

Investment roadmap

SEPTEMBER 2024

AT A GLANCE

- The main article explores the **potential economic and financial policies of the two candidates in the US presidential election**. We would regard a Trump victory as challenging for financial markets if, as he has suggested, he curtails Fed independence, forcibly repatriates many migrant workers and raises tariffs significantly. While tax cuts in his first term were clearly supportive for US equities, the large US budget deficit may curtail equally material moves in this context. We would expect Harris to be continuity-Biden in some respects, but see risks in spending commitments not being matched by prospective tax rises. In addition, some possible policies – such as price controls – seem to be economically incoherent electoral gimmicks. If enough of these sorts of policy were implemented, the economic costs would escalate. We also expect heightened volatility post-election, particularly if the result were to be contested.
- Our conviction that the **global economy** is slowing remains intact, and in a global context there are few outliers. We view this as a ‘mini-cycle’ rather than the precursor to recession. The global inflation background is also improving given the more downbeat growth picture, and we view market pricing of inflation – close to central bank targets – as appropriate.
- The Fed has signalled that **policy rate cuts** are imminent, and markets are pricing a sustained multi-year easing process. While we think that discounted US rate cuts are somewhat aggressive, the direction of travel is clear. The easing process is, however, likely to be more dampened in the UK and Europe.
- **Global equity market** multiples remain slightly extended, still largely the result of US megacap valuations. Markets outside the US are on equity multiples in line with or below historic norms. The more important theme in equity markets has been the large rotation away from very large cap stocks, warranted in part by rising profits in sectors that had previously lagged the market.
- An important theme underlying Saranac’s multi-asset positioning has been the relatively low expected returns, by historical standards, of equities over fixed income. While this gap has moved slightly more in favour of equities given the fall in bond yields, expected outperformance is still very moderate by historical standards. In short, **risk premia** remain low.
- In the **private markets** section, we review the current state of the M&A market. We conclude that the recent increase in activity in this area is likely to continue.

The economic and financial consequences of Donald Trump and Kamala Harris

1. What is at stake?

The significant revival in Democrat polling since Kamala Harris emerged as the party's candidate has not delivered a lead sufficient to make her favourite to be President. Once allowance is made for the idiosyncrasies of the US electoral system, the outcome is still close to the toss of a coin, which happen to be the odds more formally in many prediction markets. An evaluation of the implications for the US – and indeed global – economy and financial markets of both candidates remains very relevant.

This is not straightforward. Trump says a lot, but it is never clear whether this should be taken literally, seriously or not seriously at all. Harris, by contrast, has to date said relatively little on economic policy and may not add much more over the coming weeks. So in neither case are we dealing with clear and well-formulated programmes.

One school of thought suggests we can learn from the past: Harris will be continuity-Biden and a second Trump term will be like the first when, despite the bluster and the covid shock at the end of the period, there was no clear break in established economic and asset class trends after 2016.

Such simple extrapolation is problematic. Harris is an unknown quantity and may in the end seek to differentiate herself in important respects from Biden, not replicate his administration's policy preferences, for example in the context of corporate price controls. In addition, Trump was unprepared to be President in 2016, and was heavily reliant on, and constrained by, more orthodox Republican personnel. This is no longer the case. He now dominates the Republican Party, and has manufactured a sympathetic Supreme Court. He has been expecting to win, and he now has a formidable political infrastructure supporting him, which could allow for the rapid implementation of a clear Trumpian agenda from the start of next year, with fewer constraints from the US legal system than in the past. At the same time, there are signs that he is moving closer to the financial elite in the US and away from the more populist positions that characterised his first term.

Of course, the broader context is also important. The House and Senate results matter, and a new President who controls only one or even neither will face material constraints on their domestic agenda (if less so in foreign affairs). In addition, any Presidency is likely to be shaped more by domestic and global 'shocks' that are beyond either of the candidates' control – Macmillan's 'events, dear boy, events' – rather than the winner shaping the world largely unfettered. It is often the case that reactions to these unforeseen events determine a Presidency to a greater extent than the implementation of a well-articulated programme enunciated in the pre-election period. Perhaps the Reagan Presidency was the last when this was the case. And, of course, pledges made during an election campaign may not be delivered on, and new policies that were not put before the electorate may instead see the light of day.

These caveats notwithstanding, however, it remains the case that US and global economic and financial conditions after the election will be highly sensitive to the result on the night.

2. Convergence and divergence between the candidates

In some respects, there is a similar starting point to both campaigns, as both the Democrat and Republican candidates reject the ‘Washington Consensus’ associated with free trade and limited state intervention. This has already led to policy convergence in particular areas, so that ‘Bidenism’ in many respects represented continuity with ‘Trumpism’ rather than dismantling it. For example, both implemented activist policies to support domestic industries, an aggressive trade and foreign-policy stance towards China, and constraints on immigration. It is also noteworthy that in antitrust policy, the Biden Administration recently successfully concluded a case against Google that was in fact launched by Trump.

However, the differences remain stark going forward. For Trump, the end game is a lower-taxed and less-regulated private sector operating behind much higher tariffs, particularly against China, and with a much smaller state. For Harris, the role of the active state is to constrain corporate power where it is perceived to be damaging to the US middle-class (e.g. working class), and she supports targeted interventions in areas such as new energy investment or semiconductors, funded by higher taxes on companies and individuals.

These high-level visions, and the policies associated with them, are clearly different. They may, however, ultimately face the same challenge in terms of policy implementation. The elephant in the room, which may ultimately become the largest market mover over the next few years, and the main constraint on both candidates’ aspirations, is the unsustainable US fiscal position, which both candidates appear more likely to exacerbate rather than address.

This paper’s focus is on domestic rather than foreign policy. There are significant differences between the two candidates in this latter respect, with Trump’s isolationism contrasting with Harris’s more traditional globally-oriented stance. These differences could well have market consequences – for example, a US withdrawal from NATO – but we do not explore these issues here.

3. Trump

i. Tax cuts and deregulation

We note that many respected market commentators are relaxed about the possible impact of a Trump Presidency. In this respect, the potential for further tax cuts is widely cited, with the personal and corporate tax cuts in his first term cited as a central feature supporting the economy and equity markets at that time. More of the same is possible, with Trump advocating an extension of the lower tax rates he implemented in his first term, which are due to expire shortly, and a further cut in corporate tax rates. Tax cuts are seen in a broader context of limiting state involvement across a wide range of activities, leaving greater freedom for private business through, for example, much less regulation.

However, it is debatable whether there would be the same benign impact from tax cuts this time around. The corporate tax rate is already low, and for many companies the effective rate they pay is already lower than the statutory rate. More fundamentally, however, the fiscal position of the US is fundamentally different from 2016. The federal deficit is now around 7% of GDP, double its level at that time, and official projections show that on current policies no sustained reduction is likely – in fact the opposite is true

– so that the debt to GDP ratio is on a clear and unsustainable rising trend. Over many decades, the US has been able to rely on overseas investors, particularly from Asia to fund this deficit, but in an increasingly fractured global trading system and heightened political animosity between the major power blocs, this may not remain the case. This problem may also be exacerbated if Trump's pursuit of a lower dollar travels easily from the campaign trail to the White House.

This deterioration in the fiscal position has not been a particular market issue to date, but as Liz Truss found out a couple of years ago, it can rapidly become one if markets sniff out incoherent tax and spending plans. Although Trump's rhetoric emphasises the desire radically to reduce the size of the state, rhetoric is cheap. It's easier to implement immediate large tax cuts than to fund them through immediate and so far largely unidentified spending reductions. As a result, it is naive to assume that the consequences of significant tax cuts would be as favourable for US financial markets this time around compared to 2016.

Moreover, the regulatory sphere may be one critical area in which Trump 2024 differs from Trump 2016. In the earlier manifestation of Trumpism, he lambasted corporate bosses and suggested a large state role for looking after 'ordinary' people, hence his support for Medicare and Social Security. The later version appears less populist and more in tandem with the 'regulation-light' sympathies of financial elites, as evidenced most obviously in support for and from Elon Musk. For example, Trump's praise in the 'X' interview with Musk for the firing of striking Tesla workers may be evidence of such a shift in priorities. The one area in which he has been publicly sympathetic towards higher immigration is in supporting green cards for all foreign university students on graduation, which would be likely to be supportive of the tech sector.

ii. The three challenges

We note also three policy pronouncements from Trump that, if implemented, could be highly deleterious for financial markets – the potential limitations on the independence of the Fed by allowing greater Presidential influence on decisions, large-scale deportations of migrant workers, and a sharp rise in tariffs.

a. The Fed

Trump has hinted in very general terms of constraining the Fed, presumably to facilitate a move to lower interest rates and a weaker dollar. There is a variety of interventions that could be made. At the 'lighter' end of the spectrum, this would involve changing the membership of the FOMC, the committee responsible for interest rate decisions, potentially including replacing Powell. The conventional timetable does not, however, allow for rapid change. Powell's term does not expire until mid-2026, and the first vacancy for a new Board member is at the start of that year. Immediate and dramatic personnel turnover is unlikely to result from this slow-moving established process governing the evolution of FOMC membership. Even at the end of a second Trump term the make-up of the Committee would be unlikely to have changed fundamentally, not least because five of the twelve-person Committee are rotating Chairs of the Regional Feds, who are not Presidential appointments.

Of course, a Trump appointee as Chair even in two years could change market perception of the Fed if well-flagged in advance, with a favoured political appointee likely to undermine confidence well before the event. More generally, even if there

are no significant changes in personnel, the Fed may feel constrained if the threat of politically motivated change hangs over the central bank. Trump could also in principle be still more radical, and attempt to replace Powell immediately. It's not clear, however, that he has this power. The issue would be likely to end up in the Supreme Court, and even if Trump were successful, he may be limited to naming a successor from the current Board members rather than choosing 'one of his own'. Legal controversy would also be considerable if Trump attempted to make political appointees directly to the Board, for example the Treasury Secretary.

A further possibility is that Trump could ask Congress for more direct control over interest rate policy, for example through legislation that requires rate decisions to be subject to Presidential approval. A possible constraint in this respect is that a 60 vote approval in the Senate is required, and such a majority is unlikely to be attained even if the Republicans had control.

The highest level of escalation would be to change the entire institutional foundation of the Fed. The unitary executive theory proposed by conservative scholars, based on Article II of the constitution, asserts that executive power is vested only in the President. This implies that independent bodies like the Fed are unconstitutional, and its power should accrue instead to the President. Any proposed change along these lines would again go to the Supreme Court, but the market instability associated with such a process – or indeed any increased political control over the Fed – would be considerable.

b. Repatriation of migrant workers

The second potential source of a Trump 'shock' would be if there were to be repatriation of unauthorised working migrants from the US. As noted above, immigration is in fact an area of policy convergence with Harris, with both candidates arguing for greater control. Widespread repatriation is, however, a proposal specific to the Trump campaign, with the limited repatriations enforced under both Obama and Biden being of a much lower order of magnitude. There are possibly eleven million unauthorised workers in the US, around 7% of the total workforce. Trump has suggested that all should be removed, while Vance has intimated that one million would be a legitimate short-term target.

The legal, political, and practical impediments to such a policy are significant, but if these were surmounted, the economic impact of widespread repatriation could be highly material. For example, the swift removal of say 1.5 million workers would represent a loss of over 1% of the US labour force in a short space of time, with particularly severe impacts in agriculture, hotels, and construction. The adverse shock could, depending on the economy's momentum at the time, be sufficient to lead to a recession. At the same time, labour shortages could boost wage growth by an amount sufficient for the Fed to identify a material adverse change in the inflation and interest-rate outlook.

Of course, Trump's statements in this context may be designed as a deterrent to future immigration rather than a policy to be implemented. However, the consequences if it were would be highly problematic.

c. Tariffs

The third potential Trump shock refers to tariff policy, particularly with respect to China. As with immigration, this has not been an issue that has separated the two main parties in recent years. Biden could have eliminated Trump's tariffs, but did not do so, and like Trump has enacted policies designed to keep economic activity in the US. The US-China relationship has not improved since Trump left office.

However, Trump, unlike Harris, is proposing a further escalation, with still-higher tariffs on Chinese imports and potentially a higher general tariff on all imports. One version of this strategy is that tariff revenues would replace federal income tax, an entirely fanciful notion but one that at least illustrates policy priorities. We note the widely accepted economic harm that tariffs do. Import-dependent industries suffer, prices for consumers rise, and exporters face retaliation in overseas markets. The adverse consequences of widespread repatriation discussed above, with growth lower and inflation higher, would be strongly reinforced by such a policy.

If these three policy measures were pursued, the impact on the US economy and markets could be highly deleterious – which may be why they just won't happen. On this view, Trump is fundamentally a pragmatist who measures success by how the economy and the stock market are performing, and all the above is rhetoric designed largely to give him negotiating leverage. Time will tell on that, but the significant macro risks in this context should not be understated.

4. Harris

Harris has only recently stepped into the electoral limelight and has said little of substance about economic policy since her elevation. Indeed, to date her campaign has focused more on personality than policy, and while the campaign retains its current momentum, the policy vacuum may not be filled. When she does advocate specific measures, such as those concerning corporate 'price-gouging', these seem designed to placate key voters worried about the cost of living rather than a clear expression of her political beliefs.

This is not a recent phenomenon, as Harris is not a conviction politician. Rather she occupies a position somewhat to the left of the Democratic Party's centre, and is pragmatic in terms of policies advocated around this anchor. In recent years, she has tacked to a much harder stance on immigration, and has also moved from denigrating fracking to supporting it. As a pragmatist, she may also be susceptible to power shifts within the Democrat Party. For example, there are still voices within it advocating dismantling tariffs, and the firing of Lina Khan, Biden's crusading anti-trust tsar.

As a starting point we would assume that there will be strong elements of continuity between the Biden administration and hers, particularly as concerns state-directed reindustrialisation. Under Biden, this has involved significant public investment to facilitate a shift to a lower carbon economy, and a 'green jobs' agenda that made state support for some of the companies involved in this enterprise conditional on union recognition and upholding workplace standards. The Biden administration has also pursued a more aggressive anti-monopoly agenda, particularly towards sectors such as healthcare and energy, where companies were seen to be abusing monopoly power.

In many respects, Harris can be seen as continuing this agenda. The cost of living is seen as one of the most important factors for US voters, particularly food and medical prices. Harris has pledged to block unfair mergers and acquisitions in concentrated sectors

where ‘price gouging’ is deemed relevant, and to encourage smaller business in the sector. One recent idea has been to prevent ‘profiteering’ through the application of fines by the FTC, and possibly also direct price controls.

Harris is also focused on the ‘care’ economy, looking to reduce student debt outstanding, make housing and childcare cheaper, and to provide support to teachers and construction workers. A further focus is on tax-breaks for builders creating homes for first-time buyers, helping this latter group with deposits, and limiting scope for financial investors to buy homes. These spending commitments would be funded by a higher corporate tax rate (28% from 21%), a higher top rate of tax of almost 45% on capital gains and dividends, and a levy on unrealised gains for investors with assets over \$100 million.

Given the vague nature of Harris’s economic commitments and the strong pragmatic element in her policy preferences, it’s less easy to see scope for major economic and financial upheaval if she were to win, compared to the adverse potential impacts from the more radical and destabilising policy proposals emanating from the Trump camp. The success or otherwise of her policy programme would be more dependent on the effectiveness of a technocratic approach to managing more efficiently various aspects of the US state, including its resourcing and priorities. In this respect, it’s far from clear that at least some of the policies – such as price controls – would be effective. In this regard, the greatest economic risk associated with Harris would be a series of policies aimed at vote winning rather than efficacy, which lack a coherent rationale and are poorly implemented. The costs in this case may emerge in the form of death by a thousand cuts rather than from a single blow, but over a four-year period such costs could cumulate to become more visible.

In addition, we also note the fiscal risk associated with a Harris victory. While Trump may find it easier to cut taxes than raise spending, Harris may find it easier to raise spending than taxes, and so find the fiscal background equally restrictive on her ambitions.

5. Investment strategy and the election

We regard the election result as too close to call, and hence not the primary driver of our overall investment strategy for now. We would expect higher volatility around the time of the election, particularly if Trump rejected a Harris victory as legitimate. This could continue if a Trump Presidency were to be associated with any attacks on US constitutional norms. We have a higher weight in gold than usual in multi-asset portfolios as a result of these risks, and a higher level of equity hedging through equity put options. We also regard US fiscal risk as likely irrespective of the election result, and have holdings in US short-dated inflation-linked bonds as a hedge against potential yield-curve steepening.

In terms of sector performance, the largest implications are in the energy sector, with a Trump victory strongly supportive for fossil fuels but strongly negative for new energy sectors. The ranking would be reversed on a Harris victory. There may also be a case for domestic over foreign focused companies irrespective of who wins, but the favoured sectors would differ – perhaps financials for Trump and construction for a Harris victory. A Democrat victory would also be likely to penalise companies in the food and health sectors.

Given the uncertainties, we are not at this stage changing our major asset class position to reflect the changing political environment in the US, and our prime concern is that neither candidate may end up delivering a programme that is clearly supportive for US economic and financial market performance.

Public markets

EQUITIES



- Asset class outlook +

Valuation



Earnings



Positive

Infrastructure &
Resource Scarcity;
MedTech; Japan

Negative

Low-quality, high-
valuation companies;
Emerging Markets

Market background

August started with a spike in volatility on the back of a weak US jobs report causing the market to fear that the US economy was on the precipice of a dramatic economic slowdown. Calm was restored in short order following some reassuring data and Fed Chair Powell’s Jackson Hole speech, which took a more dovish tone. By the end of August you would be forgiven for thinking it was a subdued summer month. The Global Equity Strategy ended the month up 1.2%.

Targeted exposure

We favour a number of longer-term themes spanning numerous sectors. The AI theme has dominated markets over the past 18 months and, given the comments from tech firms over the 2Q earnings season there’s little to indicate momentum is fading. The focus may be evolving towards energy supply and software development. We favour companies who can benefit from this. We believe medical technology is an important theme as health systems need to become more efficient to cater for an ageing population. At a country level, our thesis on improved corporate governance in South Korea has faded as political gridlock slows any progress.

Public markets

GOVERNMENT BONDS



Short maturity



Long maturity



Positive

US 2-5Y TIPS, UK Gilts, Australian Sovereign and Agency bonds across tenors

Negative

>5 year European sovereign bonds, Japanese government bonds.

Market background

US Treasuries rallied in August as a weak US job report, the lowest inflation print in three years and Jerome Powell’s speech at Jackson Hole, all but confirmed that the Fed will start cutting interest rates at the September meeting. End of August, the market was pricing 100bp of cuts by the end of the year, implying a “jumbo” 50bp rate cut at one of past three meetings of the year. Over the past few months, Gilts underperformed Treasuries, driven by a narrative of sticky UK services inflation and sustained wage growth. As such, the yield differential between 10-year US Treasuries and 10-year Gilts went from +40bp in April to -10bp at the end of August.

Targeted exposure

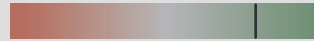
After an uninterrupted fourth-month long USD bond market rally, we trimmed the interest rate duration of our bond portfolios by taking profits on US treasury and US agency MBS positions. With inflation break-evens back to 2%, we maintain a balanced exposure between nominal and inflation-linked bonds. We now view the market pricing for interest rate cuts in US to be on the aggressive side, limiting the prospects for further duration gains in our view. Conversely, we think the Bank of England’s and Royal Bank of Australia’s rate cutting cycle are underpriced, offering attractive duration return prospects.

Public markets

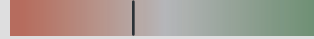
CORPORATE AND EMERGING MARKET DEBT



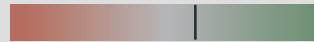
Investment grade credit



High yield



SUB



EM debt



Positive

AAA/A securitisation, £IG credit

Negative

US High Yield.

Market background

In August, \$ credit continued to outperform € and £ credit, powered by the outperformance of the US Treasury market. \$IG returned +1.5% in August vs only +0.3% for €IG and £IG. As such the \$IG market yield fell by 22bp to 4.95%, compared to a 1bp rise to 5.25% for £IG, leading to a 30bp yield differential last seen in September 2023. Despite elevated volatility, HY spreads ended the month close to cyclical tights, leaving us cautious in the space.

Targeted exposure

We now think that £IG credit offers compelling relative value against \$IG, both from a duration and spread level perspectives. As such, we rotated some USD fixed income positions towards GBP IG credit to capture the attractive yield differential that has appeared between both markets, especially as the cost of currency hedging remaining close to 0. We maintain a preference for subordinated debt over HY, but we favour short-dated high-yielding instruments following the decline in spreads, preferring to take duration risk in the sovereign allocation.

Public markets

HEDGE FUNDS



Equity markets have staged an impressive rally during August, amid a confluence of factors including receding growth concerns or recession odds, a sharp reversal across the volatility complex, and flows from CTAs/rules-based funds turning from a headwind to tailwind. Despite the market rebound, a report from Goldman Sach's Prime Services mentions that gross and net leverage ratios have declined, suggesting little recovery in risk appetite after the large de-grossing episode in July. In fact, from a flow perspective hedge funds are on track to net sell global equities at the fastest pace since March 2022, driven by short sales in the US and long sales across the rest of the world.

Themes to highlight during the month:

- (1) hedge funds are selling large caps stocks in August and have been buying small caps;
- (2) information technology is the most net sold sector MTD in August and on track to be net sold for a fourth straight month, led by shorts in semis and semi equipment partially offset by long buys in software;
- (3) consumer stocks have seen large de-grossing in August, driven by long sales in discretionary and short covers in staples; and
- (4) amid a lower rates environment, managers appear to be gravitating towards high dividend stocks, as energy, utilities, and real estate (S&P sectors with the highest dividend yields) are all among the most net bought in August.

In terms of factor exposures, after falling throughout June and July, hedge fund's momentum exposure has stabilised in August and is now roughly in-line with 1-year and 5-year averages. Exposure towards the growth factor has ticked up, though remains well below its YTD high.

Public markets

CURRENCIES

Dollar



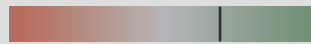
Sterling



Euro



Yen



Market background

The USD declined by 2% in trade-weighted terms in August as US rates expectations dragged the dollar lower. Powell's recent comments signalled rate cuts for September. Four cuts are expected in the past three Fed meetings of this year, with rates are priced to be closer to 3% by 2026. US macro data were more mixed in August, but in aggregate data continued to come in below expectations, notwithstanding some positive prints, which helped allay growth fears.

Targeted exposure

We expect that currency markets will increasingly focus on the November election. Following a strong rebound at the start of August, the unwind of the yen carry trade has paused. Given relative expectations for US and UK interest rates a year ahead, where the US is expected to cut materially more than the UK, we would fade recent strength in sterling in the \$1.32, as additional BoE cuts may be priced back into forward curves.

Public markets

COMMODITIES

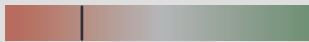
Gold



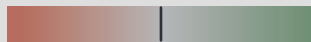
Energy



Industrial metals



Softs



Market background

There has been material divergence in commodity prices so far this year. Gold has been a very strong performer, supported by lower bond yields, significant central bank purchases, and an unsettled global political background. Cyclical industrial metals have typically sold off since the spring, as global manufacturing and construction sectors have remained depressed. The oil price has been more stable, the recent sell-off notwithstanding. Agricultural commodities have remained weak.

Targeted exposure

Support for the gold price is likely to be sustained, given rising global political tensions, falling interest rates and diversification away from the US dollar. We also expect oil prices to hold up. Industrial metals are likely to remain under pressure until the global economy picks up. We expect uranium prices to find a floor given the recent sell-off, with the potential for large gains given demand/supply imbalances in the sector.

Private markets

M&A activity update

Given the slowdown we've seen over the past 18 months in private equity managers ability to distribute capital back to investors, we thought it would be useful to spend this month's private markets piece providing an update on the current state of the M&A market.

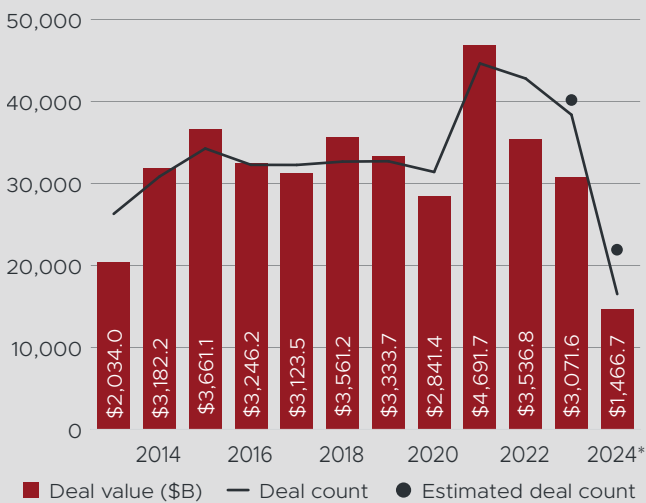
As we look back over the first half of 2024, we can say that the mild recovery in the M&A market expected at the start of the year, as rate outlooks shifted to a positive stance, has firmly occurred. On a global basis, we've seen M&A activity tracking between 10% and 15% higher than for the same period in 2023, on both deal count and value respectively. This activity, while was initially driven by corporate activity; Q2 2024 saw the resurgence of private equity into the market, coming in at 41% of total activity.

This revival in activity has largely been driven by banks re-entering the market, which has caused spreads to tighten and therefore made financing costs much cheaper for private equity participants.

The charts below highlight the level of M&A activity and buyer types over the past 11 years.

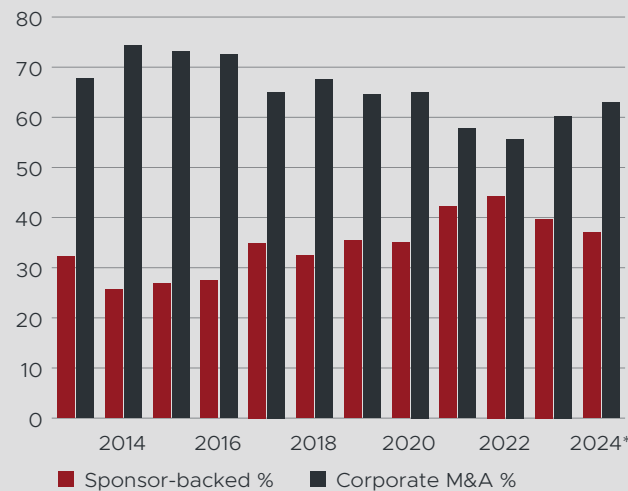
While we've seen a notable uptick in activity vs 2023, it is worth noting that we are still off the peaks of activity we saw in 2021 and prior. This is largely because markets are much more cautious, valuations have been correcting at a much slower compared with public valuations, and financing costs are 500bps higher than they were only two years ago.

Global M&A activity



*As of 06/30/2024
Source: Bloomberg, Saranac.

Sponsor backed deals as a share of all deal value



*As of 06/30/2024
Source: Bloomberg, Saranac.

Rate outlook

The outlook for the M&A market is heavily correlated with the rates market, and therefore we think it's important to understand how the market is expecting rates to move, both directionally and at what speed. Based on the latest expectations we can see that the market is pricing in nine rate cuts between now and Q3 2026, taking the implied fed rate down from the current 5% to 3.2%. While we are somewhat cautious on the number of rate cuts expected; what's important for the M&A market is whether these expectations have flowed through into loan pricing, which so far this year, seems to be the case. New issue sponsored direct lending spreads have tightened meaningfully over the course of the year, and with rate expectations where they are, we don't see this reverting in the near term. In fact, we would expect further tightening to occur if more positive macroeconomic and inflationary data continues.

Private equity dry powder

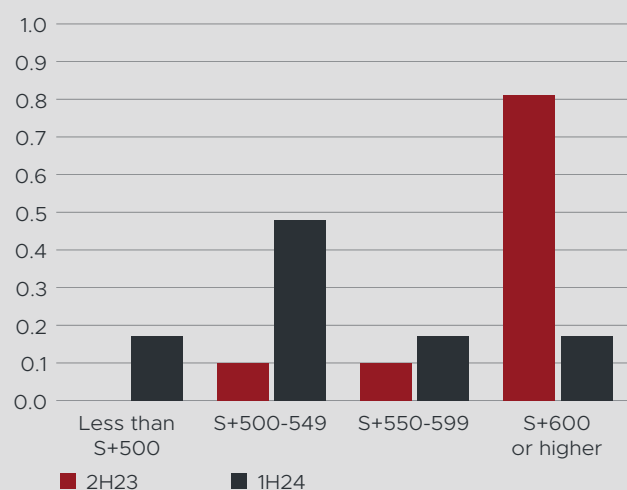
Another key factor in M&A activity is the availability of private equity capital. Over the past 12 months we've seen the big brands raise mega-funds: EQT's 10th flagship buyout closed at \$23.7bn, Cinven's 8th fund closed at \$14.5bn, and CVC flagship closed at \$26.8bn. These examples are representative of what we've seen across the market, big brands have been able to raise their biggest funds ever as institutional LPs have played it safe, re-upping into well-established names.

This has created a huge dispersion in where capital is now available, and how much dry powder is now sitting on the sidelines ready to deploy. The dynamics of this now means that there are a number of mega funds entering their investment period and are therefore now in position in which they have to deploy. We think that this is likely to play into the uptick in M&A activity we expect to see over the next 18-months, particularly on the larger side of the scale.

Outlook

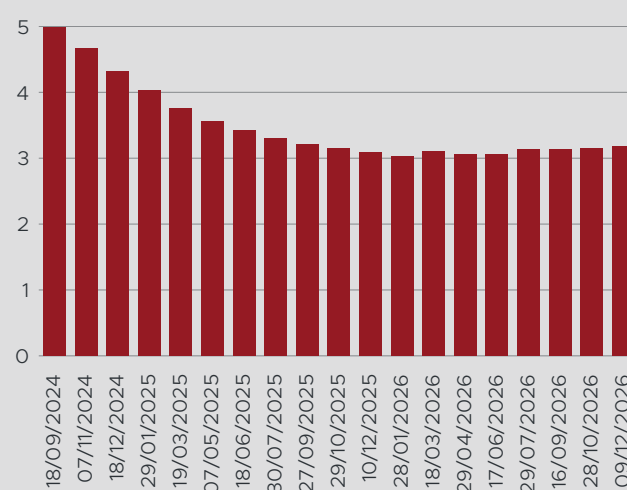
As a result of the above factors, we have the view that the current uptick in M&A activity is likely to continue, and while we don't expect the levels to reach the peaks of 2021, we are confident that as rate expectations continue to play out, and mega funds begin to deploy capital, a reversion to the long-term average is likely over the next 12 to 24 months. If we are correct in our thinking, it does mean that the decline we have seen in private equity valuations is unlikely to continue, and while valuations vary depending on sector, country, and enterprise value; on an aggregate basis we could start to see a rebound in valuations, meaning those that have been waiting on the sidelines for a steep value correction, could end up missing out on the current opportunity we see for long-term allocations to buyout strategies.

Distribution of spreads: new issue sponsored direct lending



Source: Bloomberg, Saranac.

Implied rate



Source: Bloomberg, Saranac.

Private markets

ALTERNATIVE SOURCES OF RETURN

Secondaries



Undercapitalisation of the secondary market has created a structural imbalance between supply and demand, creating an attractive environment for long-term allocation to secondaries

Special situations



Favourable market environment given the likely stress corporates will face in a higher rate environment

Venture capital



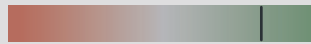
Early-stage venture has benefited from the correction in late-stage valuations, providing an opportune time to invest in long-term productivity gains, labour replacement and other venture investment qualities

Infrastructure



Attractive, long-term asset class given supply chain issues, regulatory initiatives and geopolitical uncertainty are driving demand for new / the development of infrastructure higher

Real estate



As cap rates have expanded and lending has tightened, we see opportunities to acquire high-quality assets at attractive entry prices GP stakes and financing

GP stakes and financing



Opportunity for higher yield and greater structural protection as a result of limited GP liquidity

Real assets



At risk from weak growth environment

Private debt



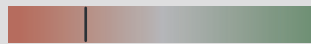
A negative economic outlook with the potential for above-trend default rates and extension risk make private direct lending unattractive on a risk-adjusted basis

Leveraged buyouts



Softened valuations, reduced debt levels, and increasing focus on corporate carve-out opportunities has created a window for investors to deploy into operationally focused private equity strategies

Mid-market growth



A prolonged period of weak/negative earnings growth as a result of a weak economic environment and increased cost of capital will see valuations struggle in the short term

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We founded Saranac Partners to do things differently. To create a community based around like-minded people, shared wisdom and collective learning. To work as partners, creating compelling opportunities and effective solutions. To offer unfailing support, honest challenge and thoughtful inspiration.

Our business combines the personal touch of a private office with the capability and breadth of a large institution. Our firm has strategic shareholders, outstanding technology, broad capabilities and the highest standards of corporate governance. Saranac Partners is a signatory to the United Nations Principles of Responsible Investing (UNPRI).


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We start with the question. We listen and seek to understand. We don't make assumptions or force solutions. Rather we co-create a path with our clients.

 **Strategy.** Planning, governance and oversight

 **Financing.** Access to diverse sources of capital

 **Investments.** Allocation and deployment of capital

 **Corporate advisory.** Supporting corporates and business owners

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