CAPITAL MARKETS MONTHLY

CROWN AGENTS INVESTMENT MANAGEMENT

FIXED INCOME COMMENTARY

Excessive rate cut expectations are revised materially to converge with the Fed dots

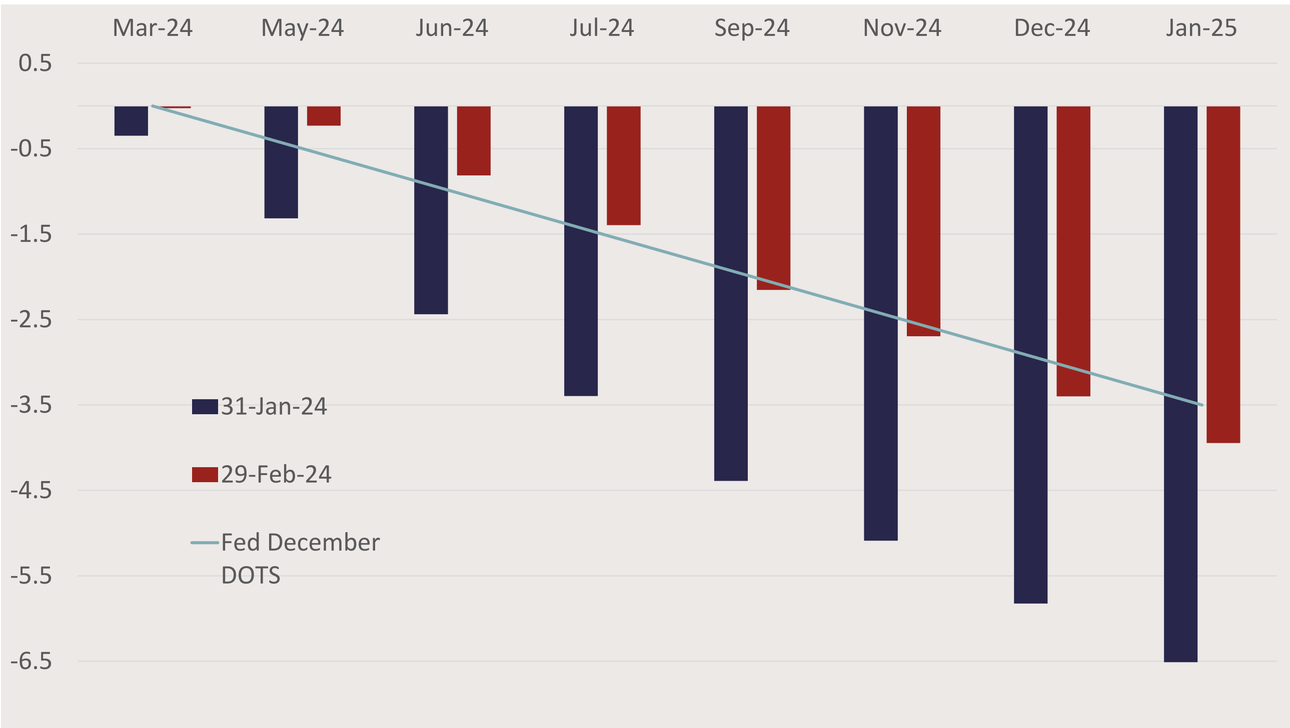
In February 2024, US Treasury yields pushed higher and the curve flattened. The benchmark 2-year note yield increased from 4.21% to 4.64% resulting in a disappointing return for short bond indices. The Bank of America ICE 1-3 Year US Treasury Index returned -0.41% in February as capital losses exceeded income. The long bond yield increased by a more moderate 20 basis points, but this resulted is a 3.7% capital loss, due to the high sensitivity to changes in yield.

The relatively aggressive pricing and timing of monetary policy easing, which had persisted in January, was materially revised over the course of February 2024. The implied probability of a 25-basis point cut at the March FOMC meeting continued to decline from 80% at the start of the year to 40% at the end of January, and then to around zero by the end of February. Stronger economic data, including a surge in Nonfarm Payrolls, together with a slight disappointment in the CPI report, which was released on 13th February, resulted in a major revision to the expected path of short-term interest rates in the US. Communication from the Federal Reserve, including the minutes from the January FOMC meeting, all suggested that rate cuts would be less aggressive that markets had anticipated, and that monetary policy easing would begin later than previously expected.

Going forward, continued labour market strength and persistently high core inflation may prevent significant declines in US Treasury yields. Notwithstanding these macroeconomic factors, we do expect rate cuts to materialise toward the end of the second quarter or shortly afterwards.

The following shows implied rate cuts, based on Fed funds futures, at 31st January 2024 and 29th February 2024, compared to the forecast path from Federal Reserve's dot plot from the December FOMC meeting.

Projected path of US interest rates



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

During February 2024 there were 16 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 USD 29bn, somewhat lower than the previous month. The large benchmark transactions from the tier 1 SSAs, such as ADB, BNG, EIB and NIB were priced at very expensive levels versus US Treasuries. CAIM participated in the NEDWBK 5yr, NRW 3yr and World Bank floating rate notes, which were priced at SOFR + 28 basis points, equivalent to a yield of 5.59%.

Issuer	Maturity	Issue Spread	Rating
Agence Francaise de Developpement EPIC	05/03/2029	T + 63bp	AA-
Asian Development Bank	06/03/2029	T + 13bp	AAA
Bank of England Euro Note	05/03/2027	T + 10bp	AA-
BNG Bank NV	01/03/2027	T + 15bp	AAA
European Investment Bank	13/02/2034	T + 15bp	AAA
Export Development Canada	13/02/2029	T + 16bp	AAA
Inter-American Investment Corp	14/02/2029	T + 26bp	AA+
International Bank for Reconstruction & Development	23/02/2027	SOFR + 28bp	AAA
Kommunalbanken AS	03/03/2028	SOFR + 40bp	AAA
Korea Development Bank	15/02/2027	T + 45bp	AA-
Korea Development Bank	15/02/2029	T + 51bp	AA-
Korea Housing Finance Corp	27/08/2027	T + 58bp	AA
Kreditanstalt fuer Wiederaufbau	28/02/2034	T + 16bp	AAA
Nederlandse Waterschapsbank	28/02/2029	T + 22bp	AAA
Nordic Investment Bank	28/02/2029	T + 13bp	AAA
State of North Rhine-Westphalia Germany	16/02/2027	T + 15bp	AA+

Source: CAIM, March 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

US Dollar upward momentum weakens

February turned out to be another successful trading month for the US Dollar, however the scale of gains indicates positive upward momentum to be at risk. Looking at the US Dollar performance against the key G10 crosses one may say that the global risk-on themes were fully reflected in the traditional safe haven currencies underperformance. The Swiss Franc lost almost 3% while the Japanese Yen value dropped by 2.5%. However, at the same time traditional high beta currencies disappointed too with the Norwegian Krone depreciating by over 1.5% and the Australian Dollar's value contracting by 1%. Therefore, we think that the adjustment of the interest rate path which came amid stronger than expected economic data was the single most important factor affecting US Dollar value in February. (Please see the G10 crosses + gold table below)

Also, the technical picture seems to influence the trading activity. The US Dollar index (DXY) opened the month testing the 61.8% (103.20) Fibonacci's retracement line with daily ranges being limited by the 50-Day Moving Average support line. It bounced off this line and broke through the 200 Day Moving Average line which fuelled an upward momentum sending it to test the top of the trading range at 105.00, just above the 38.2% (104.70) Fibonacci's retracement line. The positive price momentum evaporated sending the DXY to the 50% retracement line where it closed the month at 0.85% gain.

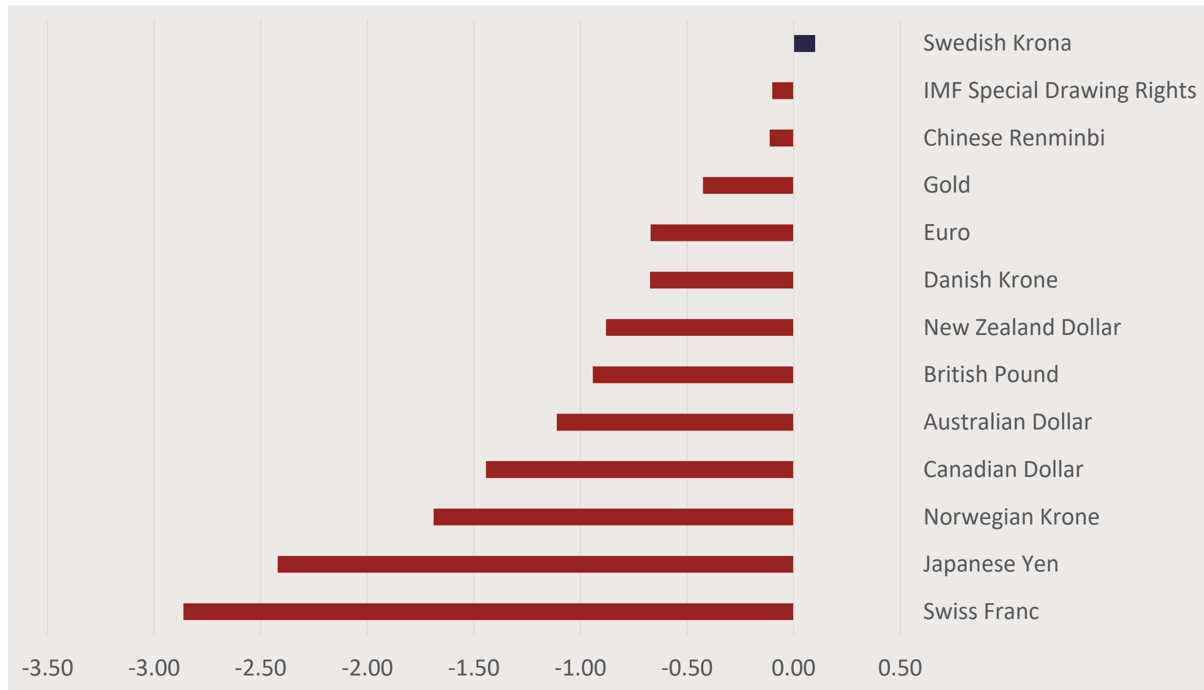
Going forward, we believe that with the current implied Fed's interest rate path (only three 0.25 bps cuts being priced in) the interest rate factor will not be a decisive for the US Dollar strength. The fundamentals outside the USA and other central banks' policy meetings should be seen as a source affecting the currencies value. Also, for most crosses, the technical picture is not an insignificant factor. The EURUSD managed to bounce off 1.0720 which proved to be a significant technical level over the last 12 months. The cross closed the month at 1.0800 just under the key trend line. We expect it to take this line and ultimately to break the 50-Day moving Average line which successfully managed to cap the EURUSD cross gains since late January. A break there should result in a move towards 1.1000 and higher towards 1.1250 which is our preferred scenario.

Regarding the USDJPY, while the cross consolidated above the 150 level, suggesting a potential move towards 155.00, we caution that testing this level might trigger BoJ intervention, potentially pushing it back towards the 145.00 level. As for the GBPUSD, any support is anticipated to come from external factors, given weak fundamentals and political uncertainties acting as major headwinds for the British Pound.

Concerning the Chinese Renminbi, its value remained relatively stable against the US Dollar in February. This stability is attributed not only to PBoC indirect support but also to strong inflows of international capital into the Chinese equity market. Looking ahead, we anticipate a Renminbi recovery, driven by better economic growth, potentially lowering its valuations against the US Dollar below the 7.00 level.

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.

February Performance vs. USD (%)



Source: CAIM March 2024.

United States

US- Investors choose economic resilience rather than inflation for now

US equity markets advanced with the S&P 500 pushing past the 5,000 mark for the first time. In part, that was because of continued excitement around AI, and the Magnificent 7 posted their best monthly performance in 9 months. However, with inflation still above target and surprising on the upside in the US, investors pushed out the timing of future rate cuts, and sovereign bonds lost further ground. Currently investors are assuming that the move higher in yields is reflective of economic resilience and relatively strong earnings reports.

In macro news, we saw the headline and core CPI for January come in stronger, pushing the year-on-year levels to 3.1% and 3.9% respectively, reducing the already slim chances that the Fed will be lowering rates in the near-term. Shelter caught everyone by surprise and increased 0.6% in January, the largest factor in the monthly increase in the core index. However, this was not the only anomaly, with the 'supercore inflation', which covers core services ex housing, rising to 4.3% YoY, its highest level since last May and the largest monthly increase since April 2022. If that was not enough, January's strong payrolls report massively beat expectations, with upside revisions to the prior two months.

Corporate earnings for the fourth quarter are coming to a close, with better than expected results, especially from the majority of the Magnificent seven, aided by downbeat expectations coming into the season. Meta saw a stunning gain, as its revenue guidance for Q1 came in clearly above analysts' expectations, and the company announced additional share buybacks and its first ever dividend. Amazon advanced after posting a strong profit outlook for Q1, despite its sales guidance for Q1 coming in a touch below estimates, and investors appeared to reward both companies for their cost control efforts. By contrast, Apple's shares were down in after-hours trading, with a deepening sales slump in China taking the shine off what was otherwise a modest beat. Nvidia reported stronger revenue numbers, representing a dramatic +265% increase in sales compared to a year earlier. It projected $24bn of revenue for the current quarter, with Nvidia's CEO speaking of a "tipping point" for generative AI.

However, it was not all plain sailing with the regional banking sector seeing further losses as New York Community Bancorp, which purchased the assets of the collapsed Signature Bank last year reported a loss on January 31 as they raised their expected loan losses on commercial real estate. This raised fears that the full consequences from higher interest rates are still yet to materialise, particularly give the amount of debt that needs refinancing over 2024 and 2025.

Regarding market performance, the magnificent seven drove the market with outperforming sectors being consumer discretionary and IT together with some of the cyclicals, namely industrials and materials. The defensive, yield proxy sectors of utilities, consumer staples and real estate underperformed over the month.

Europe

Investors forgiving on earnings, focusing on guidance

European equity markets extended their recent gains despite the stronger macro data pushing out the chances of a March interest rate cut, with Q4 corporate earnings, while negative, and guidance better than expected.

Turning to macro, the January flash CPI release came in a bit higher than the consensus had expected. Core CPI also fell a tenth to +3.3%, which is the lowest core inflation seen since March 2022, but the slower decline has added to questions about how soon the ECB will be able to cut rates. At the same time, we also heard that the Euro Area unemployment rate had remained at 6.4% in December, matching its joint-lowest since the single currency's formation. These releases saw pricing of a March cut by the ECB decline from 23% to 17%, and overnight it's down to 16%

In corporate earnings news better than expected numbers from the consumer discretionary and IT sectors saw outperformance for the month while utilities and real estate gave poor guidance and saw relative underperformance for the month.

Developed Asia

Nascent reaction towards China policies and LNY holiday data aid sentiment

Developed Asian equity markets were helped by positive sentiment towards recent Chinese stimulative policies while the Nikkei 225 continued its momentum surpassing its previous record from 1989.

Investors have continued to grow in confidence that the end of the negative interest rate policy within Japan could be near, following comments from the BoJ's Hajime Takata, who said that "my view is that the price target is finally coming into sight". This is despite the high likelihood that Japan is in a technical recession, following Q4 GDP coming in at -0.4 QoQ following Q3 of -2.9% and markets paring back expectations of rate hike bets, with the expected probability of a 10bps hike by April falling from 73% to 69%. Confidence remained on strong earnings results, with sales/profits increasing, while margins improved together with more corporate action related to TSE-led reform. On the flip side, another month of weak activity data for January raised concerns about domestic demand, which lead to weak performance for domestic demand related sector.

Hong Kong markets advanced on local and Chinese stimulative policies, while news that for Lunar New year holidays, the number of tourists/tourism revenue reached 119%/108% of 2019 levels was a further support. HK announced full elimination of stamp duties on residential property.

Emerging markets

EM equities saw strong gains, marginally outperforming the aggregate developed market index, after four consecutive months of underperformance. The outperformance leadership was concentrated in North Asia markets specifically China, South Korea and Taiwan. The major boost for EM equities were from specific tailwinds for China, namely better macro data around Lunar New Year, further policy step-up and Korea as the government initiated the start of the "Corporate Value-up Program".

Among regions, EM Asia led performance, followed by CEEMEA, while LatAm lagged.

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