CAPITAL MARKETS MONTHLY

CAIM CROWN AGENTS INVESTMENT MANAGEMENT

FIXED INCOME COMMENTARY

2024 begins with solid fixed income returns as rate cut conviction grows

The US government yield curve steepened in January as short-dated Treasury yields declined while Long Bond yields increased. The 2-year to 30-year yield spread increased from -22 basis points to -4 basis points, marking a significant curve evolution from the substantially inverted term structure that persisted for most of 2023.

US macroeconomic developments in January were broadly supportive of fixed income valuations, although the CPI inflation report from the Bureau of Labour Statistics, released on 11th January, did marginally exceed the consensus forecast – accelerating from 3.1% to 3.4%. Core services remained the largest component of CPI inflation. It should be noted, however, that the Federal Reserve's preferred inflation gauge, the US Personal Consumption Expenditure Core Price Index, declined from 3.2% to 2.9%.

The GDP report, released on 25th January, showed that US economic growth advanced by 3.3% (annualised) in the fourth quarter of last year. This was materially higher than the consensus forecast of around 2% but did not materially impact of future inflation expectations. A key determinant of future monetary policy adjustments will be the strength of the labour market. There is evidence of strong underlying momentum in payroll growth, which could translate to prolonged wage pressures. The Federal Reserve may prefer to delay the first rate cut past the end of Q1 until there is solid evidence that core inflation is heading to 2%.

The following chart shows the open, high, low and closing yield for the benchmark US Treasury 2-year Note since the beginning of the fourth quarter of last year. The downward trajectory has now consolidated at around 4.25%.

US Treasury 2-Year Note yield

Source: Bloomberg Finance L.P., February 2024.

During January 2024 there were 29 new issues from Sovereign, Supranational and Agency borrowers in USD with amount outstanding of at least USD 500m, credit rating at least A+ and maturity between 1 and 10 years. The total amount issued was a very substantial USD 58bn. The World Bank and EIB transactions were USD 5bn size. The IBRD 7-year was issued at T+17bp and did not tighten in secondary trading. The EIB 5-year performed better, tightening around 4 basis points. The best value transactions were arguably, Corporation Andina de Fomento, Central American Bank for Economic Integration and OPEC Fund. These transactions performed very strongly, tightening 21, 27 and 10 basis points respectively. The CABEI 3-year bond was the best performing deal last month and CAIM participated in this transaction in significant size.

Issuer	Maturity	Issue Spread	Rating
Export-Import Bank of Korea	11/01/2029	CT3 + 63bp	AA
Export-Import Bank of Korea	11/01/2027	CT3 + 53bp	AA
Export-Import Bank of Korea	11/01/2034	CT3 + 73bp	AA
World Bank	10/01/2031	CT3 + 17bp	AAA
Asian Development Bank	12/01/2027	CT3 + 12bp	AAA
European Investment Bank	15/02/2029	CT3 + 15bp	AAA
Asian Development Bank	12/01/2034	CT3 + 21bp	AAA
Kreditanstalt fuer Wiederaufbau	15/03/2029	CT3 + 15bp	AAA
Oesterreichische Kontrollbank	18/01/2029	CT3 + 17bp	AA+
Province of Ontario Canada	18/01/2029	CT3 + 29bp	A+
Asian Infrastructure Investment Bank	18/01/2029	CT3 + 26bp	AAA
Caisse d'Amortissement de la Dette Sociale	24/01/2027	CT3 + 19bp	AA
Corp Andina de Fomento	24/01/2029	CT3 + 104bp	AA
Council Of Europe Development Bank	24/01/2029	CT3 + 15bp	AAA
Kommunalbanken	24/01/2029	CT3 + 24bp	AAA
African Development Bank	25/02/2027	CT3 + 10bp	AAA
Central American Bank for Economic Integration	25/01/2027	CT3 + 96bp	AA
Chile International Bond	22/01/2029	CT3 + 85bp	A
Japan Bank for International Cooperation	24/01/2031	CT3 + 41bp	A+
Landeskreditbank Baden-Wuerttemberg	26/01/2026	CT3 + 16bp	AA+
CPPIB Capital	30/01/2027	CT3 + 26bp	AAA
Development Bank of Japan	30/01/2034	CT3 + 47bp	A+
Inter-American Development Bank	15/02/2029	CT3 + 15bp	AAA
Kreditanstalt fuer Wiederaufbau	31/01/2028	CT3 + 3bp	AAA
Municipality Finance	31/01/2029	CT3 + 23bp	AA+
Caisse des Depots et Consignations	31/01/2027	CT3 + 15bp	AA
Svensk Exportkredit	01/02/2029	CT3 + 26bp	AA+
Rentenbank	06/02/2031	CT3 + 17bp	AAA
OPEC Fund	08/02/2027	CT3 + 58bp	AA+

Source: CAIM, February 2024.

We will continue to monitor primary market transactions closely with the expectation that we may participate - selecting those securities that offer good value, in terms of yield spread relative to US Treasury securities, on a risk adjusted basis.

FOREIGN EXCHANGE COMMENTARY

The New Year and the ‘New’ US Dollar

The late December sell-off left the US Dollar (USD) in oversold territory. However, January witnessed a notable reversal of fortunes, establishing the USD as the best-performing currency within the G10 bloc. The most substantial gains were recorded against currencies that underperformed in December 2023. Notably, the Japanese Yen depreciated by 3.6%, the antipodean bloc contracted by 3%, and the Scandies' currencies experienced a 2.7% contraction. In comparison, the British Pound suffered the least, with a marginal deterioration of 0.10% in its value (refer to the table below for detailed G10 crosses performance).

Despite a prevailing 'risk-on' sentiment that propelled equity indices to record highs and the fixed income market pricing in aggressive interest rate paths for 2024 and beyond, the USD exhibited broad-based gains. Corporates successfully placed a record amount of new debt at the higher end of the pricing spectrum. Economic data releases remained market-friendly, indicating minimal inflationary pressure and a positive outlook for economic growth.

However, our analysis suggests that the decisive factor influencing January's price action was the flow factor. Looking ahead, we anticipate that its effects will diminish, directing market attention towards the fundamental picture. In our view, the impending change in the interest rate regime will be the most significant factor influencing USD valuations. Despite the January gains, we maintain our expectation that the DXY will trade weaker in 2024.

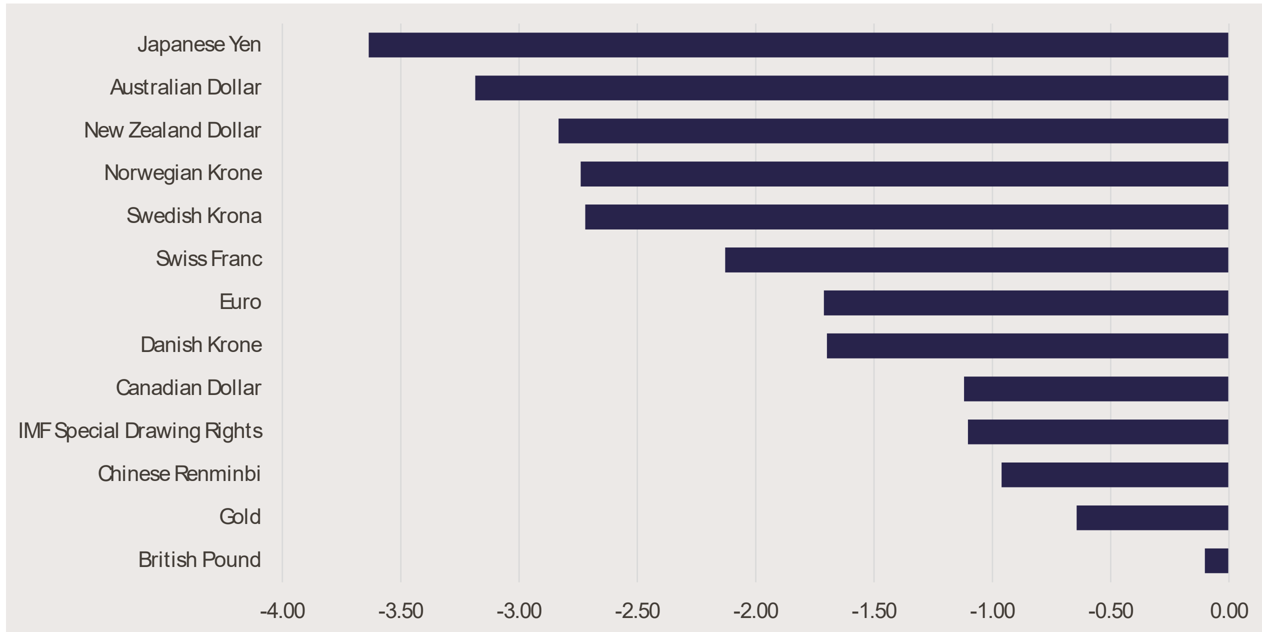
From a technical standpoint, the January price action is perceived as a correction from oversold conditions, aligning with our preferred scenario outlined in the December report. We allowed the DXY to move towards the 104.00-104.50 range, expecting it to limit further gains. Recent observations align with this projection, as the strong upward momentum in early January lifted the index from the 101.00 area to 103.50-104.00. The 200-Day Moving Average line, situated at this level (depicted as the light blue line on the chart below), has successfully capped DXY gains since the third week of January. A retreat below 102.75 is anticipated to fuel negative price momentum, prompting a decline in the DXY. The initial key support is positioned at 102.00, followed by 100.75-101.00, and ultimately, 100.00.

The EURUSD

Source: CAIM February 2024.

Regarding the Chinese Renminbi, the positive momentum observed in December was overshadowed by mixed economic data, suggesting the need for additional monetary and fiscal stimulus. We believe this will be crucial for the Renminbi's positive performance in 2024. Key technical levels include support at 7.10, followed by 6.9500 and 6.70, while on the upside, resistance is expected at 7.20 and 7.30.

January Performance vs. USD (%)



Source: CAIM February 2024.

United States

Markets advance on the soft-landing theme despite Fed's hawkish rhetoric

US equity markets continued their advance, reaching new historic highs as hopes for a soft landing continued. Macro data was for the most part was supportive with Q4 GDP at an annualised rate of +3.3%, whilst the unemployment rate remained at 3.7% in December. Another continued theme from 2023 was how narrow the equity rally was, since the equal-weighted S&P 500 was down -0.8% over the month, continuing to lag the overall index. Monetary policy expectations were less supportive as the market push back the prospects of Q1 rate cuts due to data and Fed speak, with Fed Chair Powell's suggested a March cut was unlikely following the FOMC January meeting.

Moving to monetary policy, the latest FOMC meeting was judged to be hawkish as the dropping of the tightening bias, no longer talking about "the extent of any additional policy firming", was expected. The Committee stated it "does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2% ", offering some gentle pushback on expectations of an imminent rate cut. Towards the end of the press conference Powell then delivered an explicit pushback against expectations of a March rate cut, saying that a March cut "is probably not the most likely case" and adding "I don't think it is likely that the Committee will reach a level of confidence by the time of the March meeting".

In macro news, the soft-landing theme continued with strong growth data as noted above while inflation data suggested a more moderate PCE inflation, the Fed's preferred gauge. CPI was slightly stronger, but there was a greater-than-expected decline in the PPI. The headlines of the latest jobs report painted a solid picture, with stronger headline payrolls, the unemployment rate staying at 3.7% and average hourly earnings rising. Other details were some somewhat softer with negative payroll revisions for the previous two months, a decline in the average working week and with unemployment rate stability coming thanks to a decline in the participation rate.

Following large downgrades, corporate earnings for the fourth quarter started to be announced in a defensive environment. EPS growth was better than expected with Tech and Communication Services seeing more robust delivery, with a strong set of Q4 results reported by Netflix, which saw its highest quarterly subscriber growth since the early phase of the pandemic. Both Alphabet and Microsoft beat on earnings but were not able to show positive momentum due to the recent strong rally. However, most sectors are currently reporting negative or flat EPS growth with commodity sectors, Discretionary and Healthcare particularly weak.

In other earnings news NY Community Bancorp, which had bought most of Signature Bank last year, which was one of the banks that failed in the regional banking turmoil, saw a 38% decline in its share price in the last two trading days of January. It cut its dividend and reported that loan-loss provision was up to $552m in Q4, which led to losses for other regional banks, with the KBW Regional Banking Index fell -6.00%, marking its worst daily performance since the turmoil last March.

Regarding market performance, market breadth was weaker than December with fewer sectors outperforming the main indices. Communication Services did the best, while Real Estate was a laggard. Across style and size themes, growth outperformed value, while small underperformed large cap on the back of a meaningful decline in small cap P/Es despite a modest improvement in EPS.

Europe

Investors focus on future growth potential

European equity markets advanced over the month as macro data came in slightly better than expected yet there remained mixed messages on ECB monetary policy, which reined in it somewhat dovish themes from the end of last year.

Rates were left on hold as expected, and the statement repeated its language from December. President Lagarde said that the consensus "was that it was premature to discuss rate cuts" and that they "need to be further along in the disinflation process before we can be sufficiently confident that inflation will actually hit the target in a timely manner".

Optimism was clear in Europe, since the Q4 GDP release showed zero growth, rather than the -0.1% contraction expected. Significantly, that means the Euro Area avoided a technical recession, as the Q3 number had a -0.1% contraction, so a Q4 contraction would have meant the economy had contracted for two consecutive quarters.

In corporate earnings news, it is still early on but there are fewer than expected companies beating EPS estimates and the EPS growth level is surprising on the downside, whilst revenues are surprising to the upside. It seems investors are more interested in earnings guidance and that bad news was already discounted in some companies' share prices. Commodity sectors are a drag on earnings in Europe. In terms of performance, support is coming from technology with ASML and SAP providing stellar earnings and guidance.

Developed Asia

A lack of robust China policy response hinders markets

Developed Asian equity markets underperformed as sentiment in HK/China remained depressed on a lack of sufficient policy responses deemed necessary to lift business and consumer confidence on top of reports of new U.S. restrictions on China's biotech and tech segments.

Japanese equities continued the strong performance on more favourable macro tailwinds since end-2023, both domestically and from the US, continued JPY depreciation and expectations for further Tokyo Stock Exchange reforms. This boosted Japanese equity indices to a 33-year high, testing the all-time high reached back in 1990 in mid-month. In corporate earnings news, we are seeing a greater than expected number of companies beating EPS estimates, with the overall EPS growth level stronger also.

Emerging markets

EM equities declined in January, underperforming developed markets markedly. Risk sentiment weakened, as investors perceived an improving US economy as a sign that the Fed will keep interest rates higher for longer. The largest drags in performance were from China where policy supports in China currently remain insufficient to boost markets, as economic and equity risk premia concerns persist.

All EM regions posted negative performance in January, with EM Asia the worst performer, followed by LatAm and CEEMEA.

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