APRIL 2024

CAPITAL MARKETS MONTHLY

CROWN AGENTS INVESTMENT MANAGEMENT

FIXED INCOME COMMENTARY

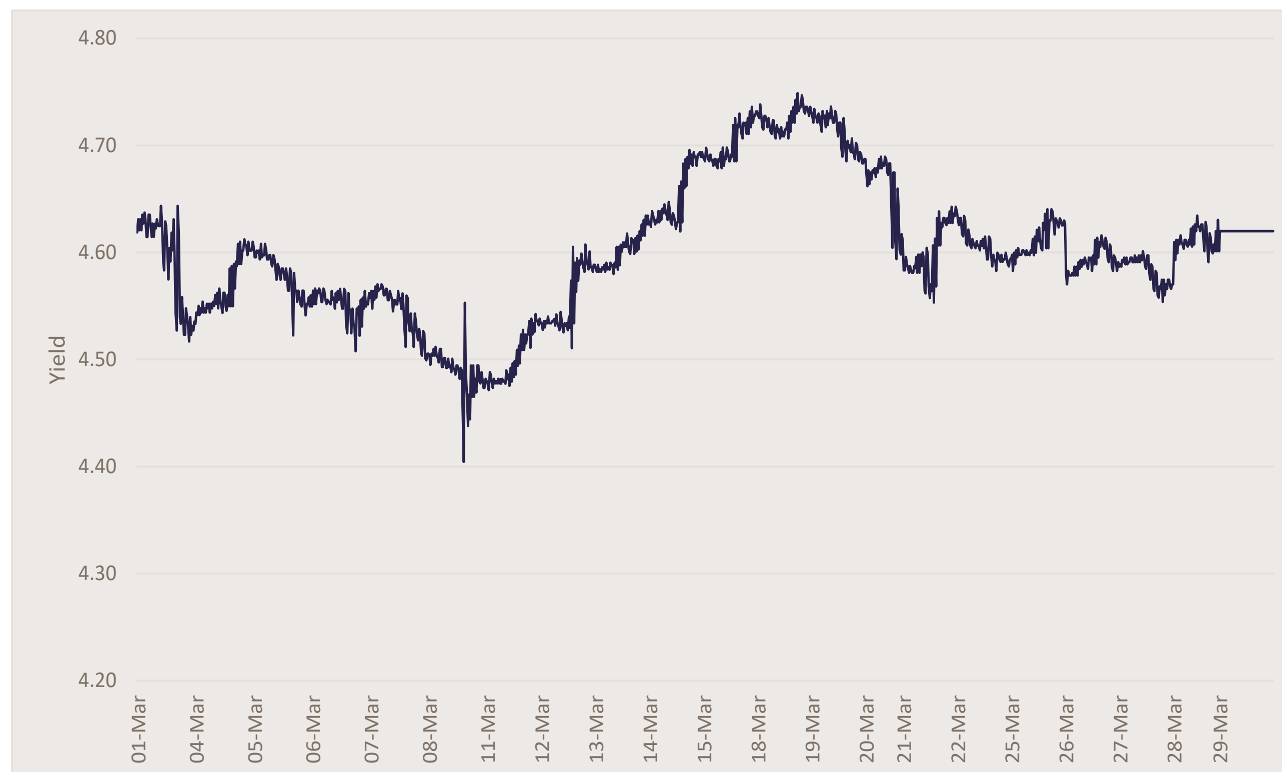
Federal Reserve Upgrades Macroeconomic Outlook but Hints at June Rate Cut

The statement released after the conclusion of the US Federal Open Markets Committee meeting on 20th March was virtually unchanged from the January meeting. The only amendment to the FOMC statement was a reference to stronger employment gains following the solid Nonfarm Payroll number, released on 8th March, of an additional 275,000 jobs. More significantly, the FOMC's economic projections continued to show 75 basis points of interest rate cuts for 2024 while some commentators had anticipated this might narrow to 50 basis points. There was an upward revision to the median projected Fed funds rate for the end of 2025 from 3.625% to 3.875%. Importantly, the Fed's estimate of inflation (core-PCE) was increased from 2.4% to 2.6% which, in the context of no upward revision to the 2024 dot plot, clearly signals that the FOMC is comfortable cutting rates with inflation above the 2% target. Therefore a 25 basis point rate cut at the June FOMC meeting remains a strong possibility provided there is no material change to the inflation outlook.

US Treasury yields were somewhat volatile last month. While the benchmark 2-year Treasury yield was net unchanged at 4.62% from 29th February to 31st March, this security traded as low as 4.40% immediately following the employment report to a peak of 4.75% following the CPI and PPI reports mid-month.

The following chart, using data from Bloomberg, shows the progression of the US Treasury 2-year yield over the course of March 2024.

US Treasury Benchmark 2-year Yield



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

During March 2024 there were 13 new issues from Sovereign, Supranational and Agency borrowers in USD with amount outstanding of at least USD 250m, credit rating at least A+ and maturity between 1 and 10 years. The total amount issued was USD 24bn, lower than the previous month. US Agencies and callable SSAs have been excluded from the list. Secondary market price action was generally positive as spreads narrowed. However, the Tier-1 issues, such as EIB and KFW were priced at relatively tight levels, leaving little room for performance. The USD 3.75bn Quebec 5-year also struggled to perform given the substantial issue size, leaving this transaction well offered at around the issue spread.

Issuer	Maturity	Issue Spread	Rating
Export Development Canada	08/03/2025	T + 24bp	AAA
European Investment Bank	19/03/2027	T + 9bp	AAA
Asian Infrastructure Investment Bank	13/03/2034	T + 25bp	AAA
Israel Government	12/03/2034	T + 145bp	A+
Israel Government	12/03/2029	T + 135bp	A+
Kreditanstalt fuer Wiederaufbau	01/03/2027	T + 10bp	AAA
Dexia	19/03/2027	T + 25bp	AA-
Kommuninvest	30/09/2026	T + 24bp	AAA
Export Development Canada	28/06/2025	FF + 11bp	AAA
OMERS	26/03/2031	T + 54bp	AA+
Korea National Oil Corporation	03/04/2029	T + 80bp	AA
Korea National Oil Corporation	03/04/2027	T + 70bp	AA
Province of Quebec	03/04/2029	T + 28bp	AA-
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 in a full ‘wait and see mode’

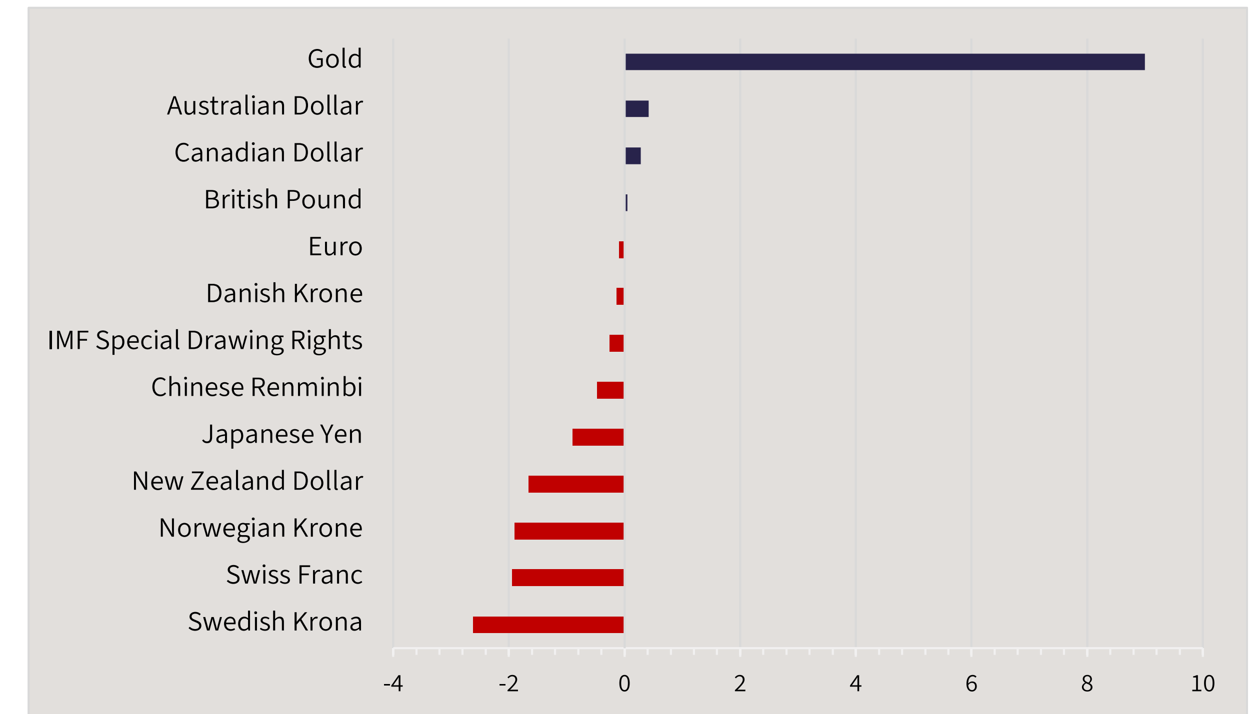
Many, including ourselves, were disappointed as the US Dollar index (DXY) failed to break its multi-week-old trading range. Despite highly anticipated central bank meetings in March that brought expected changes, medium-term implied volatility levels remained subdued. Among these meetings, the Bank of Japan’s decision to abandon its negative interest rates policy was eagerly awaited. However, the market reaction proved to be short-lived. The USDJPY initially moved from the 150.00 level towards 145.00, but it halted at 147.00 and reversed course, ultimately reaching a new multi-decade high at 151.70 in the last trading week. This temporary strength of the JPY helped other key currency pairs advance against the greenback. The EURUSD strengthened by 2%, approaching the 1.1000 level, while the GBPUSD marked a fresh new high for the year at 1.2860. However, these gains against the US Dollar lasted for only a few days, despite Federal Reserve Chairman Powell confirming expectations of lowered rates later in the year. The relative dovishness from other central banks was likely the main factor supporting the observed US Dollar recovery in the latter part of the month, allowing it to close positively against most G10 currencies.

It’s worth noting that in March, the focus of the market was on Gold rather than currencies. Gold had one of its best months in recent years, advancing by 9.0% and reaching a new all-time high, closing the month at $2231 per once troy. Looking ahead, while a correction may be expected around the $2250.00 mark, predicting the peak for gold this year seems nearly impossible given the complexity of the current geopolitical and monetary landscape.

Regarding G10 currency crosses, the USDJPY remains a key factor. At the moment, it seems that the Bank of Japan’s decision hasn’t significantly affected demand for leveraged strategies involving the JPY. However, the pressure to weaken the Yen further appears limited, as Japanese authorities are expected to intervene sooner rather than later. Such a move should support other key G10 crosses, particularly the EUR and GBP. Whether this move will support risk appetite remains uncertain.

Regarding the Renminbi, fundamentals remain mixed. The weak JPY pushed the USDCNY through the key resistance level at 7.2000, resulting in the CNY/CNH basis widening to over 4 figures, a level not seen for months. We are aware of growing speculative, option-related strategies putting extra pressure on the CNY. However, in the medium to long-term, we maintain our view that improving fundamentals should have positive effects outweigh the negative positioning and reverse the CNY trend.

March Performance vs. USD (%)



Source: CAIM March 2024.

United States

US- Markets reach new highs on the Goldilocks scenario

US equity markets advanced with the S&P 500 driven by growing confidence that rate cuts are finally on the horizon, despite some pushback on renewed inflation worries as US CPI/PPI prices were rising faster than expected. The robust earnings season for the S&P 500 combined with the Goldilocks tone from the Federal Reserve sent market indices to new highs with market leadership appearing to shift in favour of cyclical stocks and last year's laggards.

In terms of monetary policy, the latest FOMC statement was little changed as the FOMC continued to see that "it will likely be appropriate to begin dialling back policy restraint at some point this year" while wanting to gain "greater confidence that inflation is moving sustainably toward 2%". The dot plot showed the median 2024 dot unchanged at three cuts this year, despite their 2024's economic projections being revised higher, with real GDP growth revised up from 1.4% to 2.1%, core PCE inflation up two-tenths to 2.6%, and unemployment a tenth lower to 4.0%.

In macro news, the latest payrolls data beat expectations, while the unemployment rate rose to 3.9%, its highest level since December 2021, while average hourly earnings slowed to +0.1% month-on-month. These headline moves were supportive of a soft-landing narrative, but there were also some weaker details, notably a -124k downward revision to January's payrolls. Turning to inflation, the latest US CPI/PPI reports for February, saw inflation come in strongly for a second month running, and led to growing fears that the last phase of getting inflation back to target would be the hardest. In fact, the Atlanta Fed's sticky CPI series is now up by +5.1% on a 3m annualised basis, the fastest it's been since April 2023. So, the concern for markets will be that inflation is showing some signs of rebounding, or at the very least stabilising at above-target levels.

Following strong Q4 2023 numbers we are soon to start the Q1 2024 earnings cycle. Interestingly given concerns in the market about a possible economic slowdown or recession, analysts have lowered EPS estimates by a smaller margin than average for the first quarter and for the calendar year 2024. Clearly this brings a slightly higher hurdle for those announcements as they come along.

Turning to politics, the Super Tuesday results saw Nikki Haley drop out of the Republican primary race, after former President Donald Trump won every state except Vermont, which went for Haley. There are several primaries remaining until June, but with Trump and Biden now the only major candidates left in either primary race, that sets up a direct re-match in the general election between the two candidates for the first time since 1956.

Regarding market performance, we started to see some rotation into the value, cyclical names with energy the standout assisted by stronger crude oil prices and the general supportive macro picture which also aided the materials sector. On the underperforming side the consumer discretionary sector was a laggard with Tesla declining amid new price cuts and discounts by EV maker. The IT sector was also a laggard mostly due to a 5% decline for Apple as an anti-trust lawsuit against the firm was filed by the US Justice Department and sixteen US states together with negative year on year sale growth from China year to date. In the communication services sector Alphabet and Meta could be at risk of significant fines in the EU amid a new investigation into the firms' compliance with the Digital Markets Act. The Act looks to restrict the dominance of the biggest online platforms and came into effect earlier this month.

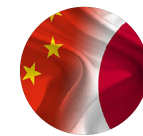
Europe

Investors encouraged by signs of recovery from lows

European equity markets extended their recent gains with the latest ECB decision suggesting that interest rate cuts would soon be occurring, while signs of a recovery in domestic cyclical activity and improving data surprises helped sentiment.

The ECB decision was a big catalyst for the rally, since although it left rates unchanged, several aspects suggested the window for rate cuts was coming into view. For instance, its latest inflation projections were revised downwards, with it at 2% in 2026, namely at target and headline being slightly underneath. Alongside that, the near-term growth forecast was revised down, with 2024 lowered by two-tenths from December to 0.6%. In President Lagarde's comments, there was also something of a steer towards June, saying that "We will know a little more in April, but we will know a lot more in June".

In terms of performance, it was a case of a rotation in favour of the laggards, in terms of real estate and the recent momentum of value cyclical plays with energy and materials outperforming. On the other hand, the underperformers were the IT and consumer discretionary sectors with Kering, the luxury goods maker announcing weak guidance on Chinese sales.



Developed Asia

The First BOJ hike in 17 years

Developed Asian equity markets were helped by strength in AI tech related issues while China macro data lost momentum following strength in January-February and US/China tensions rose.

Japan for the most part saw strength with macro data including 4Q23 GDP expanding at an annualized rate of 0.4% helped by robust spending by businesses; while the strength in first round of spring wage negotiations were deemed supportive for consumers.

The first BoJ hike in 17 years, lifted rates from -0.1% to a range of 0-0.1% and scrapped Yield Curve Control and ended ETF/REIT purchases but these programs had been pretty dormant of late. As this had been flagged both in news reports and BOJ commentaries there was limited market reaction. The dovish tone remained as the BOJ will continue JGB purchases at the same rate for now even if the consensus suggests these will decrease going forward given the conditions for the program have become stricter. As a result, the monetary base and the BoJ's balance sheet will decline going forward.

Hong Kong markets were negatively impacted by a new ban by the US government on AMD selling its AI chips to China, while property developers were dragged lower as Country Garden Holdings Co. missed a 96-million-yuan ($13 million) coupon payment on a yuan bond for the first time.

Emerging markets

EM equities saw modest gains in March, resuming its underperformance to DM amid a dovish Fed but a likely shallower trajectory. The likelihood of a soft-landing has increased as evidenced by PMIs firming up and stickier inflation. China equities saw a pullback from February's strong performance as US-China tensions picked up due to various congressional actions that would reduce US investments in China.

Among regions, EM Asia saw gains, while LATAM consolidated and CEEMEA saw slight losses.

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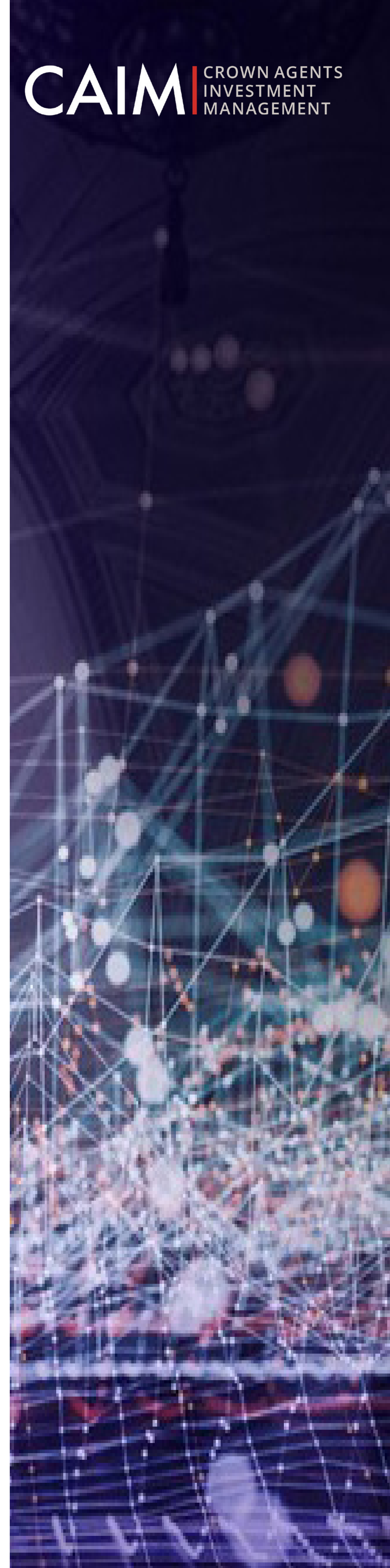

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