



July Monthly Report

Dear Investors

We are pleased to provide you with the July 2024 Monthly Report for the Fawkes Capital Fund (“Fund”). In this monthly report, we:

- (1) Update our performance for July 2024.
- (2) Update our views on the current macroeconomic environment

Performance Update

In July, the Fund gave back a small portion of the gains made over the last 6 months. Performance of the month was -2.4%. The main detractors were our investment holdings in Qualcomm, interest rates and unhedged and natural currency exposures from our stock holdings. Various contributions from single-name stock investments from our major themes explained last month provided an offset.

Jul-24	1 Mth	3 Mth	1 yr	2 Yrs	3 Yrs	SI (ann)	SI (cum)
Fund (Net)	-2.4%	-0.5%	9.2%	3.7%	8.0%	6.8%	23.9%
Blended Index	2.1%	3.3%	9.0%	8.2%	5.1%	5.7%	19.3%
All Ords	3.8%	5.5%	13.4%	12.3%	7.1%	8.3%	29.8%
RBA Cash	0.4%	1.1%	4.4%	3.8%	2.6%	2.4%	8.0%

Returns are calculated net of fees and represent the combined income and capital returns over the specified period. All returns provided are in AUD. Blended Index returns are composed of 50% All Ords / 50% RBA Cash.

As at the time of writing, we have made some major asset allocation changes. We have closed out much of our single-name stock exposure. Instead, due to the increased uncertainty in the outlook above and the opportunities available in macro markets (which we’ll detail in future notes), we’ve decided to concentrate our investments in the most liquid of instruments. Instead of owning single-name stocks, we’ve decided to invest much of our equity exposure in highly liquid index futures. We continue to monitor the situation closely and will adjust the portfolio accordingly. Despite the market turmoil in August that emanated from Japan, the portfolio has so far performed well.

The Macroeconomic Environment

In the grand scheme of things, broader economic events significantly influence where asset values ultimately settle in the medium term. Regardless of their investment philosophy, history’s greatest investors have demonstrated a keen awareness of market cycles.

Benjamin Graham advocated for buying stocks when the overall market is trading at low prices. This typically happens during recessions. Graham’s most famous disciple, Warren Buffett, emphasises the importance of understanding market cycles, famously stating that anything written by Howard Marks, a cycle-conscious investor, goes straight to the top of his to-read list. Buffett’s awareness of macroeconomic factors is well-documented, exemplified by his mid-2000s essay and bet against the US dollar. A closer examination of his investment strategy reveals that he tends to sell stocks when they perform well and increases his investments during economic downturns. While we believe that attractive investment opportunities should be pursued even on the brink of a recession, it is evident that broader economic cycles play a significant role in value-driven decision-making.

The pressing question today is whether we’re headed towards a soft landing or a recession. What’s unfolding?



As we detailed in a [recent note](#), the recent rise in the US unemployment rate has re-ignited concerns about a potential recession. Historically, whenever the unemployment rate has increased by around 1%, a recession has ensued, regardless of whether the central bank cuts interest rates or not.

While we believe it'd be unwise to exercise wilful blindness towards the possibility of a recession, will history repeat itself this time around? This economic cycle has been markedly different from previous ones, largely due to the excess savings accumulated during the COVID-19 pandemic and the stimulative fiscal policies implemented thereafter. Will the labour market crack this time around? We've delved deeper into the situation, recognizing that it will significantly influence asset pricing in the next six months.

Firstly, the current rise in the unemployment rate differs from previous instances. In times past, by the time the unemployment rate had risen by 1%, the US economy was shedding jobs, and initial claims for unemployment insurance had seen a substantial increase. However, this time, that's not really the case:

Historic Rises in the U/E Rate of 1%

Today	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24
U/E Rate	3.4	3.8	3.8	3.8	3.7	3.7	3.7	3.9	3.8	3.9	4.0	4.1	4.3
Chg from Low		0.4	0.4	0.4	0.3	0.3	0.3	0.5	0.4	0.5	0.6	0.7	0.9
Payrolls	116	142	178	97	114	222	188	168	242	108	216	179	114
Initial Claims	232	250	220	215	220	210	210	215	212	210	225	230	230
Chg from Low		18	-12	-17	-12	-22	-22	-17	-20	-22	-7	-2	-2
Continuing Claims	1,780	1,800	1,800	1,810	1,800	1,810	1,750	1,790	1,800	1,790	1,790	1,830	1,870
Chg from Low		20	20	30	20	30	-30	10	20	10	10	50	90

GFC	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08
U/E Rate	4.7	4.7	4.7	5.0	5.0	4.9	5.1	5.0	5.4	5.6	5.8	6.1	6.1
Chg from Low: May 07 (4.4)	0.3	0.3	0.3	0.6	0.6	0.5	0.7	0.6	1.0	1.2	1.4	1.7	1.7
Payrolls	86	72	116	105	1	-71	-70	-219	-190	-158	-197	-283	-450
Initial Claims	315	330	340	355	340	350	370	360	370	380	410	420	460
Chg from Low	10	25	35	50	35	45	65	55	65	75	105	115	155
Continuing Claims	2,550	2,550	2,620	2,700	2,800	2,870	2,950	2,970	3,020	3,080	3,200	3,380	3,500
Chg from Low	70	70	140	220	320	390	470	490	540	600	720	900	1,020

Tech Crash	Dec-00	Jan-01	Feb-01	Mar-01	Apr-01	May-01	Jun-01	Jul-01	Aug-01	Sep-01	Oct-01	Nov-01	Dec-01
U/E Rate	3.9	4.2	4.2	4.3	4.4	4.3	4.5	4.6	4.9	5.0	5.3	5.5	5.7
Chg from Low		0.3	0.3	0.4	0.5	0.4	0.6	0.7	1.0	1.1	1.4	1.6	1.8
Payrolls	165	-19	87	-35	-296	-44	-115	-123	-149	-259	-313	-311	-157
Initial Claims	350	340	375	390	400	400	400	400	400	450	480	450	410
Chg from Low		-10	25	40	50	50	50	50	50	100	130	100	60
Continuing Claims	2,300	2,350	2,480	2,590	2,700	2,880	2,950	3,000	3,100	3,300	3,500	3,650	3,600
Chg from Low		50	130	110	110	180	70	50	100	200	200	150	-50

1990 Recession	Jun-90	Jul-90	Aug-90	Sep-90	Oct-90	Nov-90	Dec-90	Jan-91	Feb-91	Mar-91	Apr-91	May-91	Jun-91
U/E Rate	5.2	5.5	5.7	5.9	5.9	6.2	6.3	6.4	6.6	6.8	6.7	6.9	6.9
Chg from Low		0.3	0.5	0.7	0.7	1.0	1.1	1.2	1.4	1.6	1.5	1.7	1.7
Payrolls	23	-35	-212	-90	-146	-154	-52	-117	-320	-162	-217	-102	88
Initial Claims	365	368	380	392	425	450	460	445	485	500	470	445	420
Chg from Low		3	15	27	60	85	95	80	120	135	105	80	55
Continuing Claims	2,420	2,450	2,510	2,600	2,750	2,970	2,970	3,100	3,250	3,350	3,485	3,470	3,400
Chg from Low		30	90	180	330	550	550	680	830	930	1,065	1,050	980

Source: Bureau of Labor Statistics

As the table above indicates, today's 1% rise in the unemployment rate has not been accompanied by job losses, or a steep rise the number of people claiming unemployment insurance. While the labour market is clearly weakening, it hasn't yet cracked. But will it crack in the near future?

Historically, the key factor that differentiates soft landings (such as those in 1986-87 and 1995-96) from recessions is whether the labour market cracks or not. A common catalyst for a weakening labour market is when nominal spending growth falls below wage growth. When the increase in the amount of people who are willing to spend falls



below the cost of holding onto staff, profits tend to shrink. Shrinking profits tend to lead businesses to reduce headcount.

In scenarios of soft landings, nominal GDP growth typically does not fall below wage growth:

Soft Landings

	Q1 1985	Q2 1985	Q3 1985	Q4 1985	Q1 1986	Q2 1986	Q3 1986	Q4 1986	Q1 1987	Q2 1987	Q3 1987	Q4 1987
Wages (Ann)	5.2%	4.4%	4.4%	3.2%	4.0%	2.4%	2.4%	4.0%	3.2%	3.2%	4.0%	4.0%
Nominal GDP	8.2%	7.1%	7.4%	7.1%	6.5%	5.8%	5.0%	4.8%	4.8%	5.7%	6.0%	7.5%
Nom GDP - Wages	3.0%	2.7%	3.0%	3.9%	2.5%	3.4%	2.6%	0.8%	1.6%	2.5%	2.0%	3.5%
Inflation	3.7%	3.8%	3.1%	3.8%	2.3%	1.8%	1.8%	1.1%	3.0%	3.7%	4.4%	4.6%
Real Wages	1.5%	0.6%	1.3%	-0.6%	1.7%	0.6%	0.6%	2.9%	0.2%	-0.5%	-0.4%	-0.6%
Fed Rate				8.0%	7.5%	6.5%	6.0%	6.0%	6.5%	6.5%	6.5%	6.5%
Consumer Credit			6.5	5.7	5.1	5.0	5.5	2.5	-1.0	5.0	4.0	3.5

	Q1 1994	Q2 1994	Q3 1994	Q4 1994	Q1 1995	Q2 1995	Q3 1995	Q4 1995	Q1 1996	Q2 1996	Q3 1996	Q4 1996
Wages (Ann)	4.4%	3.6%	2.8%	2.4%	2.8%	2.8%	2.4%	2.4%	3.2%	2.8%	2.8%	2.8%
Nominal GDP	5.7%	6.4%	6.5%	6.3%	5.7%	4.6%	4.8%	4.3%	4.6%	6.0%	5.8%	6.3%
Nom GDP - Wages	1.3%	2.8%	3.7%	3.9%	2.9%	1.8%	2.4%	1.9%	1.4%	3.2%	3.0%	3.5%
Inflation	2.5%	2.5%	3.0%	2.7%	2.9%	3.0%	2.5%	2.5%	2.8%	2.8%	3.0%	3.3%
Real Wages	-1.2%	0.3%	0.7%	1.2%	0.0%	-1.2%	-0.1%	-0.7%	-1.4%	0.4%	0.0%	0.2%
Consumer Credit					12.0	12.0	12.0	11.0	11.0	11.0		

Source: Bureau of Labor Statistics and Bureau of Economic Analysis

In recessions, the opposite is true:

Hard Landings

	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009
Wages (Ann)	3.2%	3.6%	3.2%	3.2%	2.8%	2.8%	2.8%	2.0%	1.2%	1.2%	2.0%	1.6%
Nominal GDP	4.5%	4.7%	5.0%	4.8%	3.5%	3.2%	2.3%	-0.7%	-1.9%	-3.3%	-3.0%	0.3%
Nom GDP - Wages	1.3%	1.1%	1.8%	1.6%	0.7%	0.4%	-0.5%	-2.7%	-3.1%	-4.5%	-5.0%	-1.3%
Inflation	2.8%	2.7%	2.8%	4.1%	4.0%	5.0%	4.9%	0.1%	-0.4%	-1.4%	-1.3%	2.7%
Real Wages	0.4%	0.9%	0.4%	-0.9%	-1.2%	-2.2%	-2.1%	1.9%	1.6%	2.6%	3.3%	-1.1%

	Q1 1999	Q2 1999	Q3 1999	Q4 1999	Q1 2000	Q2 2000	Q3 2000	Q4 2000	Q1 2001	Q2 2001	Q3 2001	Q4 2001
Wages (Ann)	1.6%	4.0%	4.0%	4.0%	4.8%	4.4%	4.0%	3.2%	4.4%	4.0%	4.4%	3.6%
Nominal GDP	6.1%	6.2%	6.2%	6.5%	6.3%	7.6%	6.5%	5.4%	4.7%	3.4%	2.7%	2.1%
Nom GDP - Wages	4.5%	2.2%	2.2%	2.5%	1.5%	3.2%	2.5%	2.2%	0.3%	-0.6%	-1.7%	-1.5%
Inflation	1.7%	2.0%	2.6%	2.7%	3.8%	3.7%	3.5%	3.4%	2.9%	3.2%	2.6%	2.0%
Real Wages	-0.1%	2.0%	1.4%	1.3%	1.0%	0.7%	0.5%	-0.2%	1.5%	0.8%	1.8%	1.6%

	Q1 1989	Q2 1989	Q3 1989	Q4 1989	Q1 1990	Q2 1990	Q3 1990	Q4 1990	Q1 1991	Q2 1991	Q3 1991	Q4 1991
Wages (Ann)	4.4%	5.2%	5.6%	4.8%	4.8%	5.6%	4.8%	4.0%	4.0%	4.8%	3.2%	4.0%
Nominal GDP	8.6%	8.1%	7.8%	6.4%	6.6%	6.2%	5.6%	4.5%	2.8%	2.8%	3.2%	4.3%
Nom GDP - Wages	4.2%	2.9%	2.2%	1.6%	1.8%	0.6%	0.8%	0.5%	-1.2%	-2.0%	0.0%	0.3%
Inflation	5.0%	5.2%	4.3%	4.6%	5.2%	4.7%	6.2%	6.1%	4.9%	4.7%	3.4%	3.1%
Real Wages	-0.6%	0.0%	1.3%	0.2%	-0.4%	0.9%	-1.4%	-2.1%	-0.9%	0.1%	-0.2%	0.9%

Source: Bureau of Labor Statistics and Bureau of Economic Analysis

We measure nominal spending in three different ways to track how the consumer is faring. The first is by tracking the revenue growth of American business segments. Imperfectly, the 75 major companies we track account for around \$5 trillion of annual American consumer spending, or roughly one-quarter of total consumer spending. After factoring in rent, mortgages, and utilities, these companies likely represent closer to half of discretionary spending.

The second method involves analysing the segment results of the three major debit and credit card issuers in the US – Mastercard, Visa, and American Express. Together, they process about \$12 trillion in annual consumer spending, which represents approximately 60% of total U.S. consumer spending.



Finally, we triangulate these sources by looking at the payment volumes of the seven largest banks in the US, which combined account for around \$4 trillion of annual spend. Based on these measures, nominal spending growth still outweighs wages growth by a healthy margin:

Annual Spending Growth	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24
1. Individual Companies (\$5t)	7.1%	4.7%	5.8%	5.5%	4.4%	4.1%
2. Visa, Mastercard and Amex (\$12t)	9.6%	5.4%	5.5%	4.6%	5.6%	4.9%
3. Bank Card Spending Data (\$4t)	11.1%	7.8%	8.0%	7.1%	7.2%	5.4%
Weighted Average Consumer Spend	9.4%	5.7%	6.1%	5.3%	5.7%	4.8%
Wages Growth	4.8%	4.0%	4.8%	4.4%	4.4%	3.6%
Difference	4.6%	1.7%	1.3%	0.9%	1.3%	1.2%

Source: Retail Company Reports, Industrial Company Reports and Bureau of Labor Statistics

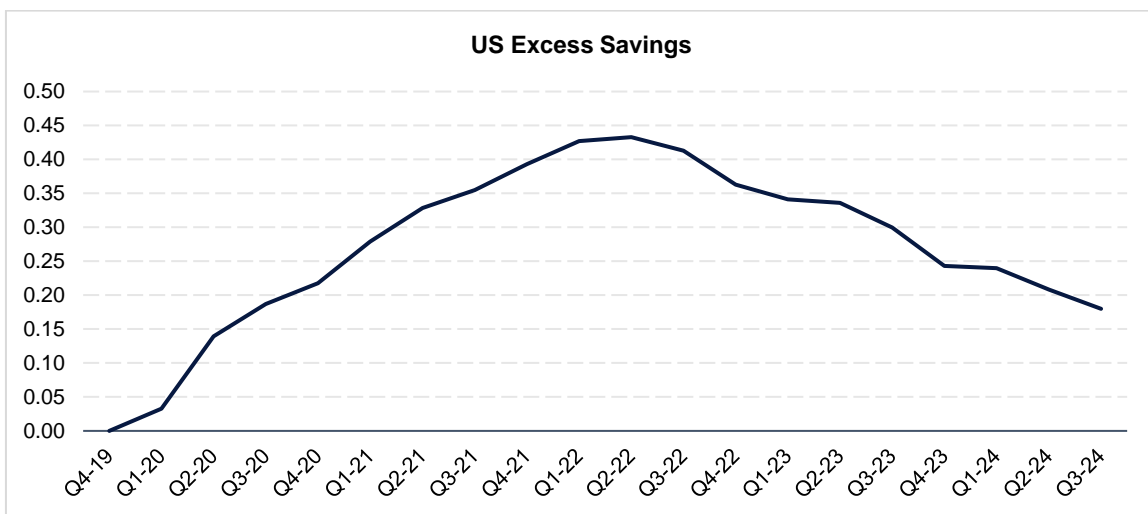
What also stands out to us is that the core consumer companies we track are experiencing relatively stable growth.

Annual Spending Growth	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24
Core Consumer Spend Growth	5.5%	3.6%	3.4%	4.3%	4.9%	3.4%
Industrial Spend Growth (\$1.6t)	8.4%	7.2%	2.1%	2.5%	2.1%	1.8%
Total Industrial and Consumer	8.1%	6.5%	5.3%	5.4%	4.2%	3.7%

Source: Retail Company Reports, Industrial Company Reports and Bureau of Labor Statistics

Many of the companies in this segment have guided towards only slightly slower nominal spending growth in the next quarter or two. Similarly, nominal spending growth at the major card issuers has only slightly decreased compared to a year ago.

High interest rates are working their way through the system by reducing the spending power of those earning lower incomes. The Fed's plan is working. Wages growth has normalised back to pre-Covid levels and nominal spending growth has also slowed. This combination of high interest rates, normalised wages growth and a pace of nominal spending growth that exceeds wages growth is producing the desired decline in consumer savings:

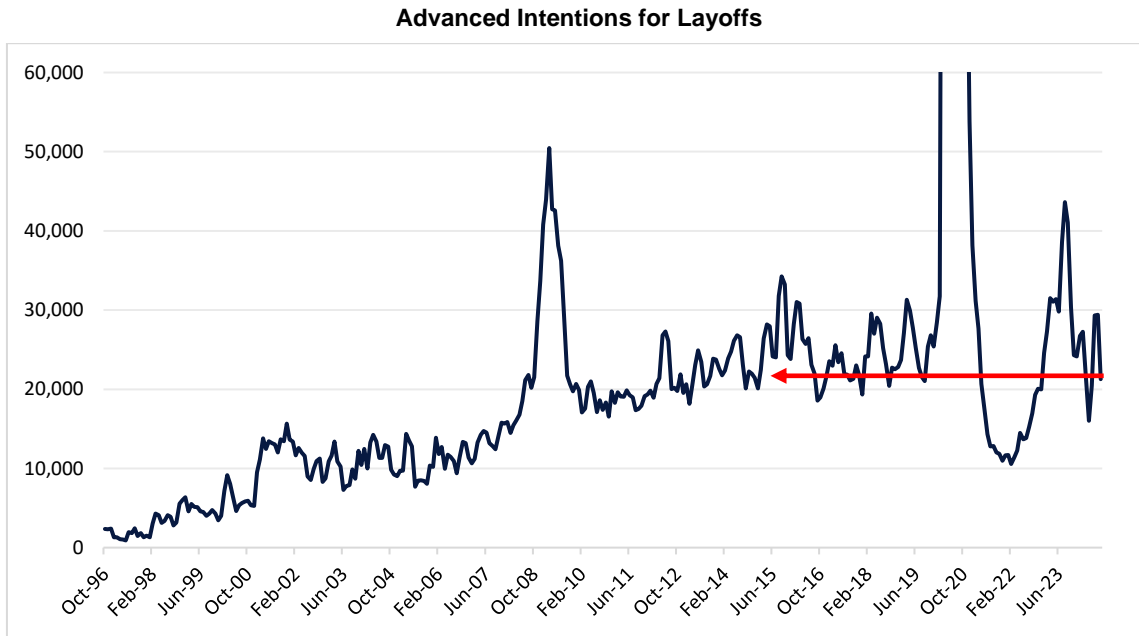


Source: Bank of America, JP Morgan, Wells Fargo Company Reports

Now that excess savings have fallen to more reasonable levels, and inflation has returned to normal, the economy now desperately needs the Federal Reserve to cut rates. If the Fed cuts rates a little too slowly, then the weakest part of the economy, the industrial segment, may start to shed jobs. This job-shedding process would likely lead to a faster decline in nominal spending growth.



So far however, we're not seeing it. We track advance intentions to lay off staff from various sources, and the data is yet to show anything to be worried about. Advanced intentions to lay off staff remain in the range of pre-Covid:



Source: State Departments of Labor and Intelligence

Nor are we observing any major layoffs from the companies that are hurting the most from our dataset. Ordinarily, before a recession, there will be a month or two where layoffs surge. After the normalisation of the labour market post-Covid, we're yet to see that transpire.

What do we assess the prospects of a soft landing going forward? After further analysis, we believe the chances remain quite favourable. While we previously noted an increased risk of recession, our additional research has led to two key insights.

First, the decline in nominal spending growth is likely to be gradual due to two factors: (i) the excess savings within the system, which can sustain nominal spending growth above wage growth, and (ii) the forward guidance on sales growth we've observed so far in the third quarter.

Second, many large companies that have been under the most pressure have either (i) already reduced their headcount or (ii) are unlikely to implement significant further job cuts.

Together, these factors suggest that the Federal Reserve may have enough time and a sufficient window to achieve a soft landing. Subsequent rate cuts could gradually ease the interest burden on consumers, helping to counterbalance the decline in savings.

However, we don't entirely rule out the possibility of a recession. Unlike in 2022, nominal spending growth is now low enough that some sort of shock could tip the economy into contraction. Nonetheless, we now slightly revise our outlook to favour a soft landing over a recession at this stage.

We continue to closely monitor the situation. We have implemented tools to track the state of the labour market and layoffs in real-time. If circumstances change, we will adjust our portfolio positioning accordingly.

Kind Regards,
Fawkes Capital Management



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