mediocre global growth, China's already-large market presence, geopolitical tensions (in particular, ongoing US tariffs and export controls), and the shift in focus of multinationals from 'lower cost' to 'greater resilience'. Meanwhile, property — and ultimately infrastructure — investment must adjust to a downtrend in population and slowing urbanization. If China stalls that creates a headwind for many dependent Asian economies.

Our asset allocation remains broadly neutral

Equities have outperformed bonds through the summer, with government bond yields having an upward bias after the stronger than expected growth data. The equity market rally has broadened, with some cyclical sectors surpassing the technology sector performance.

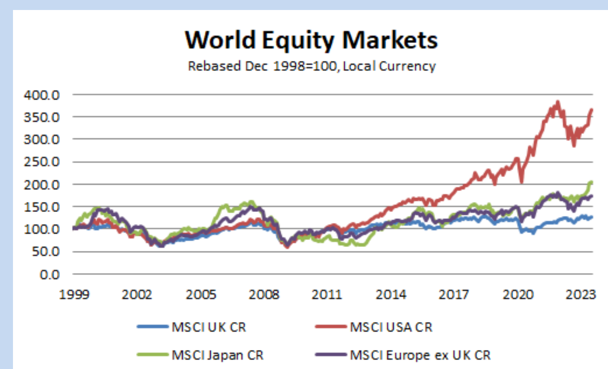
We remain neutral equity/credit and underweight bonds, with a focus on higher quality in equities and credit. We are in a late cycle markets regime - while inflation is normalising, growth is slowing and central banks are still tightening policy, which limits upside to risky assets. We expect growth to slow alongside inflation through the rest of the year under the weight of tighter monetary conditions. Equity volatility remains moderate, helped by resilient US growth and a good Q2 2023 earnings reporting season. We see equities stuck in a trading range.

Markets at a glance



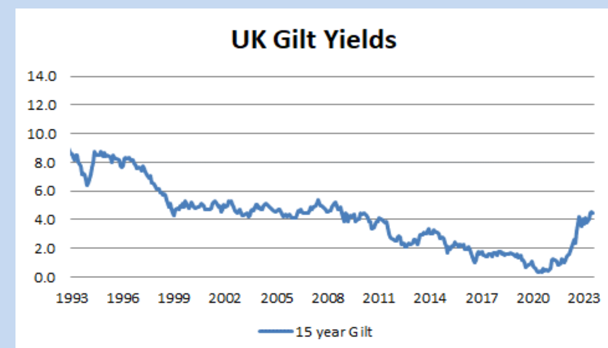
Source: Lipper for Investment Management

The market is dogged by a lack of international investors on growth and inflation concerns. But rising bond yields also do not help valuation, as risk free rates continue to rise and the yield offered by equity looks less attractive by comparison. The FTSE 100 dividend yield of 4.1% is now lower than the nominal 10-year gilt yield. The better comparison, of course, is with real bond yields (equities are a real asset as dividends should grow with inflation), and while it is true that equity yields remain more attractive than real bond yields, bonds now offer a positive real yield to investors. Furthermore, the price / earnings valuation of UK equities is among the lowest in the developed world. UK equities are cheap by international standards, but there are not yet significant catalysts to change this state.



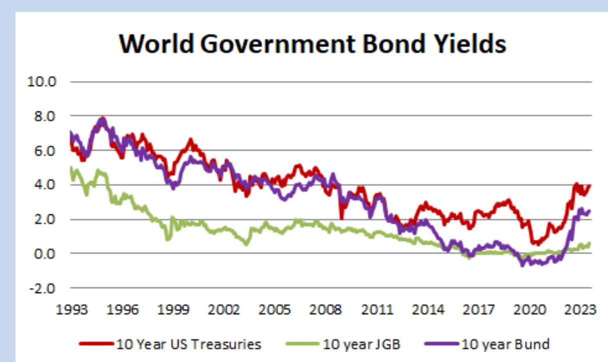
Source: Lipper for Investment Management

Equity volatility is moderate, helped by resilient US growth and a good Q2 2023 earnings reporting season. A likely peak in repo rates, especially in the US later in the year, could make fixed income more attractive in due course. European equities have decoupled from the better US market and continue to register fund outflows. The positive impulse from lower gas prices has failed to compensate for a combination of weaker European activity data, negative macro surprises, concerns over headwinds from China and sticky core inflation. We expect US equities to outperform most regions through the third quarter.



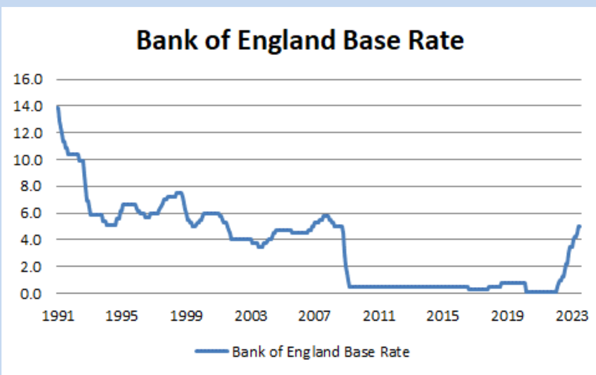
Source: Lipper for Investment Management

More than any other advanced economy, the UK has been squeezed by higher prices, but new data show that inflation may be starting to fall. The spike in gilt yields last year was largely driven by a heightened UK risk premium and concerns about the sustainability of government finances, given large unfinanced tax cuts. This time the rise in yields appears to be a function of resilient economic growth, still high inflation and a Central Bank that is not leading markets. A flat yield curve with 10-year gilts at 4.4% may rise further as the Bank of England continues to raise rates.



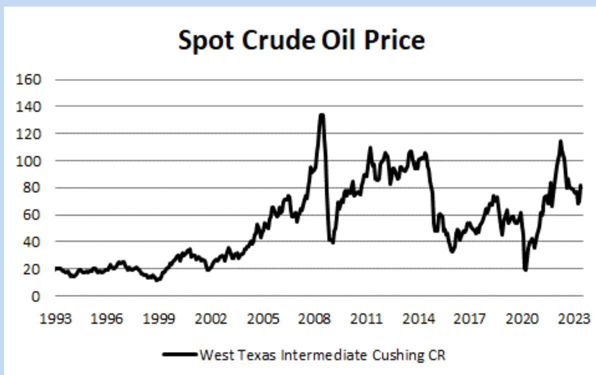
Source: Infront

Long dated US bonds have witnessed a sell-off, with 30-year Treasury yields rising by over 40bp recently. The bear steepening of the yield curve reflects bond risk premium repricing. Among reasons for the sell-off are the Fitch downgrade of the US sovereign credit rating; concern about a spillover from Japan following the Bank of Japan's yield curve control adjustment; markets recalibrating away from a recessionary baseline and readjusting to the idea of better growth and continued fiscal support, which could in turn imply reflationary pricing and steeper curves. Until the Fed has finished its tightening cycle, we would not be attracted to key global sovereign bond markets.



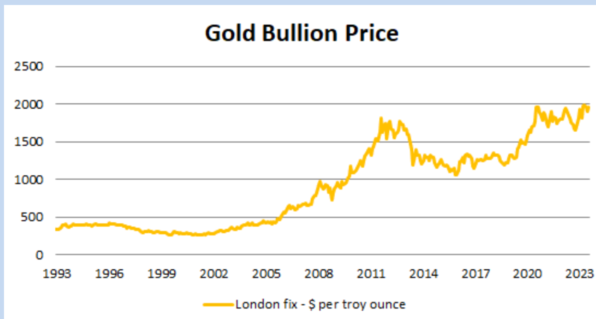
Source: Lipper for Investment Management

The Bank of England has raised the Bank Rate by 25bp to 5.25% - the 14th hike in the current phase. Progress on headline inflation and recent slowing of activity and softer labour market data prompted a step-down to a 25bp hike, despite upside surprises on wage growth. Two BoE board members voted for another 50bp hike, while only one member voted to hold. The revised Bank of England projections showed a downgrade to growth and upgrade to inflation, as the MPC incorporated upside risk to inflation into its projections. We expect one or two more 25bp hikes to 5.75% by November given their forecast for resilient activity and only a gradual cooling in wage inflation.



Source: Lipper for Investment Management

Oil prices are up approximately 20% since mid-June, as record demand and Saudi supply cuts have brought back deficits and the market has abandoned its growth pessimism. Supply growth in the next three years hinges on the effective execution of a small number of large projects. The top-13 global projects alone—which are forecast to grow by more than 100kb/d each in 2024-2026—should drive 60% of global production growth, with large contributions from deep-water in Brazil and Guyana, and US shale. The IEA projects world oil demand to rise by 2.2mb/d and world oil supply to rise by 1.2mb/d in 2023. We see this as neutral to slightly bullish for oil prices given a tighter 2023 balance and downward revisions to OECD commercial stocks. Capex—a key driver of long-run production—is picking up after seven years of underinvestment.



Source: Lipper for Investment Management

While a recessionary outlook would normally be good for gold, recently gold prices have stagnated near $2000/oz, as the situation with the regional banks in the US has proved to be less concerning than originally thought by the market and recent data even suggest that US growth may turn out to be more solid than expected. Nonetheless, we like gold from here, as we are moving past peak Fed hawkishness. This should support a rise in investment demand for gold that has been virtually absent in the last two years. We expect gold to remain supported on the back of range-bound bond yields and a weaker dollar. The balance of risks is that gold should experience stronger investment demand if global economic conditions stagnate. Conversely, a soft landing or much tighter monetary policy could result in disinvestment.

Note that where an MSCI Index has been used for illustration. This has been sourced with permission from MSCI Inc.

Quick facts

ISA Allowance 2023/2024	Stocks & Shares ISA Cash ISA Junior ISA	£20,000 £20,000 £9,000
Pension Allowance 2023/2024	The limit is the greater of £3,600 and 100% of salary, subject to the annual allowance of £60,000 (unless money has been accessed through flexi drawdown in which case the annual allowance is limited to £10,000).	

Tax facts

Income Tax	Personal Allowance 2023/2024	Up to £12,570
	Basic Rate @ 20%	£12,571 to £50,270
	Higher Rate @ 40%	£50,271 to £125,140
	Additional Rate @ 45%	Over £125,140
	Married couple's allowance:	Maximum £4,010
	Older spouse born before 6 April 1935	Up to 10% of the appropriate Min/Max
Capital Gains Tax	Annual Exemption - Individuals	£6,000
	Basic Rate tax band (residential property)	18%
	Basic Rate tax band (other assets)	10%
	Higher Rate tax band (residential property)	28%
	Higher Rate tax band (other assets)	20%
	Business Asset Disposal Relief	10%
	Business Asset Disposal Relief limit of gains	£1,000,000
Inheritance Tax	Threshold up to £325,000	Nil
	Over £325,000	40%
Corporation Tax	Full Rate	19%
	Small Companies Rate (SCR)	19%

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