
RATHBONES

# BIDEN BOWS OUT

REVIEW OF THE WEEK
22 JULY 2024

**AFTER WEEKS OF PRESSURE, PRESIDENT JOE BIDEN HAS ABANDONED HIS BID FOR RE-ELECTION. WILL THERE BE A BATTLE FOR THE DEMOCRATIC NOMINATION AT NEXT MONTH'S PARTY CONVENTION IN CHICAGO, OR WILL HIS SUCCESSOR BE CORONATED QUICKLY?**

President Joe Biden announced on Sunday that he will withdraw from the US election. He immediately endorsed his Vice President, Kamala Harris. Several other Democratic grandees have backed Harris as well, although a good number have declined to endorse her or stated plainly that the nominee should be debated and chosen the old-fashioned way.

The old-fashioned way means a gaggle of potential candidates battling it out in debates on the convention stage and political horse-trading on the floor. The goal being to secure the most votes from Democratic Party delegates from the all the states to gain the nomination. This is messy. Public arguments, aired throughout the land, can produce candidates damaged by the attacks of their own side. Not only that, but convention season is in the late summer. Waiting till late August to finalise your candidate leaves only two and a half months of campaigning till election day. In modern America, where campaigns are fought with gargantuan media budgets, every lost day is a huge deal.

It was the messiest of old-fashioned convention-floor fights in Chicago 56 years ago that pushed the Democratic Party to effectively end this way of picking candidates in favour of back-room deals and state primaries well ahead of time. That race was another tarnished by assassins. Robert "Bobby" Kennedy, who was running in second place for the Democratic nomination, was shot and killed in June 1968. In a historical rhyme Kennedy's son, Robert F Kennedy Junior, is running as a third-party candidate in this election.

While a contested convention is messy and time-consuming, it would offer choice and inject more democracy into a process that some complain is sewn up by insiders. Considering the vibe of America today and several surveys showing a widespread preference for someone other than Trump or Biden, this may be a positive for the Democratic Party. A tough choice.

For investors, more democracy would mean more uncertainty. (And that's not to say it's a bad thing, it's just a trade-off of the system!) If Harris is swiftly confirmed as the Democratic candidate, the policy planks of another Democratic presidency would likely remain relatively similar to those of Biden. If another candidate won on the convention floor, the policies could well differ, which may adjust prevailing assumptions of public spending, interest rates, inflation and business profits. Such changes could mean greater volatility in markets for shares and bonds.

As for the Republicans, they held their convention last week with candidate and former President Donald Trump selecting Junior Senator for Ohio JD Vance. Opinion polls show Trump as the odds-on favourite to retake the White House, although that was when he was pitched against Biden. We will have to see how the polls adjust when his new opponent is known.

## UK government policy outlined in King's Speech

On this side of the Atlantic, the new UK government set out its policy agenda last week in the King's Speech, with 40 bills tabled for the new Parliament.

The legislation covers many areas, including new fiscal rules for government spending, nationalising and reforming the railways, setting up a 'national wealth fund' that will finance the decarbonisation of industry and infrastructure, strengthening employment rights and initiating planning reform, alongside much else.

The number of bills announced is very high in comparison to recent history. On only one other occasion since 1997 have more than 40 bills been announced in the King's Speech: that was 2005 when 50 were unveiled. The Parliament will have to be very busy to get through them all; however, having a 180-seat majority should help the government avoid too many large amendments that would soak up time. Hopefully, it doesn't mean that poorly drafted legislation is waved through without careful scrutiny or in haste because of the workload.

## Record IT outage and stock market 'rotation'

Last week was a bad one for technology. Not only did the world see the "the largest IT outage in history", but stock prices of the large software giants fell abruptly as market winds turned against them for other reasons.

A broadening 'rotation' of investment in the US stock market has meant large scale swapping of shares in large tech companies that have performed exceedingly well in recent years for smaller businesses, particularly in different industries, that have lagged for some time. The mid-cap Russell 2000 index has risen by 7% since the beginning of July, while the large-cap dominated S&P 500 index has increased just 0.8%. Small-caps posted the largest weekly return relative to large-caps on record, according to investment bank Goldman Sachs.

The catalyst appears to be a combination of subsiding American inflation (which has buoyed hopes that the US central bank will soon cut interest rates) and President Biden's decision to make it harder for US technology firms to operate and sell to China as part of his push to boost US computer chip manufacturing. Lower interest rates should reduce borrowing costs, which would benefit smaller companies more than larger ones because they tend to have both more debt and more variable-rate debt than the large-cap businesses. And large-cap tech companies tend to be more heavily engaged with China for production and sales than the smaller businesses that have a more domestic focus.

The catalyst also reacted with two broader agents of change. First, a compressing differential between sales growth at the technology giants that have powered ahead this year and the growth at smaller firms. Year-on-year sales growth at Amazon, Alphabet, Meta, Microsoft and Nvidia is set to slow from 22% in the first quarter of 2024 to 14% in the fourth quarter, while that of the median US-listed company is forecast to grow from 2% to 5%. As usual, the rate of change is what's important to investors. Second, investor positioning in the largest businesses is very stretched. This doesn't necessarily send a clear signal about future returns, but it does mean that the reaction could be quite volatile if other fundamental factors shift.

Earlier this year, we suggested that portfolios could benefit from increasing investment in smaller-cap US companies because they had become very cheap when compared with the larger stocks that make up the lion's share of the market. The gap between the valuation of smaller-cap companies and large-cap ones had grown to the largest since the turn of the millennium on several different measures. A broadening of profit trends to other companies and industries is a healthy sign for financial markets, while the broadening of performance can show the benefits of active, long-term investment management.

CrowdStrike glitch shows the danger in poor diversification

It could also be healthy for the economy overall. The largest IT outage in history was caused last week by widely used cybersecurity software developer CrowdStrike's flawed update clashing with the almost-ubiquitous Microsoft operating system, crashing thousands of businesses' computers all around the world. Airlines couldn't process tickets, retailers couldn't get their tills to work, banks couldn't be banks. Most businesses appear to be back up and running, yet it was a sharp reminder of the age-old risks that come from monocultures and a lack of diversification. Because so many people use two companies, mistakes in a few lines of code brought much of the world to a standstill.

Too many smaller units create a lack of scale and a reduction in efficiency. Yet those myriad units make for more robust systems because each will be affected by a shock in its own way, depending on its individual situation and processes. Having fewer, larger units makes a system more efficient, but introduces fragility because greater standardisation means they are likely to be affected by outside shocks in similar ways. This is true in anything, whether investments, business, agriculture or the arts. The classic example is a monoculture of crops, all copied from the same rootstock that's bred for optimal yield. Abundance turns to disaster when a mite comes along that's the kryptonite for that specific rootstock.

Perhaps our economy has become a bit too concentrated and could do with an injection of competition and variety.

If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We'd love to hear from you.