7IM

Market review

7IM COMMENTARY

JULY 2024

Monthly Musings: Resilience vs efficiency

Wouldn't it be great if money was no object? We can only dream. In reality, we have to compromise.

Take holidays. Relax at the beach all the time and you'll run out of money; so you need to work. But how much? Would you rather spend more time in a less good (cheaper) resort or less time in a nicer one? The choice and compromise are yours.

You see it everywhere in fact. An investor's budget for a building, an architect's dream for it and an engineer's risk tolerance can't ALL be satisfied. So, a compromise needs to be found to ensure something gets built! Safety and practicality, beauty and functionality, cost and benefit – somewhere, there's a middle ground!

And when we make decisions about compromising, we're often forced to decide where we stand on the resilience-efficiency scale. Decide on something that's prepared to withstand all headwinds and you're likely to have favoured something sturdy and expensive and complicated, compared to its efficient and cheap counterpart.

Building resilience comes at a price, one that many aren't willing to pay – at least not in advance. A huge example of how companies are favouring efficiency was the global IT incident on 19 July. Suddenly, everyone is talking about resilience.

On that day, a small cloud-related Microsoft update from CrowdStrike led to what's been described as the biggest IT outage of all time. This led to dramatic outages at airlines, healthcare, and banking, bringing many services across these industries to a halt.

The event barely scratched Microsoft. Its shares were largely unaffected by the outage (it's a giant company that had a glitch, right? No big deal). CrowdStrike, which is part of the S&P 500 and claims to be the cloud security provider of choice for 62 of the Fortune 100 (whereas Microsoft will be in all 100 of them), saw its shares plummet 22% over two trading sessions.

In fact, according to cyber analytics firm Parametrix, the outage is estimated to have incurred $5.4bn of total direct financial loss for Fortune 500 companies (excluding Microsoft). That's efficiency gone wrong. So efficient that when it fails, it fails big time.

The incident highlighted the fragility of the systems individuals and companies use around the world, where the objective of getting the job done doesn't include a plan B for unforeseen events.

It was also a clear example of the dependencies of major corporations on a small number of names that provide critical tools for them to carry on with their services. If companies depend on a small number of products and partnerships that provide critical services… that's risky business.

That doesn't have to happen in investing, though. Creating resilient portfolios is one of the oldest tricks in the book: spreading investments across different asset classes, names, industries, geographies, which is the best way to avoid overreliance on a small number of factors and to reduce concentration risk.

Building for resilience might be more expensive and slower than the more efficient solution. But if your portfolio only works when everything is perfect, get ready for a shock at some point!

7IM COMMENTARY

July Markets Wrap

Artificial intelligence is a concept that has been around for a while now. ChatGPT reached 100 million users in January 2023, and US stock performance has heavily tilted towards names that produce or are largely to benefit from AI.

This means that, when there's big growth in the S&P 500, it's largely associated with the usual suspects (a.k.a. the Magnificent Seven); but equally, see a large loss and the origin is likely to be the same.

We've seen that once or twice in the last few years, and it happened again in July. The S&P 500 slipped 2.3% in a single day, and the Nasdaq went down 3.6%, simply on the back of results from Tesla and Alphabet not fully meeting investor/analyst expectations.

The promise technology companies are making to investors from an AI point of view is yet to meet investor expectations. Investors want to see results from all the capital invested into AI, but there is little certainty over what and when results might come. The result so far has been an overly concentrated market, with significant fluctuations, where investors are yet to see changes to productivity or revenues from AI efforts.

Goldman Sachs analysts estimate the buildout of AI will incur $1tr of costs over the next few years, adding that the principle of replacing low-wage jobs with costly technology is the opposite of the large technology transitions of the past three decades.

At the same time, it's been an eventful month for politics. With President Biden out of the 2024 presidential race and Kamala Harris as the new Democratic nominee, little changes across the financial market. As we've said before, politics matters little for investments.

The UK is no exception: even though July saw quite some change in the political landscape, i.e., a new majority government being formed by Labour, markets remained immune to politics. The FTSE 100 went up by 3% in the month, supported by strong financial results from some of its major players.

7IM COMMENTARY

Markets Moves

Equities	1M	1Y	5Y
FTSE 100	3%	9%	11%
S&P 500	1%	21%	87%
MSCI Europe ex-UK	0%	10%	38%
Topix	-5%	17%	76%
MSCI Emerging Markets	0%	4%	6%

Government Bonds (Yield Change)*	1M	1Y	5Y
UK 10Y	-8%	-11%	562%
UST 10Y	-9%	1%	114%
Bund 10Y	-12%	-10%	610%

Currency	1M	1Y	5Y
GBP vs USD	-1%	0%	-5%
GBP vs EUR	1%	2%	8%
GBP vs JPY	-6%	5%	48%

Source: Bloomberg. Data as of 1 August 2024.

*Prices fall when yields rise, so formatting is inverted

What we're watching in August

- **1 August:** Monetary Policy Committee meeting
- **11 August:** End of the 2024 Olympic Games
- **14 August:** July CPI for UK and US.