

## Quarterly Global Asset Allocation No. 57, 20<sup>th</sup> March 2024

(i.e. 6 months – 2 years global asset allocation views)

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# Positioning Ahead of a Summer SELL-off

### Summary Extract:

“...In the near term, though, i.e. over the next 6 – 12 months, risks are rising. In particular, as we highlighted last week, there are three immediate downside risks to US/global equity markets...”

### Table of Contents – Key Sections:

1	Section 1: Summary & Conclusion	p. 2 – 8
2	Section 2: Top Level Asset Allocation Recommendations	p. 9 – 10
3	Section 3: Detailed Asset Allocation Recommendations	p. 11 – 14
4	Section 4: Key charts	p. 15
5	Section 5: Global PMI Trends	p. 16 – 17

### Published as Separate Individual Extracts

6	Eurozone Macro Analysis & Traffic Lights
7	US Macro Analysis & Traffic Lights
8	Chinese Macro Analysis & Traffic Lights
9	Global Valuation Analysis

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## Positioning Ahead of a Summer SELL-off

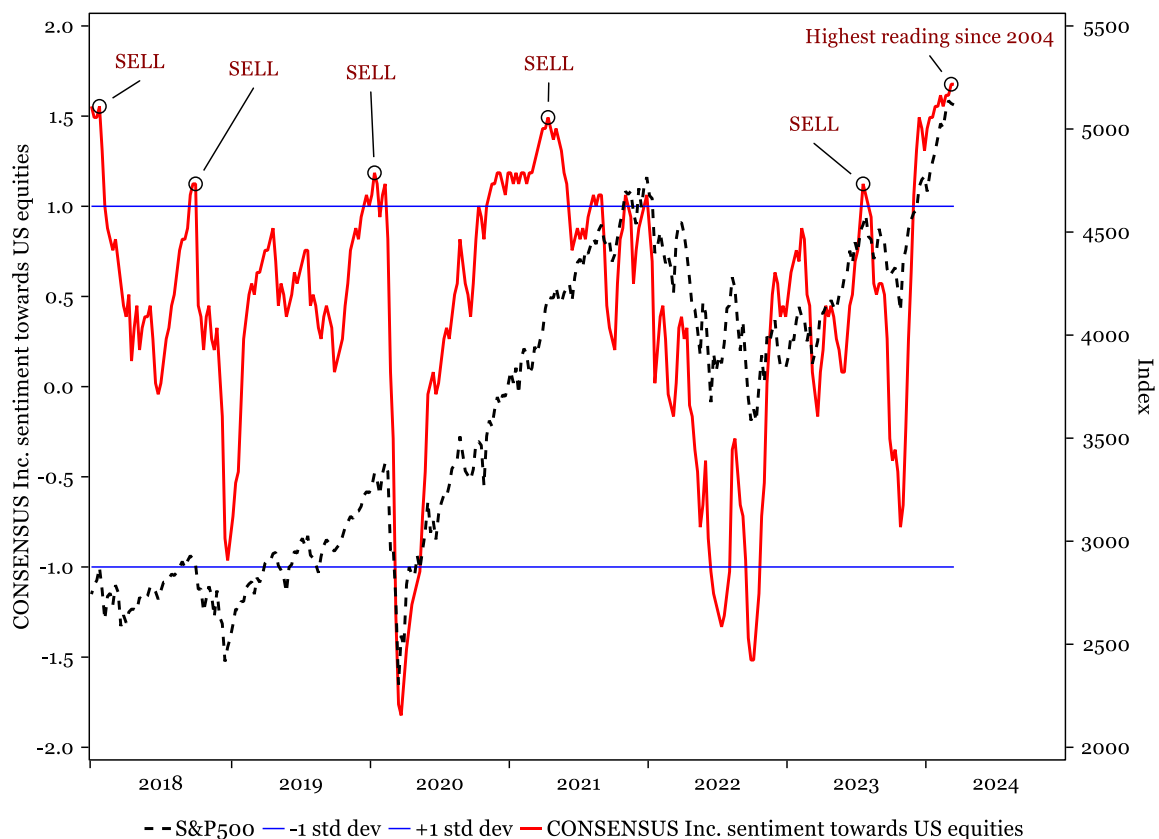
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### Summary & Conclusion

Risk assets have performed well in recent months. Global equities are up 25% since their October low; several country indices have made new record highs; and credit spreads/other risk premia have tightened (in some cases dramatically, e.g. see BTP spreads over Bunds). Elsewhere volatility across certain major asset classes has fallen/trended lower (e.g. with FX vol falling to a two year low).

Unsurprisingly, therefore, consensus thinking in markets is reasonably bullish. There's no longer talk of a US/global recession, cash levels in portfolios have fallen to low levels, and sentiment towards equities has risen to a 20 year high (e.g. see fig 1 below)<sup>1</sup>.

**Fig 1:** Consensus Inc sentiment towards US equities vs. S&P500



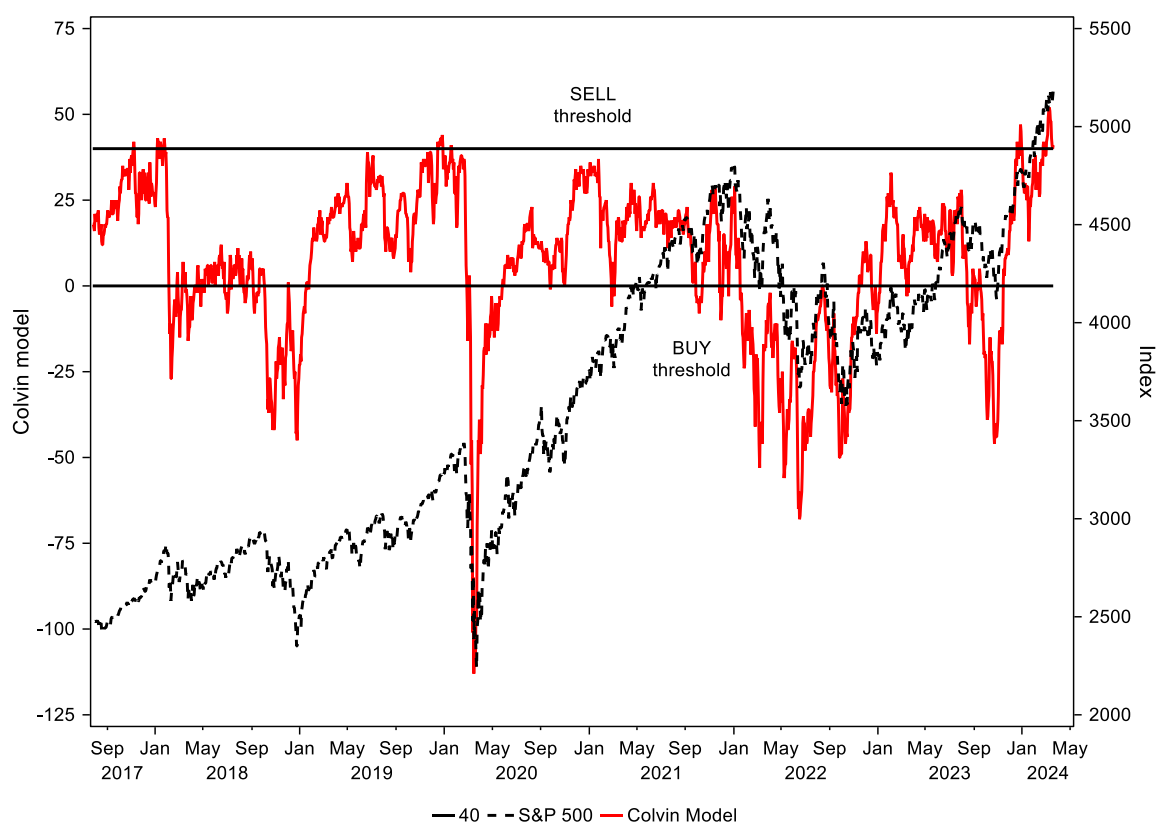
Source: Longview Economics, Macrobond

<sup>1</sup> Of note, and while sentiment indicators are therefore generating a contrarian SELL signal for equities (fig 1), bullish readings can persist for a prolonged period of time.

In December last year, we moved from meaningfully underweight risk assets (primarily equities) to modestly OW risk. In recent months, we've been adding to the OW risk position. We've increased weightings, for example, in gold and Chinese equities and have reiterated the case for staying OW Japanese and Spanish equities.

The key question, therefore, is: Given such strong gains in global markets in recent months, **has the risk reward changed?** And, how should asset allocators, with a 6 – 24 month time horizon, position their portfolio?

**Fig 1a:** Longview Colvin model (global breadth indicator) vs. S&P500



Source: Longview Economics, Macrobond

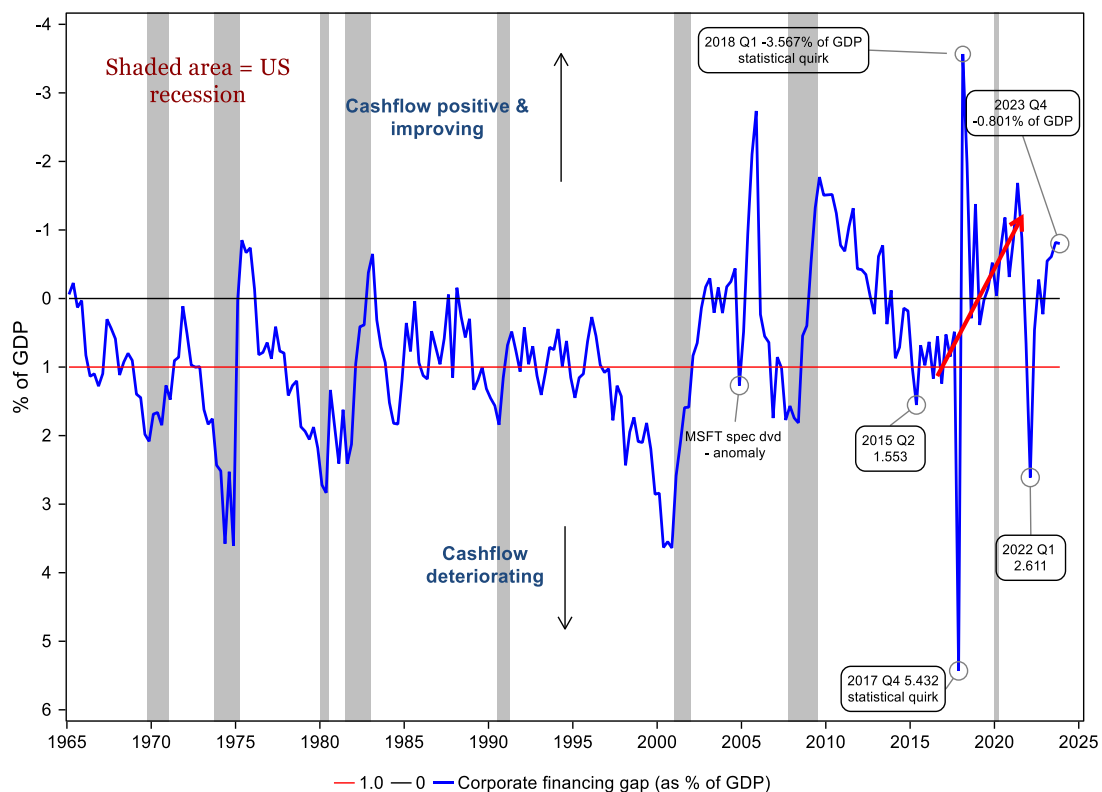
## Global Equities: Stay (modestly) OW...for now

In the **medium/long term**, i.e. on a **1 – 2 year view** the outlook for risk assets is relatively robust, in our view.

In particular, inflation should (continue to) work its way meaningfully lower in that time; US/global earnings should expand/trend higher; the Fed and other major central banks will likely embark on significant rate cutting cycles; and recession risk will probably continue to fall<sup>ii</sup>. All of that should support ongoing gains in US/global equities and other risk assets.

Of note, on that timeframe, the US economic expansion should be underpinned by the strong health of the corporate sector (fig 1b), as well as the loosening of credit conditions (for detail see AA Extract: “[US Macro: Sectoral and Structural Strength](#)”); European economic and earnings growth should reaccelerate later this year (see AA Extract: “[Europe is Deleveraging!](#)”); and, while China is battling with long term macro headwinds, its credit cycle, and economic momentum, is likely to turn higher, especially given the significant loosening of PBoC policy (see AA Extract: “[China: Economy Bouncing \(but structurally impaired\)](#)”). The bias in our portfolio, therefore, on a 1 – 2 year view, favours OW positioning in both bonds and equities.

**Fig 1b: US corporate sector financing gap (% of GDP)**



Source: Longview Economics, Macrobond

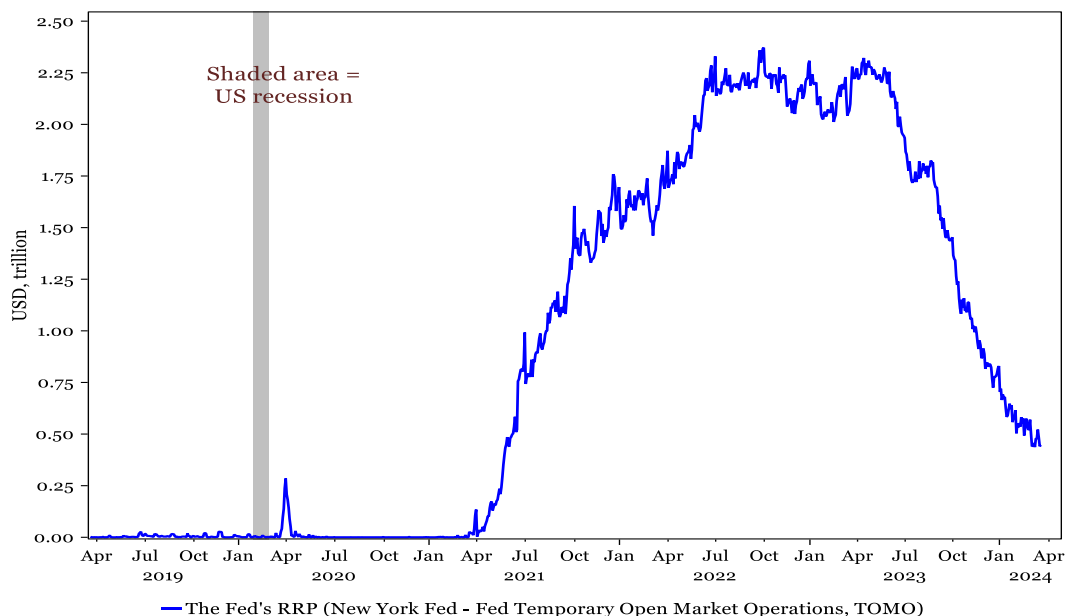
<sup>ii</sup> We downgraded recession risk in 2024 to 35% (from >50% in 2023).

In the **near term**, though, i.e. over the next **6 – 12 months**, **risks are rising**. In particular, as we highlighted last week, there are three immediate downside risks to US/global equity markets.

They include:

- (i) **rising liquidity risks**, given that (a) the Fed’s BTFP program has finished, (b) the Fed’s QT program remains ongoing, and (c) the RRP, which has been a key source of liquidity for markets in the past 9 months, has been largely drained (and is almost empty – see fig 1b below);
- (ii) **extreme US equity valuations**; and
- (iii) a growing likelihood that the **US labour market will soften**, potentially resulting in a shallow recession (for detail see last week’s Longview on Friday: “Equities: The Worry List”). NB we have assigned a 35% probability to a US recession in 2024.

**Fig 1c:** US RRP balance (USD, trillion)



Source: Longview Economics, Macrobond

Of note, those risks are growing at a time when many (although not all) of our **medium term models are warning of caution** towards global equities. The Colvin model, for example, which measures breadth across the global financial landscape, is on SELL (fig 1a); sentiment, as noted above, is bullish (and generating a SELL signal for US/global equities, fig 1); while a number of technical indicators show that certain country equity indices are overbought and vulnerable to the downside (e.g. see fig 4).

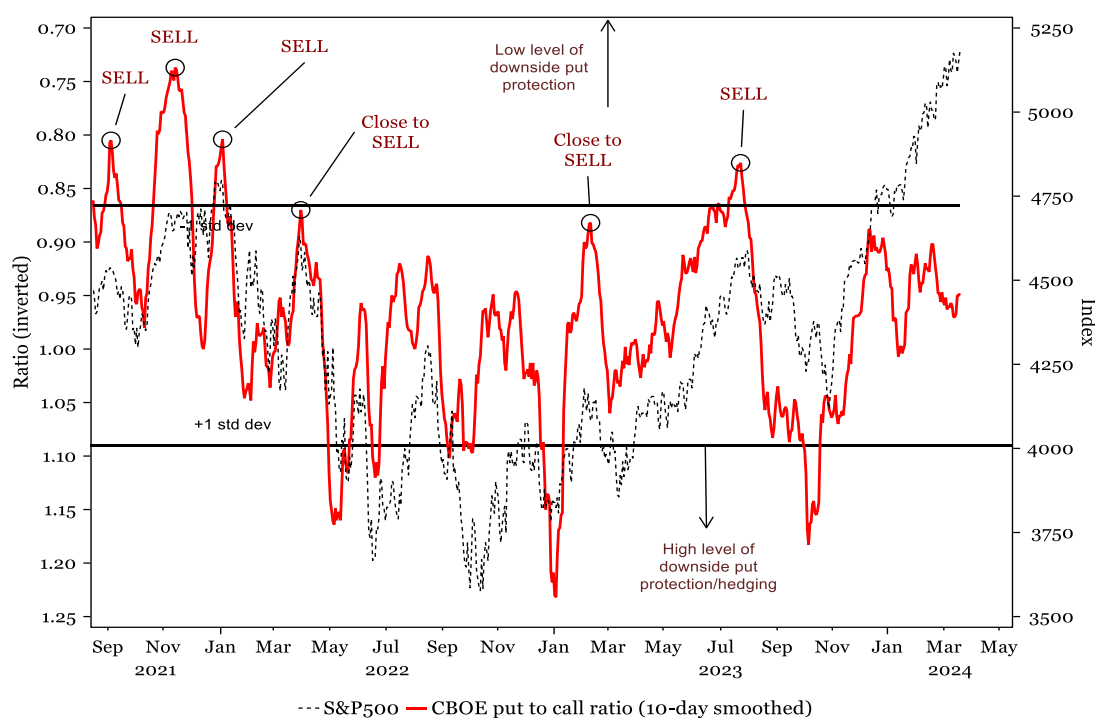
Given that backdrop, therefore, there's an **emerging case for dialling back equity exposure in strategic portfolios**, with a view to reinstating OW equity positions at lower levels. That is, the combination of those factors above should create a challenging environment for global equities at some point in coming months (and a tradable opportunity for asset allocators).

We expect, though, to start doing that when: **(i)** evidence of complacency has become broad based; and **(ii)** the risk of a tightening of dollar liquidity is imminent.

Regarding (i), while some models, as mentioned above, are on SELL others are still neutral and/or at mid-range levels (and not warning of a pullback). In particular, the medium term put to call ratio (e.g. see fig 1d below), and the SELL-off indicator are not warning of a major pullback.

Added to which, and with respect to (ii), there is still (some) further liquidity provision to come from the RRP (with its current balance of \$440bn) while the TGA balance also remains large (~\$850bn, and, therefore, a source of further potential liquidity in markets, fig 4a). In particular, when the Treasury announces its Q3 refunding program (April 29<sup>th</sup>), it may choose to keep net issuance low (as it did in January for Q2) and, instead, draw down its cash balance at the Fed (the TGA). That would draw less liquidity from markets, and consequently, by default, support equities (which, given it's an election year, is a strategy that Yellen/the Treasury is likely considering/already enacting).

**Fig 1d: CBOE put to call ratio (10 day smoothed) vs. S&P500**



Source: Longview Economics, Macrobond

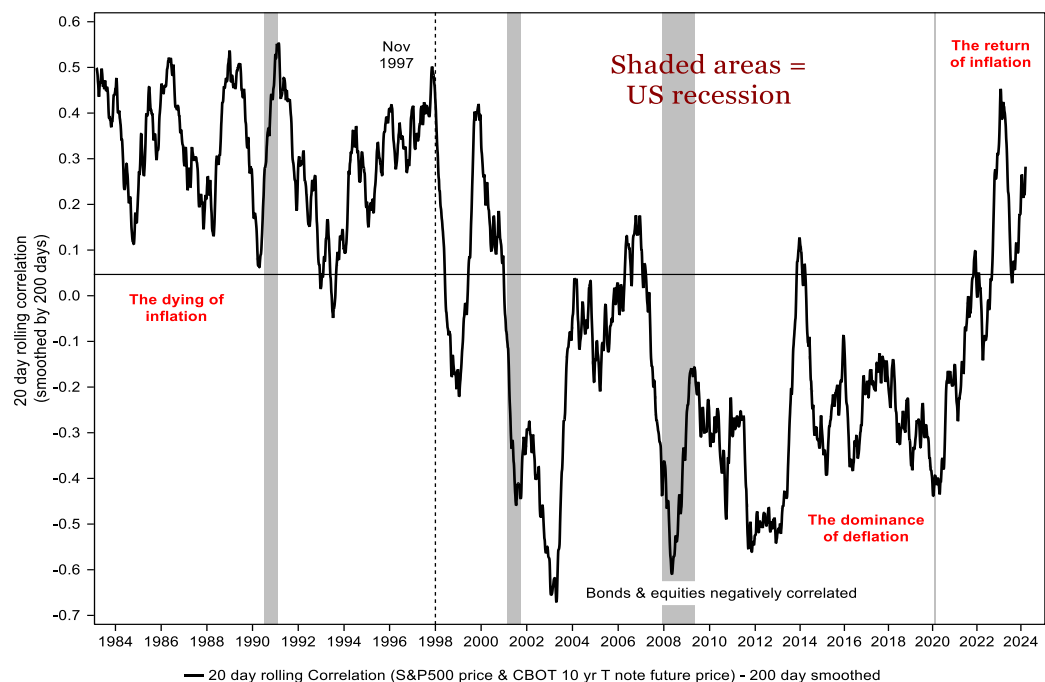
## **Sovereign Bonds:** Modestly OW (having reduced exposure in December)

All of that, though, raises a key question: In an environment in which equities/other risk assets sell-off, how do bonds perform? Is the 60:40 balanced portfolio still a valid approach and will bonds therefore be a good hedge against equity market weakness? Or is the 2022 template, with both bonds and equities selling off together, the new reality? The answer to those questions depends on the inflation regime, which determines the bond-equity correlation.

In the 20+ years from 1995/97 to 2020, for example, inflationary pressures were subdued. As a result, global macro shocks, or other problems in the global economy, generated 'disinflationary/deflationary busts' (e.g. the Eurozone crisis or the GFC). In that environment, equities sold-off on rising concerns about growth (while bonds rallied as the bond/rates market priced lower growth and inflation, as well as a Fed policy response).

In the decades prior to 1995/97, though, (and more recently), inflationary pressures have been more elevated. In those environments as the Fed has raised rates to counter inflation, it's generated macro shocks/tight money which drives equity markets lower. In that environment, therefore, the macro shocks can be characterised as 'inflationary busts'. As rates were raised in 2022, for example, equities come under pressure (while bonds sold off). In the 1980s, tight money was enacted by Volcker to combat persistent inflation. That drove phases of both bonds and equities selling off together (& conversely rallying together, as inflation pressures eased), see fig 1e below.

**Fig 1e:** US equity bond correlation (20 day rolling, 200 day smoothed)



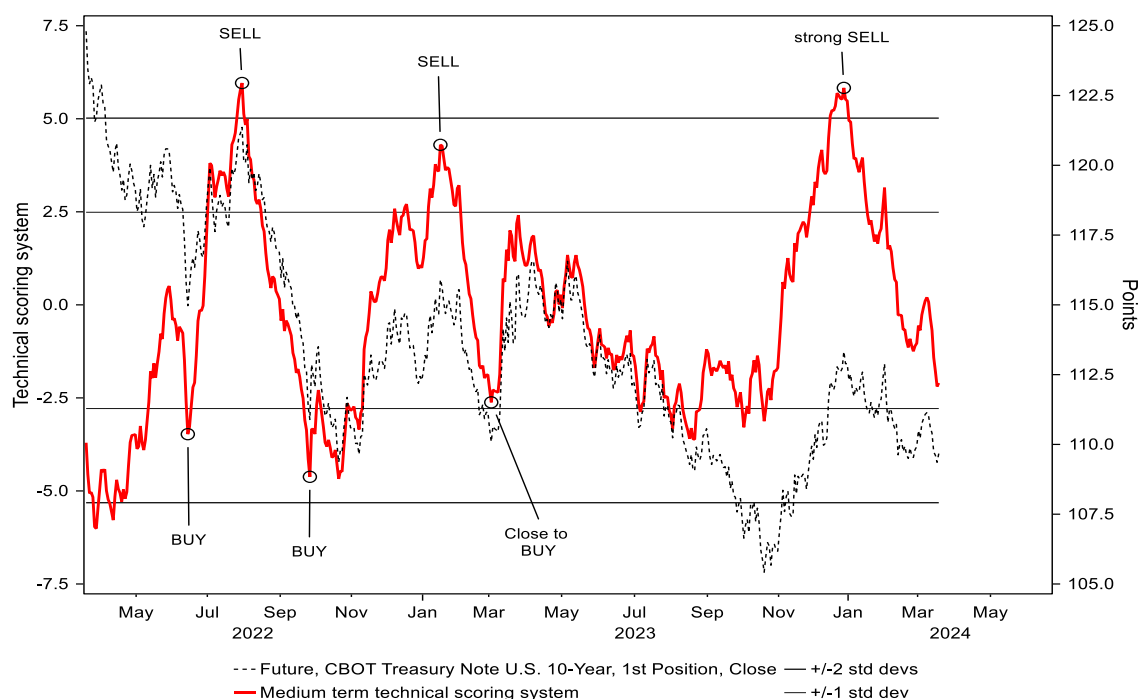
Source: Longview Economics, Macrobond

In that context, therefore, it's notable that the current perception in markets (and at the Fed) is that 'inflation is sticky'. Some data points support that view, including the uptrend in monthly core US service sector inflation (see fig 2 below). All of which enhances the chance that the Fed's policy bias remains hawkish longer than expected (or at least for now – naturally we'll know more after the Fed policy announcement and Powell press conference). As such, **in the 'liquidity-related SELL-off' scenario that we describe above, bond yields would probably move higher** (i.e. an ongoing/positive bond equity correlation, see fig 1e).

Having meaningfully reduced US Treasury weightings in our strategic portfolio in December (from +9pp. OW to +3pp. OW), those factors support the case for keeping low weightings, or indeed reducing them further.

On balance, though, we favour an unchanged position at +3pp. OW for now. In particular, a key reason to reduce weightings in December was that bonds had become notably overbought. As the chart below shows, though, bonds are now close to oversold levels (fig 1f). Furthermore, and while the perception of sticky inflation is currently a strong one, our analysis suggests that inflation should move notably lower later this year and that the labour market should soften (as noted above). As such, and while bonds may initially sell-off with equities at some point in Q2 or Q3, there's an emerging technical and macro/inflation related case for looking to re-build LONG Treasury positions, especially if weakness in equities forces the Fed to stop QT and cut rates.

**Fig 1f:** Longview medium term technical scoring system vs. US 10y futures



Source: Longview Economics, Macrobond



## Section 2: Top-level Asset Allocation Recommendations

Reflecting all of the above, we remain modestly OW sovereign bonds (US Treasuries), EM equities, and commodities (see tables 2 & 2a below). Those OW positions are balanced with an UW cash position. In particular:

- **DM Equities:** Positioning is neutral relative to the benchmark. Within DM, though, we favour somewhat tilting away from US large cap stocks (given heightened bubble risks). Instead we favour defensive and cyclically sensitive DM equity markets (i.e. in Europe and Japan). Within that we retain exposure to small & mid-cap indices (see table 3).
- **EM Equities:** We remain modestly OW Chinese equities. We also favour some exposure to commodity sensitive country indices (please see table 3a for detail).
- **DM & EM sovereign bonds:** For reasons noted above, we favour a small OW position in DM sovereign bonds (with EM bond weightings in line with the benchmark).

**Table 2:** Benchmark & Recommendations<sup>2</sup>

RISKY Assets				SAFE Assets			
Asset	L'view B'mark (%)	Mar '24 weight'g (%)	OW/UW (pp)	Asset	L'view B'mark (%)	Mar '24 weight'g (%)	OW/ UW (pp)
DM Equities	25	25	-	Developed Sovereign Debt	25	28	+3
EM Equities	10	12	+2				
Commodities	5	7	+2	Cash	15	8	-7
HY & EM Corporate Debt	5	5	-	HG Corporate Debt	10	10	-
EM Sovereign	5	5	-				
<b>Total RISKY</b>	<b>50</b>	<b>54</b>	<b>+4</b>	<b>Total SAFE</b>	<b>50</b>	<b>46</b>	<b>-4</b>

**Source:** Longview Economics

<sup>2</sup> Split of safe haven assets vs. risk assets (& vs. benchmarks)

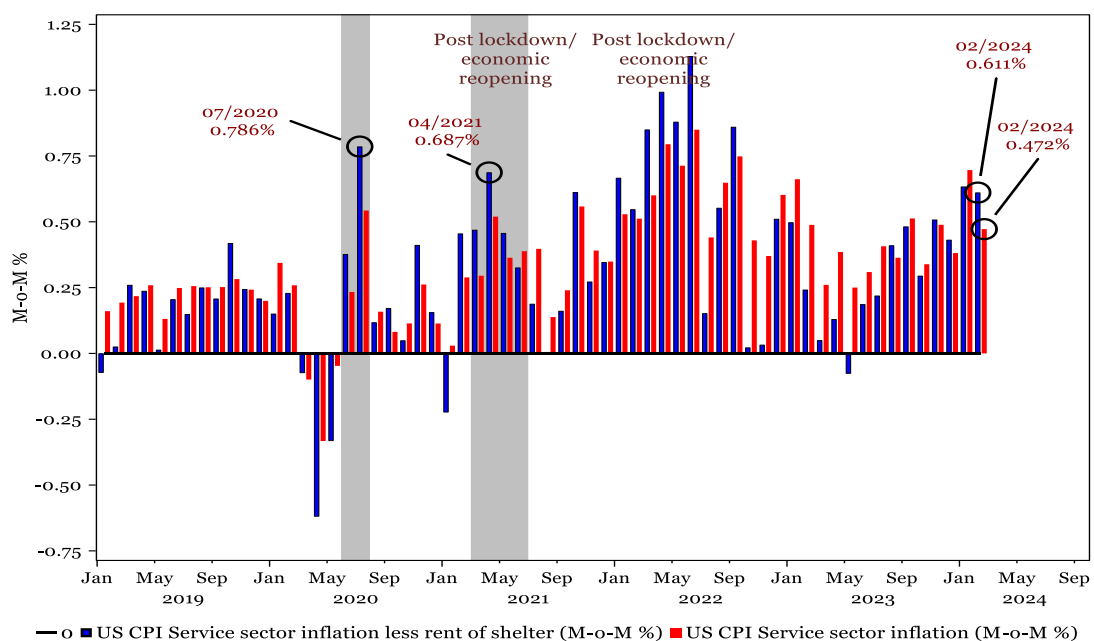
- **Commodities:** Retain OW positioning, having recently increased gold exposure, please see table 3c for detailed commodity recommendations.
- **Credit** (HY and EM): We continue to recommend NEUTRAL weightings for now, with the view to increase exposure later this year (i.e. on a summer sell-off in risk assets, if forthcoming).

**Table 2a:** Top level Strategic Recommended Asset Allocation (% weightings)

Asset Class	NEW % of total (Updated March '24)	% Breakdown	Change from last update	OLD % of total (updated Feb 24)
<b>Equity:</b>	<b>37</b>		-	<b>37</b>
- Developed		25	-	25
- Emerging		12	-	12
<b>Corporate Debt:</b>	<b>15</b>		-	<b>15</b>
- US High grade corporate		7	-	7
- EZ High grade corporate		3	-	3
- US High yield corporate		2	-	2
- EZ High yield corporate		2	-	2
- EM corporate debt		1	-	1
<b>Commodities:</b>	<b>7</b>		-	<b>7</b>
- Gold		3	-	3
- Silver		-	-	-
- Agricultural		-	-	-
- Base metals		1	-	1
- Energy		3	-	3
<b>Sovereign debt:</b>	<b>33</b>		-	<b>33</b>
- Developed		28	-	28
- Emerging		5	-	5
<b>Cash</b>	<b>8</b>	8	-	<b>8</b>

**Source:** Longview Economics

**Fig 2:** US service sector CPI (M-o-M %), shown with service sector ex. shelter



Source: Longview Economics, Macrobond

Extract Quarterly Global AA No 57, 20<sup>th</sup> March 2024

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## Section 3: Detailed Asset Allocation Recommendations

**Developed market equities:** We recommend neutral weightings in DM equities relative to our benchmark. Key country OW and UW positioning is shown in the table below.

**Fig 3:** Longview DM Equity OW/UW recommendations<sup>3</sup> vs. S&P DJ B'mark Weightings<sup>3i</sup>

Region	Category/ Theme	Country	DM index weighting	B'mark allocation (pp.)	OW/ UW	Total allocation	Large caps (% of total)	Mid caps (% of total)	Small caps (% of total)	Percentage points OW/UW								
										-10	-5	0	5	10				
Americas	Tech/Growth	USA	68%	17.0	(6.9)	10.1	33.3	33.3	33.3									
	Commodity	Canada	3%	0.8	0.0	0.8	In line with benchmark											
Asia & Oceania		Australia	2%	0.5	0.0	0.5	In line with benchmark											
		US Dollar	Japan	7%	1.9	1.3	3.2	100	0	0								
			South Korea	2%	0.4	0.0	0.4	In line with benchmark										
			Hong Kong	1%	0.1	0.0	0.1	In line with benchmark										
Europe	Cyclicals	Germany	2%	0.5	0.8	1.3	In line with benchmark											
		Sweden	1%	0.3	0.6	0.8	In line with benchmark											
	Defensives	Switzerland	2%	0.6	1.2	1.8	In line with benchmark											
		Spain	1%	0.2	1.3	1.4	0	50	50									
	Growth/ Expensive	Netherlands	1%	0.3	0.0	0.3	In line with benchmark											
		France	3%	0.7	0.0	0.7	In line with benchmark											
	Value	UK	4%	0.9	1.4	2.4	50	25	25									
		Italy	1%	0.2	0.3	0.5	In line with benchmark											
Other			3%	0.7	0.0	0.7												
DM Equities										100%	25.0	0.0	25.0					

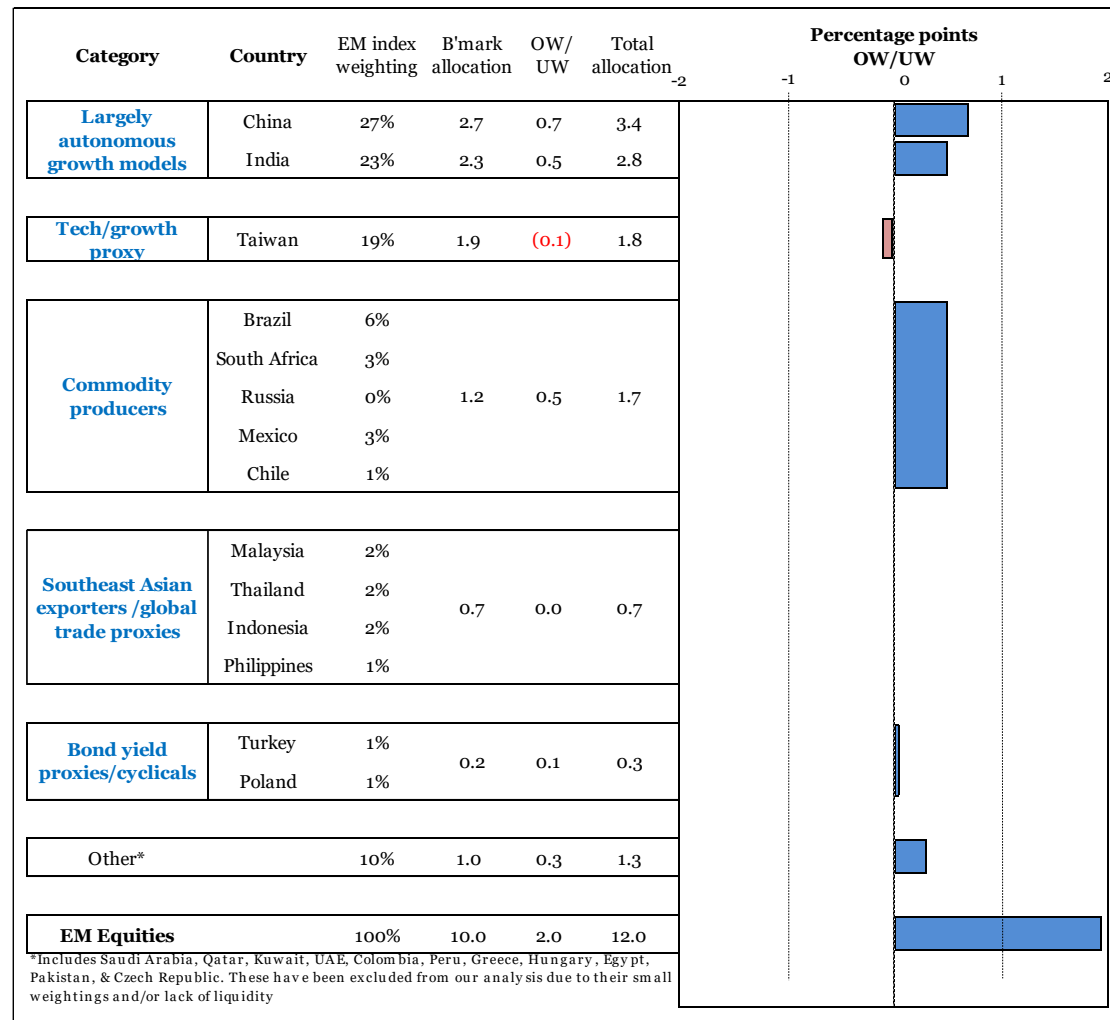
**Source:** Longview Economics, S&P Dow Jones DM index

<sup>3</sup> The large, mid and small cap equity indices for the countries listed above are (respectively): For the US: S&P500, S&P400, S&P600. For the UK: FTSE100, FTSE250, FTSE SmallCap Index. For Spain: IBEX35, IBEX Medium Cap, IBEX Small Cap.

<sup>3i</sup> Other includes: Denmark, Singapore, Belgium, Finland, Israel, Norway, Ireland, Austria, New Zealand, Luxembourg, Portugal & Iceland. NB numbers on this table may not add due to rounding.

**Emerging market equities:** We recommend a modest +2pp. OW position in EM equities (see page 9 for rationale).

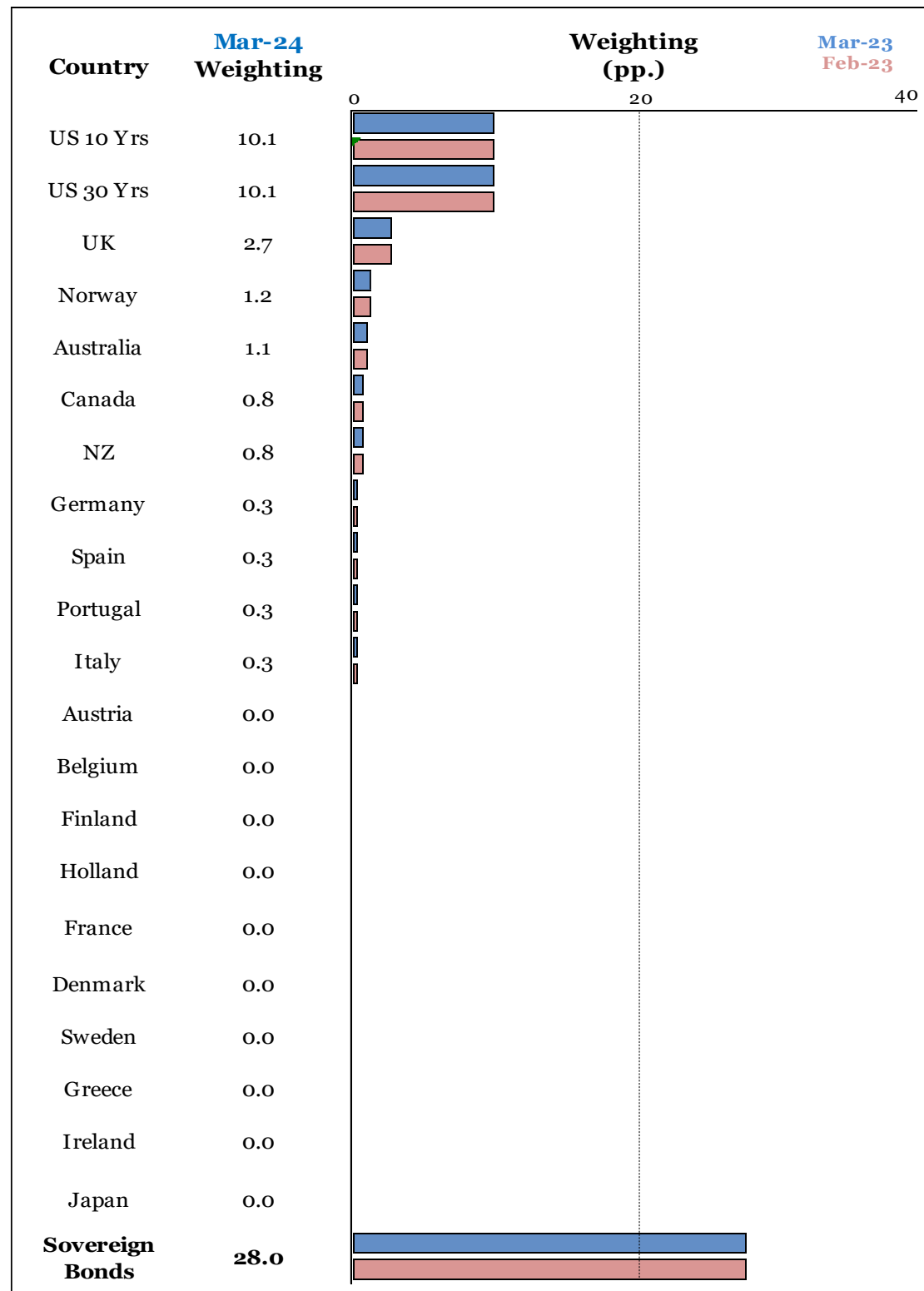
**Fig 3a:** EM equity OW/UW recommendations vs. benchmark EM Weightings



**Source:** Longview Economics, S&P Dow Jones EM index

**Developed market sovereign bonds:** Given the rationale laid out above, we recommend staying modestly OW sovereign bond positions (i.e. having reduced position size last December).

**Fig 3b:** Longview DM Sovereign Bond weightings



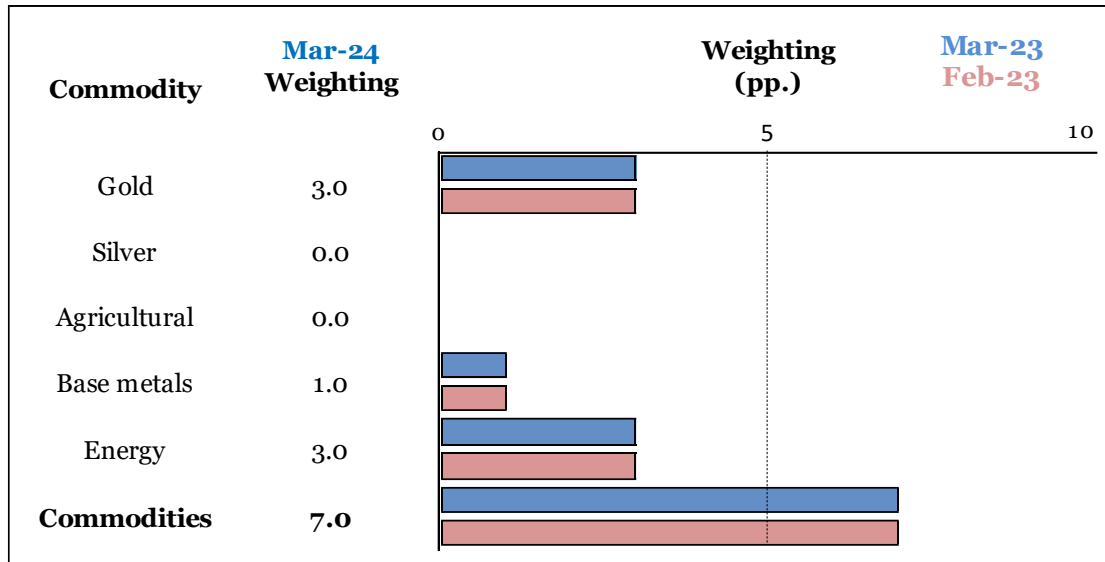
**Source:** Longview Economics

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**Commodities:** We retain a modest overweight in commodities (of +2pp. OW). Of note, we increased our allocation to gold last month.

**Fig 3c:** Commodities weightings



Source: Longview Economics

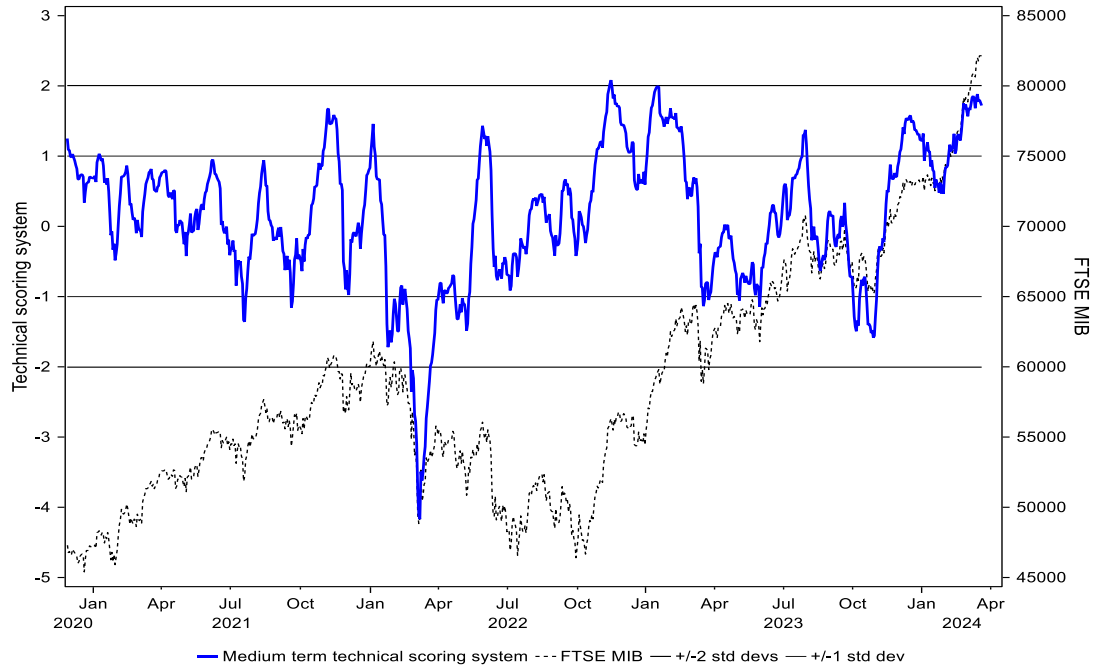
**Fig 3d:** Brent oil candlestick shown with key moving averages (USD/barrel)



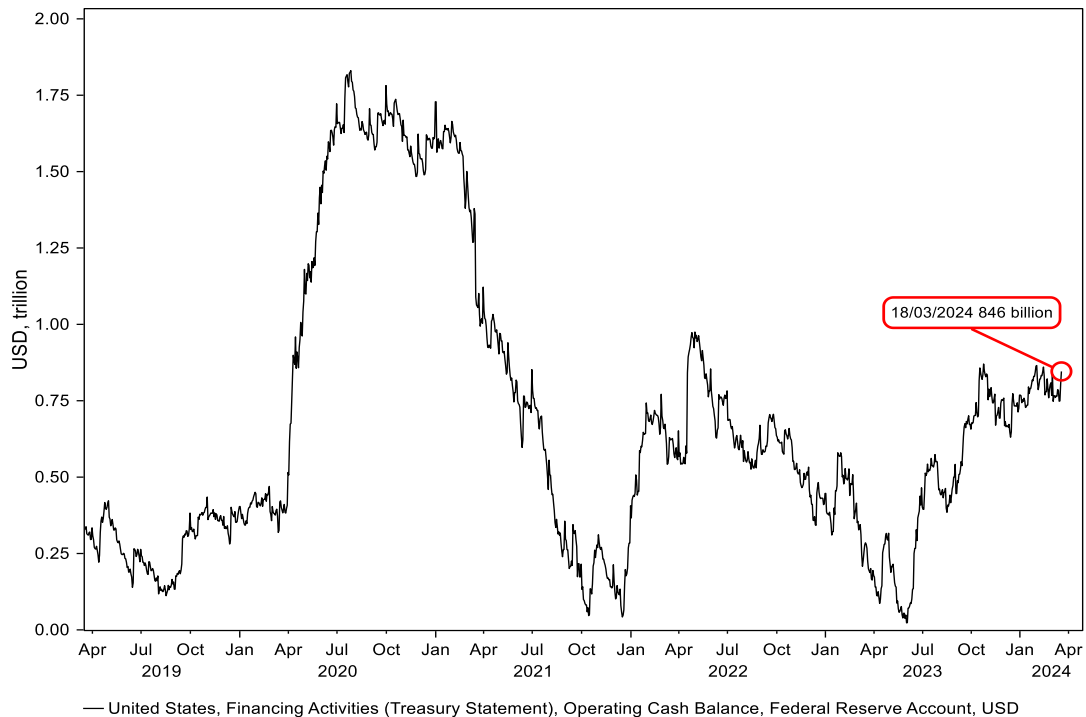
Source: Longview Economics, Macrobond

## Section 4: Key charts

**Fig 4:** Medium term technical scoring system vs. FTSE MIB index



**Fig 4a:** US 'Treasury General Account' (TGA, \$bn)



Source: Longview Economics, Macrobond

## Section 5: Global PMI trends

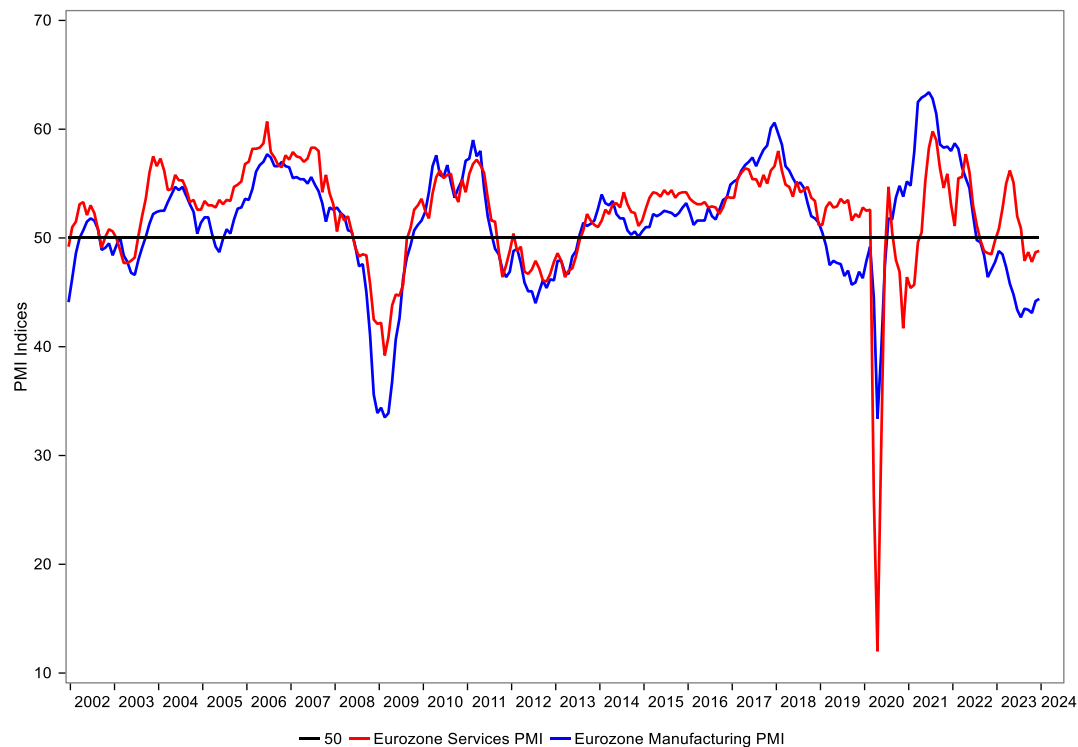
**Table 5:** Various trends in PMI indices – Western economies\*

Country - PMI Type	12/23	11/23	10/23	9/23	8/23	7/23	6/23	5/23	4/23	3/23	2/23	1/23
US - ISM Manufacturing	47.4	46.7	46.7	49.0	47.6	46.4	46.0	46.9	47.1	46.3	47.7	47.4
US - ISM Non-Manufacturing	50.6	52.7	51.8	53.6	54.5	52.7	53.9	50.3	51.9	51.2	55.1	55.2
Eurozone - Manufacturing	44.4	44.2	43.1	43.4	43.5	42.7	43.4	44.8	45.8	47.3	48.5	48.8
Eurozone - Services	48.8	48.7	47.8	48.7	47.9	50.9	52.0	55.1	56.2	55.0	52.7	50.8
Germany - Manufacturing	43.3	42.6	40.8	39.6	39.1	38.8	40.6	43.2	44.5	44.7	46.3	47.3
Germany - Services	49.3	49.6	48.2	50.3	47.3	52.3	54.1	57.2	56.0	53.7	50.9	50.7
France - Manufacturing	42.1	42.9	42.8	44.2	46.0	45.1	46.0	45.7	45.6	47.3	47.4	50.5
France - Services	45.7	45.4	45.2	44.4	46.0	47.1	48.0	52.5	54.6	53.9	53.1	49.4
UK - Manufacturing	46.2	47.2	44.8	44.3	43.0	45.3	46.5	47.1	47.8	47.9	49.3	47.0
UK - Services	53.4	50.9	49.5	49.3	49.5	51.5	53.7	55.2	55.9	52.9	53.5	48.7
Italy - Manufacturing	45.3	44.4	44.9	46.8	45.4	44.5	43.8	45.9	46.8	51.1	52.0	50.4
Italy - Services	49.8	49.5	47.7	49.9	49.8	51.5	52.2	54.0	57.6	55.7	51.6	51.2
Sweden - Manufacturing	48.8	49.0	46.3	43.3	45.5	47.6	45.2	40.9	45.9	45.5	47.2	46.9
Sweden - Services	50.0	48.5	48.7	46.3	48.4	52.7	45.9	50.2	51.1	49.9	46.4	51.2

Source: Longview Economics, Macrobond

\* These tables have not updated to Jan & Feb due to technical issues.

**Fig 5:** Eurozone manufacturing & service sector PMIs



Source: Longview Economics, Macrobond



**Table 5a:** Various trends in PMI indices – Asian economies\*

Country - PMI Type	12/23	11/23	10/23	9/23	8/23	7/23	6/23	5/23	4/23	3/23	2/23	1/23
China - Manufacturing (Official)	49.0	49.4	49.5	50.2	49.7	49.3	49.0	48.8	49.2	51.9	52.6	50.1
China - Services (Official)	50.4	50.2	50.6	51.7	51.0	51.5	53.2	54.5	56.4	58.2	56.3	54.4
China - Manufacturing (HSBC)	50.8	50.7	49.5	50.6	51.0	49.2	50.5	50.9	49.5	50.0	51.6	49.2
China - Services (HSBC)	52.9	51.5	50.4	50.2	51.8	54.1	53.9	57.1	56.4	57.8	55.0	52.9
Japan - Manufacturing	47.9	48.3	48.7	48.5	49.6	49.6	49.8	50.6	49.5	49.2	47.7	48.9
Japan - Services	51.5	50.8	51.6	53.8	54.3	53.8	54.0	55.9	55.4	55.0	54.0	52.3
India - Manufacturing	54.9	56.0	55.5	57.5	58.6	57.7	57.8	58.7	57.2	56.4	55.3	55.4
India - Services	59.0	56.9	58.4	61.0	60.1	62.3	58.5	61.2	62.0	57.8	59.4	57.2
South Korea - Manufacturing	49.9	50.0	49.8	49.9	48.9	49.4	47.8	48.4	48.1	47.6	48.5	48.5
Singapore - Manufacturing	50.5	50.3	50.2	50.1	49.9	49.8	49.7	49.5	49.7	49.9	50.0	49.8
Taiwan - Manufacturing	47.1	48.3	47.6	46.4	44.3	44.1	44.8	44.3	47.1	48.6	49.0	44.3
Indonesia - Manufacturing	52.2	51.7	51.5	52.3	53.9	53.3	52.5	50.3	52.7	51.9	51.2	51.3
Hong Kong - Manufacturing	51.3	50.1	48.9	49.6	49.8	49.4	50.3	50.6	52.4	53.5	53.9	51.2

Source: Longview Economics, Macrobond

\* These tables have not updated to Jan & Feb due to technical issues.

**Table 5b:** Various trends in PMI indices, other countries\*

Country - PMI Type	12/23	11/23	10/23	9/23	8/23	7/23	6/23	5/23	4/23	3/23	2/23	1/23
Brazil - Manufacturing	48.4	49.4	48.6	49.0	50.1	47.8	46.6	47.1	44.3	47.0	49.2	47.5
Brazil - Services	50.5	51.2	51.0	48.7	50.6	50.2	53.3	54.1	54.5	51.8	49.8	50.7
Russia - Manufacturing	54.6	53.8	53.8	54.5	52.7	52.1	52.6	53.5	52.6	53.2	53.6	52.6
Russia - Services	56.2	52.2	53.6	55.4	57.6	54.0	56.8	54.3	55.9	58.1	53.1	48.7
Turkey - Manufacturing	47.4	47.2	48.4	49.6	49.0	49.9	51.5	51.5	51.5	50.9	50.1	50.1
Poland - Manufacturing	47.4	48.7	44.5	43.9	43.1	43.5	45.1	47.0	46.6	48.3	48.5	47.5
Hungary - Manufacturing	52.8	52.2	52.3	47.4	46.7	45.7	44.2	57.1	61.9	56.0	56.3	55.0
Czech Rep. - Manufacturing	41.8	43.2	42.0	41.7	42.9	41.4	40.8	42.8	42.8	44.3	44.3	44.6
Canada - Manufacturing	56.3	54.7	53.4	53.1	53.5	48.6	50.2	53.5	56.8	58.2	51.6	60.1
South Africa - Manufacturing	50.9	48.2	45.4	45.4	49.7	47.3	47.6	49.2	49.8	48.1	48.8	53.0
Australia - Manufacturing	44.7	49.6	50.2	49.3	52.5	54.0	52.4	58.5	55.7	53.2	48.4	48.4
Australia - Services	45.6	47.7	48.0	53.3	51.7	48.8	49.2	57.8	56.2	60.0	56.2	56.2

Source: Longview Economics, Macrobond

\* These tables have not updated to Jan & Feb due to technical issues.

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