ISSUE 42 — FOURTH QUARTER 2024

INVESTMENT INSIGHTS

LOOKING AHEAD TO LABOUR'S FIRST BUDGET

Can the new government fix the UK's finances while encouraging investment and boosting economic growth?

Balancing the books
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America's debt looks set to grow regardless of who wins

An emerging challenge
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Mind the gap
Fears of an exodus of UK bosses over pay may be overdone

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FOREWORD

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Welcome to the latest edition of *Investment Insights*. As we head into the Autumn, the new Labour government is busy setting its agenda. In our lead article on page 4 we look ahead to the Chancellor's first Budget and the policies that could be announced. Rachel Reeves has tried to set the bar as low as possible, but she has an opportunity for a much-needed reset, backed by a government with a large majority.

Our next article on page 6 tackles the issue of tax, and more precisely what the Budget could mean for your money. From capital gains tax to inheritance tax and non-domiciled status — what are the possible implications for your financial plans?

The US election is around the corner. We've written a lot about the differences between the two parties, but there are some important similarities that shouldn't be forgotten. One of the most significant relates to debt and the deficit, which we explore on page 8.

We delve into China's struggling economy on page 10 and how it affects the investment decisions we're making. Recent data suggests the country continues to face substantial economic headwinds, although a recent burst of new government stimulus has provided a near-term lift for Chinese equities. We explain why we remain cautious about the longer-term outlook for the world's second-largest economy, given its structural challenges.

In our final article on page 12, we ask whether a potential 'brain drain' is on the way. If the heads of UK companies read the British newspapers, they'll wince at complaints they're paid far too much. Yet when they look across the Atlantic, they can see the gap between executive pay in the UK and US is growing wider.

We hope you enjoy this issue and look forward to updating you in the coming months. We always welcome your questions about what's happening in the world today and how it affects your investments. If you'd like to find out more, please visit rathbones.com or get in touch with your usual Rathbones contact.

E. Savage.

Liz Savage and Ed Smith
Co-chief investment officers

BALANCING THE NEED TO FIX THE FINANCES WITH STIMULATING GROWTH

It's fair to say the new government has tried to set the bar as low as possible ahead of Rachel Reeves' first Budget on 30 October. "Incredibly tough choices", "painful" and "difficult decisions" are just some of the phrases we've heard from the Chancellor and Prime Minister, not to mention warnings about the supposed £22bn "black hole" in the public finances.

There's a good deal of political expectations management going on. The Chancellor faces a significant challenge – juggling the need to support economic growth, respect her party's manifesto commitments and ensure the health of the public finances. Ms Reeves also has an opportunity for a much-needed reset, backed by a government with a large majority. It's a chance to set out a clear agenda to revive investment – the weakness of which lies behind the UK economy's long funk – and to learn lessons from some of her predecessors' wrong turns. Whether the Chancellor will grasp this opportunity remains to be seen.

Why the need to focus on investment? UK investment in the public and private sectors has been unusually weak compared with developed market peers for some time. That weakness has been a huge contributor to the chronic poor performance of the UK economy. The UK's productivity gap with France, Germany and the US has doubled since 2008. Middle-income Brits are now 20% poorer than their peers in Germany and 9% poorer than those in France. The legacy of cuts to public investment in the 2010s has been creaking public services, and a clear toll on growth. We've highlighted the impact of the parlous state of the NHS on the economy before, where the surge in waiting lists has coincided with a sharp increase (of 800,000 since before the pandemic) in the number of people out of work due to ill health.

The Darzi report recently highlighted that the UK invested £37bn less in its health service during the 2010s than if it had matched its peers' investment rates. It's not just the health service where underinvestment in the public realm is evident. Backlogs at Crown Courts are the longest on record; prisons face a capacity crisis; and 700,000 pupils are learning in schools requiring major building works or refurbishment. Unfortunately, as figure 1 shows, this isn't just a problem for the public sector. Business investment as a share of the economy has consistently been lower in the UK than the rest of the G7 group of major economies for decades, again hurting growth.

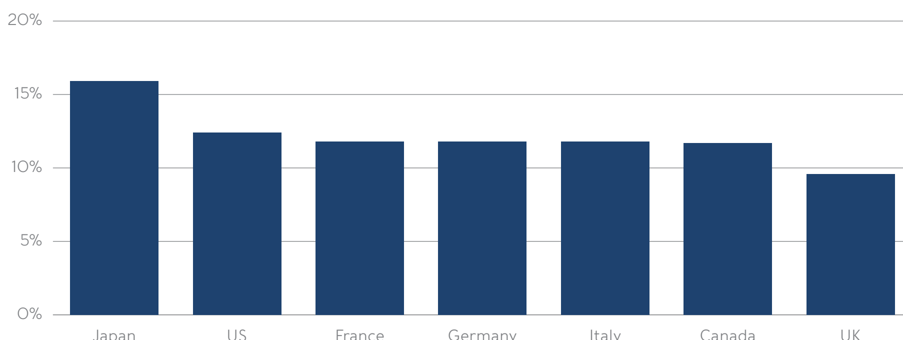
Mrs Reeves is well aware of the problem and has highlighted the issue herself many times. In a lecture at Bayes Business School earlier this year, she mentioned investment 35 times and specifically cited the UK's weakness in this area relative to its peers. But recognising the issue is one thing – doing something about it is another. There are three key things we'd like to see.

The first is avoiding the pitfall of the 2010s austerity period and ensuring public sector investment is preserved. The Chancellor is inheriting spending plans that have public sector investment falling over the next five years, dropping below its average of the past quarter century. But the experience of the 2010s demonstrates that curtailing investment like this would be self-defeating. The short-term savings generated by cutting public investment in that period proved illusory. The associated long-term damage to growth ultimately made the public finances less, not more, sustainable. Public services are starting from a weaker position now. More investment is needed, not less. The symbolism of Reeves' August announcement scrapping some road and rail investment schemes was concerning.

A fine balance

The second is avoiding counterproductive tax changes – specifically those that might discourage private investment. Increasing public investment spending will inevitably raise questions about how the change is financed. In its manifesto, Labour ruled out changes to the four taxes that raise most revenue – income tax, national insurance, VAT and corporation tax. That's why capital gains tax (CGT) and inheritance tax (IHT) have been in the spotlight ahead of the Autumn Budget. Along with council tax (which seems unlikely to be touched), they're among the next largest revenue raisers (figure 2). Some Labour MPs have made the case for much higher rates of CGT, closer to income tax rates. But there's clear danger in making sweeping changes to taxes on assets. (The next article on page 6 has more detail about what changes may be in the Budget.)

Figure 1: Investing for growth
Out of the G7 economies, the UK has had the lowest average business investment as a proportion of GDP since 2000.
Source: LSEG and Rathbones



The value of investments and the income generated by them can go down as well as up.

In most advanced economies, capital gains are taxed at a lower rate than labour income (with the UK's rate close to the average). One reason is that capital is far more flexible than labour. People can control when they crystallise capital gains, and to some extent where they accumulate and sell assets. As a result, when rates increase, taxpayer behaviour can adjust in ways that shrink the tax base. This means large increases in CGT rates may bring in disappointingly little revenue from the government's perspective. HMRC maintains estimates of the impact of potential tax changes on revenues. Its analysis suggests that large increases in CGT rates may even cause receipts to fall for precisely this reason. There's also empirical evidence that higher CGT rates can discourage entrepreneurship and investment in small firms. Pushing too hard in this area therefore risks both failing to help the public finances and working against broader efforts to support investment.

A better alternative would be to find flexibility in the fiscal rules to support investment with some extra borrowing. That does not mean abandoning independent scrutiny of the public finances à la Liz Truss. Mrs Reeves is right to emphasise the oversight of the Office for Budgetary Responsibility, which former PM Truss and her Chancellor Kwasi Kwarteng cast by the wayside during their short-lived residency in Downing Street. But the shadow of the Truss 'mini budget' debacle shouldn't cause the existing rules to become a straitjacket either. It's widely acknowledged that the current debt rule creates a perverse incentive to cut investment over current spending, regardless of the long-term value that investment may create. In that context, tweaking the rule to facilitate more investment would be a good thing, and not likely to upset the government bond market.

The third is supporting a broader pro-investment agenda. Given the entrenched weakness of investment in the UK, what's required is a holistic programme of change which addresses as many of the current roadblocks as possible.

The UK's sclerotic planning system, widely identified as a brake on growth, is a good place to start. Now's the time to deliver long-promised reform, to allow housebuilding to increase and to reduce the time and cost associated with constructing new infrastructure – an area where the UK currently scores poorly relative to peers. Similarly, both Labour and the Conservatives have flagged that the pensions system could do more to support investment in productive assets, and a change of government presents an opportunity to deliver change. Consolidation of pension schemes and incentives to invest more in productive UK assets would help. But the devil will be in the detail. Legal changes have far more chance of success than moral suasion. Otherwise, Labour's manifesto commitments to retain the 'full expensing' of some investment and the annual investment allowance for small businesses are positive.

Encouraging research and development

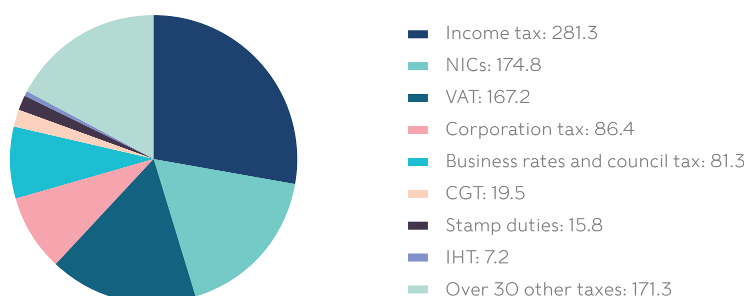
The Chancellor could also consider expanding the scope of full expensing. (It currently covers plant and machinery, but not things like training and intangible assets such as software.) She could affirm the government's commitment to the existing tax credit for research and development and the patent box system, which provides a reduced 10% tax rate on profits from relevant patents. Business rates reform has been promised too, and a useful first step here would be extending the relief for companies investing in upgrading commercial premises.

Lastly, in setting out the government's new industrial strategy, lessons should be learned from the UK's piecemeal, stop-start approach of the past decade-plus and the varying experiences of industrial policy around the world. Consistency and clearly defined, measurable targets are vital. By one count, the UK has had 11 separate strategies since 2010, usually with vague economy-wide goals that are hard to track and do nothing to promote accountability. Labour's proposal to re-establish an Industrial Strategy Council on a statutory basis that will report to Parliament is a good idea, but several of its 'missions' are ill-defined. Meanwhile, global experience suggests a decentralised, bottom-up approach has a greater chance of success than the top-down 'picking winners' model usually pursued in the UK. Working in partnership with the private sector and with local/regional governments should help to ensure both faster delivery and that investment happens where it is needed most.

Figure 2: Government revenue (£ billion)

CGT contributes a relatively small proportion to total government revenues each year.

Source: LSEG and Rathbones



HOW LABOUR'S PLANS COULD AFFECT YOUR FINANCES

With Prime Minister Keir Starmer suggesting that those with the "broadest shoulders should bear the heavier burden", what could the new government's first Budget mean for your personal financial situation?

As we noted in the lead article on pages 4 and 5, Labour has pledged not to increase the four taxes that raise the most revenue. As a result, CGT, pensions and IHT are in the spotlight. Here we'll spell out these and other tax changes that might be coming. (You can find more detail on these and other possible tax changes in a separate pre-Budget update at rathbones.com/knowledge-and-insight).

None of this is meant to be taken as advice, and of course we don't know what will be in the Budget. So please speak to your investment adviser or wealth planner if you have any questions or concerns.

Capital Gains Tax rates

Of the potential tax changes being mooted in the press, the one with the greatest potential to impact the finances of a typical Rathbones client would an increase in CGT. Relatively few people pay CGT – usually less than 0.5% of the population in any one year – though this proportion has increased noticeably over the past decade. The tax liability has jumped more than 300% in that time to £16.7 billion (as of the 2021/22 financial year). Figure 3 shows a history of changes to CGT and revenue generated from it.

Labour says it has "no plans" to raise CGT rates, and there's little wiggle room on allowances, as the tax-free allowance halved to £3,000 on 6 April 2024. For reasons we explain in our other article on the Budget on pages 4 and 5, raising CGT too much could result in less revenue being generated overall. Although no mention was made of it in the manifesto, changes to CGT can't be ruled out.

> **In order to raise the money needed to fulfil its plans to improve a range of public services, Labour will have to flex its fiscal rules or make changes to long-standing taxes, allowances, investment schemes and other rules**

Breaking into the pensions piggy bank

Labour pledged to maintain the 'triple lock' for state pensions (increased in line with inflation, wage growth or 2.5%, whichever is highest), and committed to a review of pensions aimed at 'improving outcomes' and encouraging investment in UK markets. However, this doesn't rule out changes such as subjecting state pension income to tax, changing or reducing pensions tax relief, or tax-free lump sums that can be withdrawn, or removing exemptions from IHT for pension savings. While Reeves had previously said she would reintroduce the lifetime allowance, media reports suggest Labour has backed away from this, and although not ruled out, it wasn't mentioned in the party's pre-election manifesto.

Inheritance tax

Although IHT is an unpopular tax, Labour has pointed out in the past that a very small proportion of the population actually pay it – less than 5% of deaths during the 2020/21 tax year resulted in IHT charges. With an IHT-free band of £325,000 available to all, and another £175,000 for some who leave a residence to their direct descendents, there is scope to reduce allowances, exemptions or even change the overall rate that currently sits at 40% for most.

Non-domicile status

Labour has stated it will introduce new rules from 6 April 2025. No further details were given, other than pledging to go further than the changes announced in Budget 2024. Currently non-UK domiciled individuals are broadly able to live in the UK for 15 years before their worldwide income and assets fall into the scope of UK tax. However, this allowance will be significantly reduced to just four years for capital gains and income tax. For IHT this will be reduced to 10 years. But with only 55,500 non-doms who were UK resident in 2022 it's unlikely to be a big earner for Labour.

Planning can help

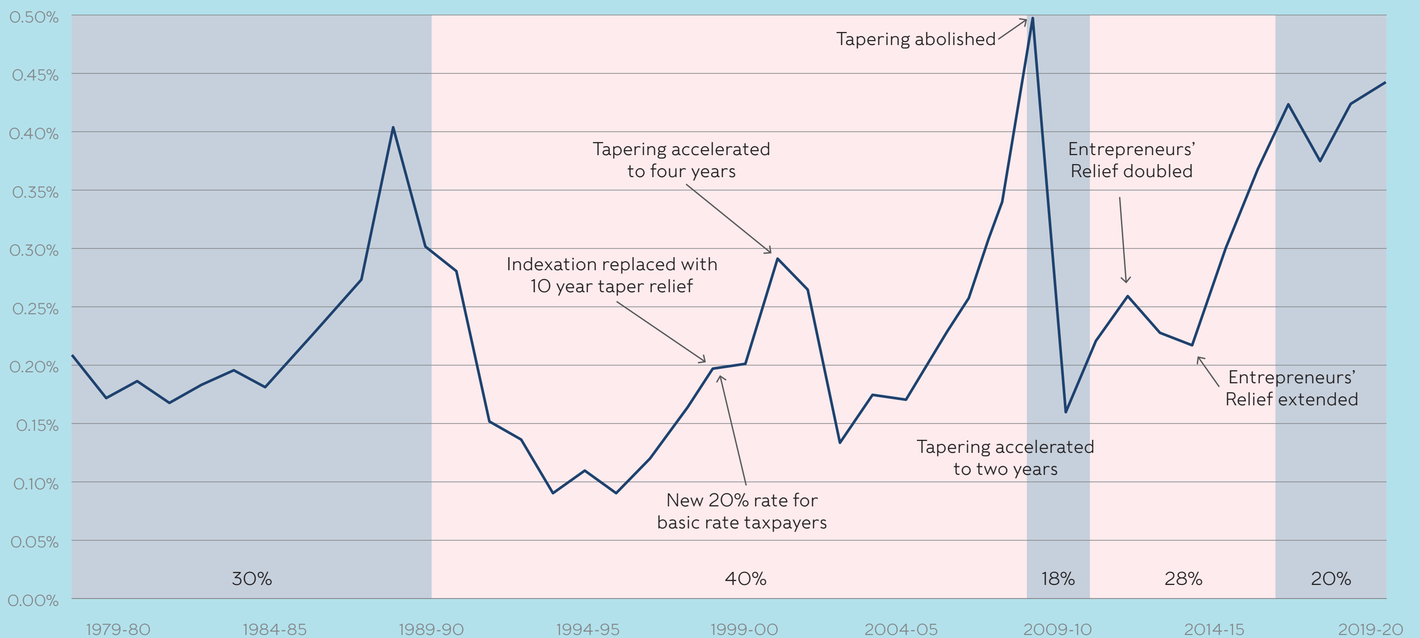
In order to raise the money needed to fulfil its plans to improve a range of public services, Labour will have to flex its fiscal rules or make changes to long-standing taxes, allowances, investment schemes and other rules. Please get in touch with your usual Rathbones contact to see if they can help, or through the contact details at the end of this publication.

Tax treatment depends on the individual circumstances of each client and may be subject to change in future. The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

Figure 3: A taxing history

This chart shows how CGT revenue as a proportion of GDP has changed over the past 40 years.

Source: Tax Policy Associates and Rathbones



AMERICA'S DEBT LOOKS SET TO GROW REGARDLESS OF WHO WINS

With the US election around the corner, we've written a lot about the differences between the two parties. But there are some important similarities that shouldn't be forgotten. One of the most significant relates to debt and the deficit. While the risks are arguably greater if Trump wins in November, the bigger picture is that *neither* party has talked about fiscal retrenchment. Regardless of the election result, big US fiscal deficits appear to be here to stay.

Some historical context illustrates the salience of this issue. Last year, the US federal deficit (the difference between the government's outlays and its receipts) stood at 6.3% of GDP. As figure 4 shows, the deficit has only been larger relative to the economy on three occasions since 1930 – during the Second World War, around the Global Financial Crisis and during the covid pandemic. The size of the deficit in 2023 was especially striking given the US economy was growing strongly and the unemployment rate was very low – factors that tend to reduce the deficit by boosting tax revenues and reducing unemployment payments.

Meanwhile, the stock of outstanding federal debt has also been rising relative to the size of the economy. The ratio of debt to GDP (excluding intragovernmental debt) reached 97.2% in 2023, slightly below its 2020 pandemic peak but otherwise the highest since the aftermath of the Second World War. The non-partisan Congressional Budget Office projects that, under current spending plans, the deficit will remain above 5% of GDP in every year of its forecast, and that the ratio of debt to GDP will continue to climb. Neither Republicans nor Democrats have tabled policy proposals that would substantially change this assessment. (The risk of even larger deficits is arguably greater under the Republicans, who are proposing to cut corporate tax rates again.)

These factors influence the investment outlook – but not necessarily in the way you might think. Public debt is an area that's especially subject to misunderstanding and obfuscation, with politicians incentivised to downplay the risks when they're in office and to magnify them when they're not.

In countries like the US, which borrow in their own currency, high public debt relative to the size of the economy alone is not necessarily a big headwind for growth. The broader context, and how the government chooses to manage its debt, matters more. The fact that the government borrows in a currency it controls allows it to avoid default. (It's a different situation entirely for countries that *don't* borrow in their own currency. They have far less flexibility when it comes to managing their debt and are much more vulnerable to sudden withdrawals of funding.)

Looking back as a guide

A couple of examples help to make the point. Take the experience of the US just after the Second World War. In the aftermath of the conflict, public debt was the highest it has ever been relative to the size of the economy. Management by the central bank into the 1950s kept government borrowing costs under control, and there was no obvious toll on economic growth. The war was followed by the 'Golden Age of Capitalism', nearly three decades of remarkably strong and sustained economic expansion. Or consider Japan, which has had a public debt ratio far higher than the current level in the US for more than two decades. It has maintained reasonable, if unspectacular, rates of per capita economic growth in that time – nothing to write home about, but no crisis either.

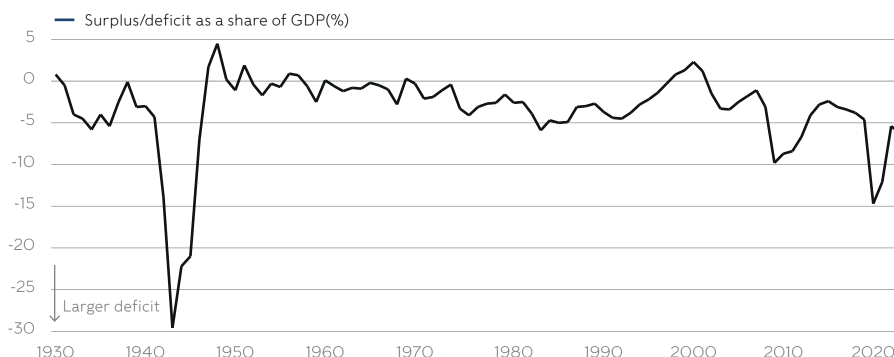
More generally, the prominent academic work that had suggested GDP growth falls sharply when public debt breaches 90% of GDP (cited by politicians from George Osborne to Paul Ryan in justification of austerity during the 2010s) has been discredited. The paper *Growth in a Time of Debt* fell victim to a simple spreadsheet error, along with various methodological flaws. Subsequent analysis has found either far smaller effects of higher public debt on growth, or no statistically significant effect at all.

Yet this is not an argument for complacency, or to ignore the debt outlook. It still matters a great deal. As we noted above, it's how policymakers choose to deal with a high and rising public debt ratio, and how those choices interact with what's going on in the economy more generally, that matters. Broadly, policymakers have four options.

Figure 4: Getting further into debt

The US deficit has only been larger relative to the economy on three occasions since 1930.

Source: OMB and Rathbones



Option one is to find a way to lift trend economic growth. This is by far the most palatable option, reducing the need for hard choices about tax and spending – but the hardest to accomplish. Policymakers have only limited control over the biggest drivers of trend growth. Growth in the working-age population in the US is projected to fall, given its demographics and public resistance to sustained high immigration. Meanwhile, the diffusion of new technologies is primarily a bottom-up process, which is hard to predict or control. The next administration could get lucky and benefit from an AI-driven surge in productivity growth. But experience suggests they shouldn't count on it.

Option two is to cut the deficit via austerity, some combination of significantly higher taxes or spending cuts. That would typically reduce government bond yields. But the current election campaign suggests it is a political impossibility, at least for now. The framing of the debate around the public finances has completely changed since the early 2010s, with seemingly no appetite for austerity-type policies whatsoever.

Ways to suppress borrowing costs

Option three is a combination of 'financial repression' and tolerating inflation. Financial repression in this context means policies designed to suppress the government's borrowing costs, such as the central bank buying more government bonds or financial regulations that compel commercial banks to increase their holdings. Such policies were deployed in both the examples above, the US after the Second World War and Japan more recently. Since financial repression can mean subordinating monetary policy to support fiscal policy, it's sometimes associated with tolerating higher inflation. Higher inflation can also make it easier to manage the government's debt, since it erodes the real value of its liabilities.

Option four is kicking the can down the road, continuing to run large deficits without taking any of the other steps above. In these circumstances the debt ratio will rise further, probably to an all-time high in the second half of this decade. Private investors would need to absorb a growing stock of government bonds. All else equal, that's likely to push the yields of government bonds up. That in turn will cause government spending on interest payments to rise even further. It's already about as large as the entire defence budget (figure 5.) As interest payments climb, the public conversation about fiscal policy may eventually change, necessitating a switch to option two or three. But clearly that doesn't seem imminent.

Of these four options, the last one seems the most likely to be pursued in the short term. That's an important reason why, as we emphasised in our Investing for the Next Decade report, government bond markets will probably remain much more volatile in the next few years than they were during the 2010s. They still have an important role to play in portfolios (the fact that yields have already risen considerably provides some offset to greater volatility). But there's cause to limit exposure to longer-dated government bonds, whose prices are more sensitive to changes in their yields. This is also a reminder of why we continue to allocate to assets like gold, and certain hedge funds, which can perform even at times when government bonds are struggling.

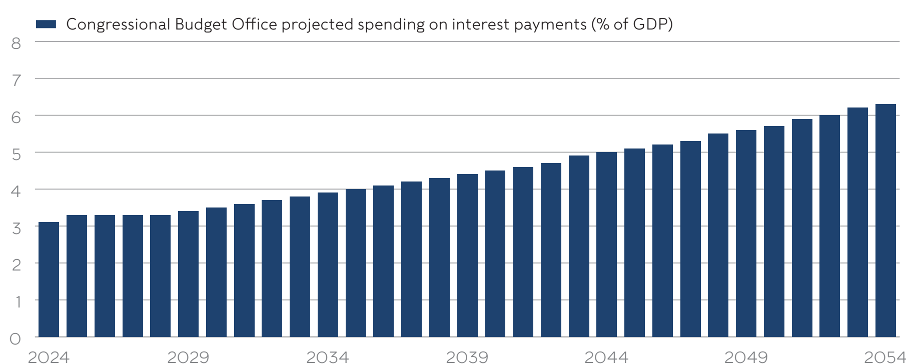
Polls apart

You can find out more about the policies of the US presidential candidates, and how the winner is likely to affect the economy and investment environment, in our special report Polls Apart. Visit our online Election Hub to see what the latest polls are saying, and for more details about policy proposals at www.rathbones.com/rathbones-election-hub-financial-insights-2024-elections

Figure 5: Keeping up with the repayments

US government spending on interest payments is already about as large as the entire defence budget and projected to rise further.

Source: CBO and Rathbones



CHINA'S ECONOMY HAS CHALLENGES AND THERE'S NO REPLACEMENT

China's stock market has surged from late September, following announcements from policymakers of more support for the country's flagging economy. At the time of writing, the market has risen over 25% from its trough, with 30 September marking the best single day for Chinese stocks since 2008. It's encouraging that the authorities are taking the country's economic downturn more seriously, and it decreases the risk of a greater slump. Yet our analysis suggests it is unlikely of sufficient scale or scope to bring about economic reacceleration. It may provide some further support to sentiment that will be helpful for local market valuations — although reasons for caution remain.

China's housing market has been in an enormous downturn since 2021, which still shows no sign of abating. The collapse in building and sales is like nothing seen in modern Chinese history (figure 6). Attempts by authorities to reduce interest rates and encourage state-owned enterprises to buy unsold properties have so far failed to turn the tide. The announcements in late September were a belated response to this weakness.

Until recently, this property slump hadn't shown up much in prices as local authorities had prevented reductions. But a growing number of cities are relaxing such controls, allowing prices to reflect the reality of the situation. On one measure, average new home prices across 70 cities are down around 8% from their peak, with the prices of existing homes about 14% lower. Prices are likely to fall further, especially for new homes.

In the long run, that should be more positive for the health of the property sector, eventually prompting a recovery in construction and sales. But in the near term, further falls in prices are likely to exacerbate problems for Chinese households, which have a significant proportion of their wealth locked up in property. Indeed, consumer confidence seems very low. These sorts of effects are why, throughout history, economic downturns associated with bursting housing bubbles have been among the most damaging and hardest to turn around.

The despondent mood among Chinese consumers is showing up in several places. Near-zero rates of inflation in China are likely to be a symptom of lacklustre demand for goods and services. Elsewhere, growth in imports from the rest of the world has been slow, while lending growth has been weak too. Improvements in imports and credit growth have been hallmarks of economic rebounds in China in the past, but they have been noticeably absent. On top of this, Western companies with significant Chinese customer bases report a uniformly downbeat picture.

Authorities are ramping up support...

Authorities have recently announced new measures to spur credit growth — including cutting mortgage rates, reducing the reserves banks are required to hold and facilitating borrowing to buy shares — but we aren't convinced that this alone will make a big difference. Even if banks are more willing to lend, households and businesses are showing little appetite to borrow. In this respect, policymakers are pushing on a string.

There are more reasons to be optimistic about the government's apparent newfound willingness to borrow and inject that money directly into the economy. Details so far are relatively light, but rumours suggest the government is considering direct transfers to some households among other policies. That would probably do more to improve confidence and willingness to borrow, boosting demand for goods and services and supporting economic growth in the near term. It would mark a clear change for China, where the authorities have previously been reluctant to support households so directly. However, the announcements were suspiciously light on detail.

...but we still see reasons to be cautious

Even so, the reported magnitude of the support should be seen in context. At about 0.8% of China's GDP, it may be enough to help stabilise economic growth, but not to drive a strong rebound given the scale of the damage to households' wealth. Nor does it change our view that the structural slowdown in China is set to continue. We've been cautious about the world's second-largest economy for a long time and argued back in 2016 and last year that the long-run outlook was one of slower growth.

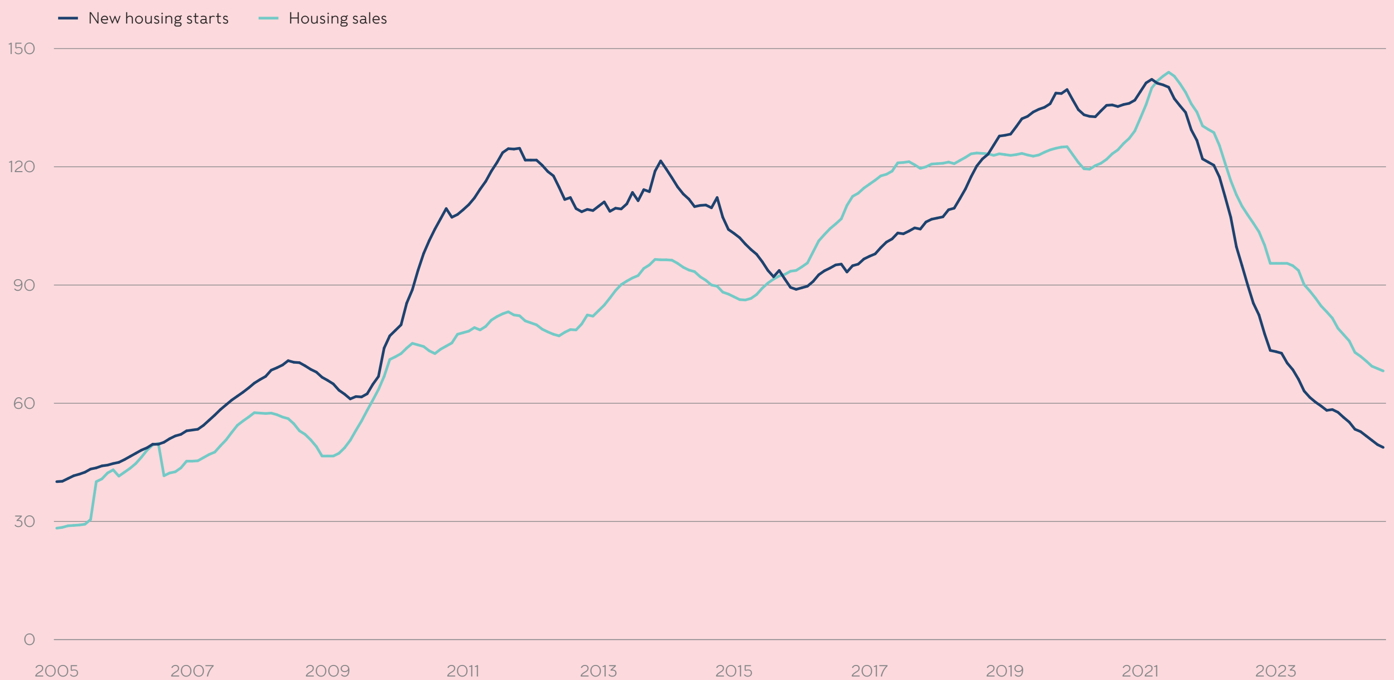
There are other risks. November's US election is one. Former President Donald Trump initiated the US-China trade war in 2018 and is threatening to escalate the situation again should he return to the White House. Democrats have taken a more targeted approach since, but have also added to restrictions on trade with China and are unlikely to change course if they win. Meanwhile, there are growing regulatory risks. We've shifted from an environment in the mid-2010s when the Chinese authorities were trying to court foreign investors to one where their interests are largely ignored.

There is a reasonable chance the Chinese stock market continues to rally over the coming year or so. A lot of negative sentiment was baked in to share prices before these announcements, and further indications that authorities are taking the downturn in China's economy more seriously could prompt more global investors to turn less downbeat. Policymakers' willingness to act allays fears about the worst-case scenario of a much deeper downturn in the economy, and raises the possibility of further, larger, stimulus measures to come. Given this possibility, we think it's sensible to hold some Chinese and China-exposed assets (including stocks in some other emerging markets). However, given our scepticism that the announcements to date will meaningfully alter the longer-term outlook in China, we are proceeding with the cautious approach that has served us well over the past few years. These assets should still only play a limited role in portfolios.

Figure 6: A property slump

Chinese housing starts and sales (millions of square metres, 12-month average) have plummeted over the past few years.

Source: LSEG and Rathbones



FEARS OF AN EXODUS OF UK BOSSES OVER PAY MAY BE OVERDONE

The heads of UK companies must be scratching their heads. If they read the British newspapers, they'll wince at complaints they're paid far too much. If CEOs look across the Atlantic, though, they see that the gap between executive pay in the UK and US is even wider than before (figure 7).

This has prompted talk of a potential 'brain drain'. There are already examples. In 2022 the CEO of UK-listed consumer goods business Reckitt Benckiser departed for a higher-paying job in the US. In March 2024, the head of UK industrial conglomerate Smiths Group did the same.

Large UK companies are responding to this potential transatlantic migration by trying to pay their CEOs more – but this has courted controversy. This year, pharmaceuticals business AstraZeneca, medical device maker Smith & Nephew and London Stock Exchange Group have faced resistance from shareholders asked to approve increases to CEO compensation packages closer to what US peers are offered.

A question of size

A common explanation is that disparities in pay reflect disparities in size. The average market capitalisation (the total value of shares held) for a company in the S&P 500 index of the biggest listed US businesses is about four times the size of the average FTSE 100 company. Given this, it makes sense to pay top business leaders in the US more, since they run larger business empires.

Even after taking company size into account, Tom Gosling, executive fellow in finance at London Business School, finds that US CEOs are paid about 50% more. How much of a problem does this actually pose for UK companies?

Despite the examples above, it's actually rare for senior executives to relocate from FTSE 100 firms to US rivals. Moreover, in both cases above, the departing CEOs were from among a very small number of FTSE 100 heads who are American citizens. This is relevant because past analysis by Boardroom Insiders, an information company, has found that only 12% of CEOs at Fortune 500 companies (the 500 biggest US companies by revenue) were born outside America. Of this group, nine in ten had emigrated to the country when young, been to a US college, or worked their way up through the international divisions of the company they eventually went on to lead.

For the top UK companies, by contrast, more recent research from headhunter Heidrick & Struggles finds that 42% of CEOs weren't British – roughly four times its equivalent number for top US companies. So it's not the US market that's sucking in so many foreign CEOs, at least in relative terms – it's the UK.

Should I stay or should I go?

If CEO pay is higher in the US, why don't British CEOs follow the example of P.G. Wodehouse, Cary Grant and John Lennon by leaving en masse for America? One answer is that human motivation is complex. Some studies into what makes CEOs tick have concluded that the opportunity to do challenging and engaging work, which generates prestige, respect and admiration, is often a greater incentive than money. We believe fears are overblown of a heavy migration of CEO talent and even entire companies from the UK because of executive pay alone.

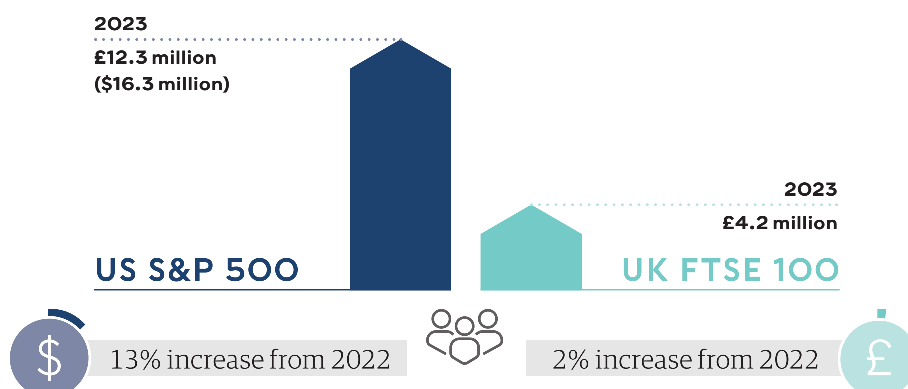
What does this mean for Rathbones? When considering how much CEOs should be paid, we're happy if shareholder funds are used to keep a talented CEO from defecting. But the reasoning has to be rigorous – every million pounds more a CEO is paid is a million pounds less to allocate to something else, such as investing in machinery, marketing or innovation. In other words, some pay packages merit a wince – but others don't.

Figure 7: Median CEO pay in 2023

The gap between executive pay in the UK and US has widened further.

Note: the median is the executive whose pay is in the exact middle; the number of CEOs paid more is the same as the number paid less.

Source: Equilar and Associated Press ; High Pay Centre



FINANCIAL MARKETS

With inflation nearing the US Federal Reserve's (Fed) 2% target, it cut interest rates for the first time since 2020. After a period of high borrowing costs, solid growth, low inflation and healthy employment, hopes have grown that the US is heading towards a soft landing — where the economy slows without a recession. In August, the Bank of England also cut rates for the first time in four years as inflationary pressures eased, but kept them unchanged at its September meeting.

Global markets fell from record highs at the end of July as investors rotated away from mega-cap growth stocks. Signs of cooling inflation fuelled hopes of interest rate cuts, helping drive investor demand for smaller companies, which tend to struggle more when rates are higher.

Volatile conditions

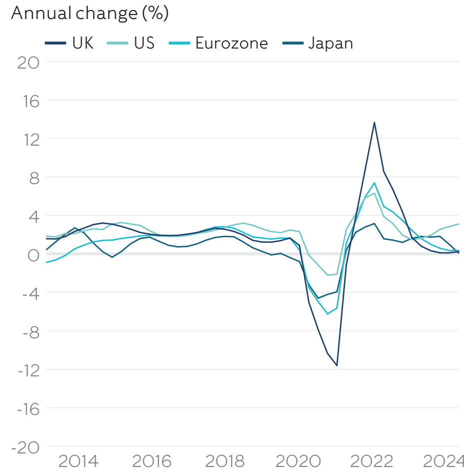
Markets were volatile at the start of August due to worries about a slowing US economy, while a larger-than-expected increase in interest rates from the bank of Japan hit the Japanese stock market hard. Selling in the US and global equity markets began after new figures showed US unemployment was rising, sparking fears of a downturn. Japan's Nikkei suffered its worst day since 1987, losing 12% in one trading session before recouping most of the losses into the end of the quarter.

The sharp fall in Japanese stocks was exacerbated by sharp gains in the yen, which lowers the value of exporters' earnings when translated back to the home currency and also makes Japanese equities more expensive for foreign investors. US and European shares also posted sharp losses, but markets soon bounced back after encouraging US data helped soothe worries of a downturn.

Towards the end of the period, Wall Street's main indices rose to record highs into the widely anticipated Fed rate cut, while the FTSE 100 also climbed. Gold reached a new record high following the Fed rate cut, amid continued buying from Asian central banks, soaring to over $2,600 an ounce.

GDP growth

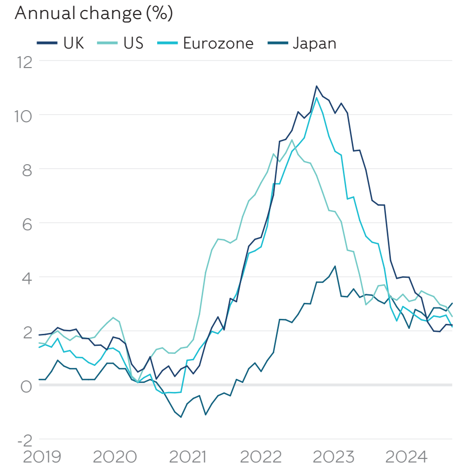
Annual change (%)



Source: Factset and Rathbones

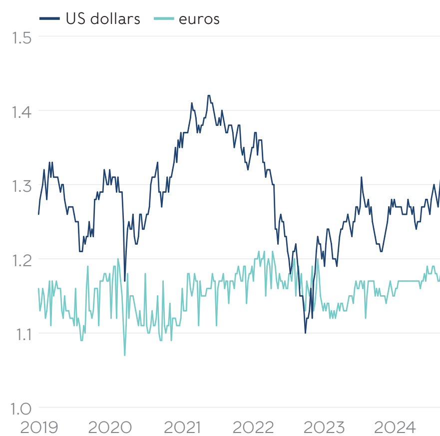
Inflation

Annual change (%)



Source: Factset and Rathbones

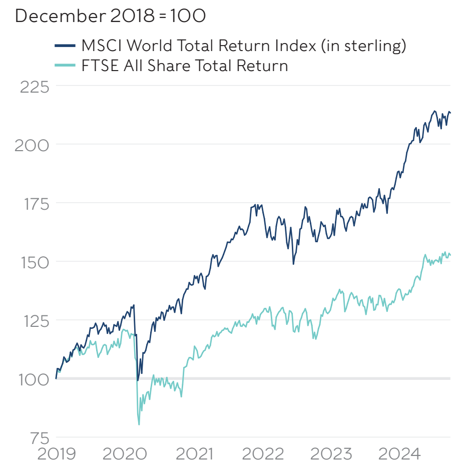
Sterling



Source: Factset and Rathbones

Equities

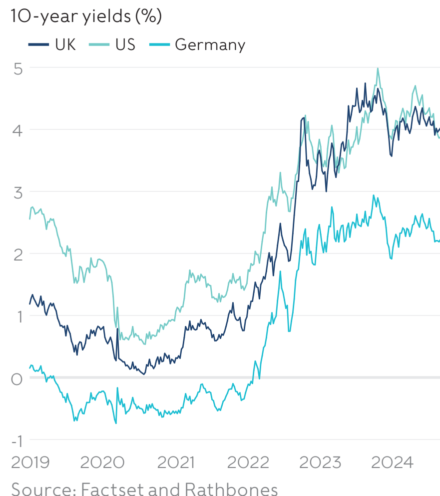
December 2018 = 100



Source: Factset and Rathbones

Government bonds

10-year yields (%)



Source: Factset and Rathbones

Gold

US dollars per troy ounce

Source: Factset and Rathbones

The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance is not a reliable indicator of future performance.

ADDITIONAL INFORMATION

Information valid at 30 September 2024, unless otherwise indicated. This document and the information within it does not constitute investment research or a research recommendation. The value of investments and the income generated by them can go down as well as up.

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