CAIM | CROWN AGENTS INVESTMENT MANAGEMENT

MARCH 2025

# CAPITAL MARKETS MONTHLY

# FIXED INCOME

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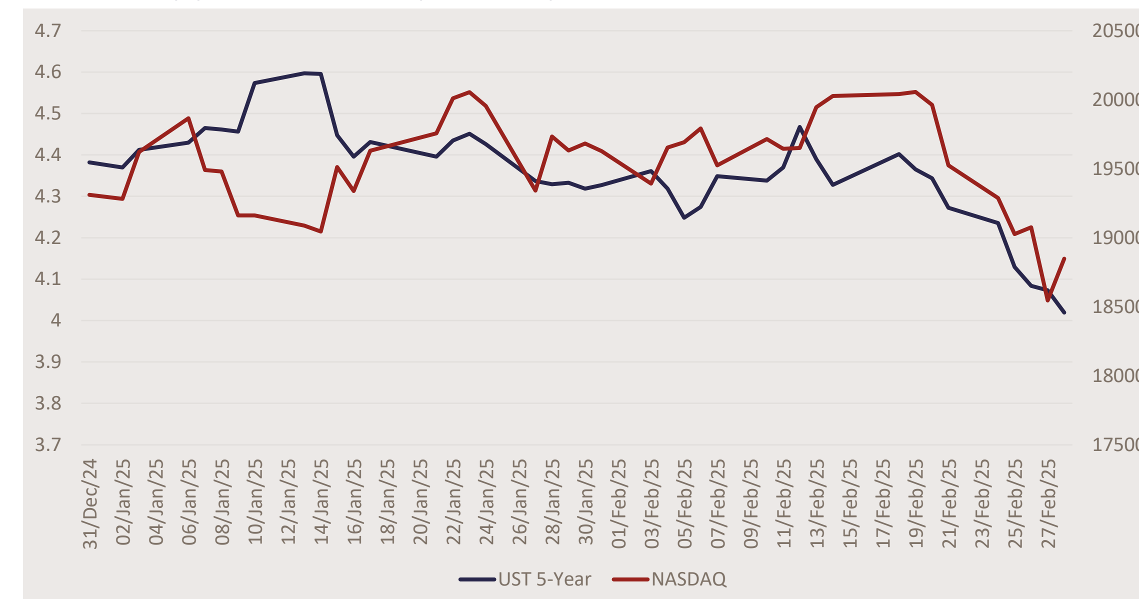
## Bond yields take a step lower as equities decline and geopolitical risks persist

US Treasury yields generally moved lower in the early days of February 2025 as US economic data was consistent with weaker growth. A contraction in Durable Goods Orders and an unexpected drop in the JOLTS headline job opening series provided a positive backdrop for bonds. The Employment Report, released by the Bureau of Labour Statistics on 7th February, showed a material deceleration in payroll growth, as the change in Non-farm Payrolls declined from 256k to 143k. However, despite the softness in the overall NFP number, the underlying components of the report were more troublesome, particularly the unexpected increase in average hourly earnings and a fall in the unemployment rate. Inflation expectations rose, which quickly translated into higher bond yields. The next key development was the consumer price inflation data on 12th February. Core CPI increased 0.4% m/m, which was above expectations. This translated into an acceleration in the annual core CPI from 3.2% to 3.3% despite a consensus forecast for a deceleration to 3.1%. The benchmark US Treasury 5-year note traded at 4.49% immediately following the CPI release, which marked the high point in yields for February.

Towards the end of the month, a sharp fall in equity markets created a bid for low-risk assets, including government bonds. The Treasury 5-year note ended February at 4.02% which was 47 basis points below the level see immediately following the CPI report.

The chart below shown the link between US Treasury yields and equity markets. The sharp sell off in equities, particularly the NASDAQ, at the end of February resulted in a risk-off bid for low-risk assets such as Treasuries.

### US Treasury yields fall sharply as equity markets sell off




Source: Bloomberg Finance L.P., February 2025.

During February 2025 there were sixteen Sovereign, Supranational and Agency borrowers in USD with amount outstanding of at least USD 500m, credit rating at least BBB- and maturity between 1 and 10 years. Except for Poland 2035s, we did not participate in SSA primary markets because issue levels were too expensive. For example, the USD 1bn Qatar 3-year tranche priced at UST+30bp (compared to initial price target of T+60bp). While we initially subscribed to this transaction, we subsequently cancelled after the issue level was amended below 40bp. In secondary trading these securities underperformed significantly as the yield spread versus treasuries widened by 22 basis points.

| Issuer | Maturity | Issue Spread | Rating |
|---|---|---|---|
| BNG | 11/02/2028 | 16 | AAA |
| European Investment Bank | 12/02/2035 | 13 | AAA |
| Landeskreditbank Baden-Wuerttemberg | 13/02/2030 | 19 | AA+ |
| Landeskreditbank Baden-Wuerttemberg | 11/02/2027 | 30 | AA+ |
| Romanian Government International Bond | 10/02/2037 | 300 | BBB- |
| State of North Rhine-Westphalia | 12/02/2030 | 18 | AA |
| International Development Association | 12/02/2035 | 15 | AAA |
| International Finance Corp | 28/08/2029 | 36 | AAA |
| Republic of Poland | 12/02/2035 | 105 | A- |
| Republic of Poland | 12/02/2030 | 75 | A- |
| Uruguay Government | 14/02/2037 | 100 | BBB+ |
| Israel Government | 19/02/2035 | 135 | A |
| Israel Government | 19/02/2030 | 120 | A |
| Bank of England | 26/02/2028 | 9 | AA |
| Qatar Government | 27/02/2035 | 45 | AA |
| Qatar Government | 27/02/2028 | 30 | AA |

Source: Bloomberg Finance L.P., January 2025.

FOREIGN EXCHANGE

**SLAWOMIR SOROCZYNSKI**

HEAD OF FIXED INCOME

## The strong US Dollar puts the US economy at an unfair disadvantage.

The US Dollar began the month on a very strong note, largely driven by market uncertainty surrounding geopolitics and tariff threats, which was probably the single most important factor fuelling its initial strength. However, as time passed, the market began to consider the potential negative side effects on US growth. These negatives quickly overshadowed the positives, which was clearly reflected in the market's growing risk aversion. As a result, traditional safe-haven assets benefited, with US government bonds delivering some of the strongest returns in months, while equity prices declined.

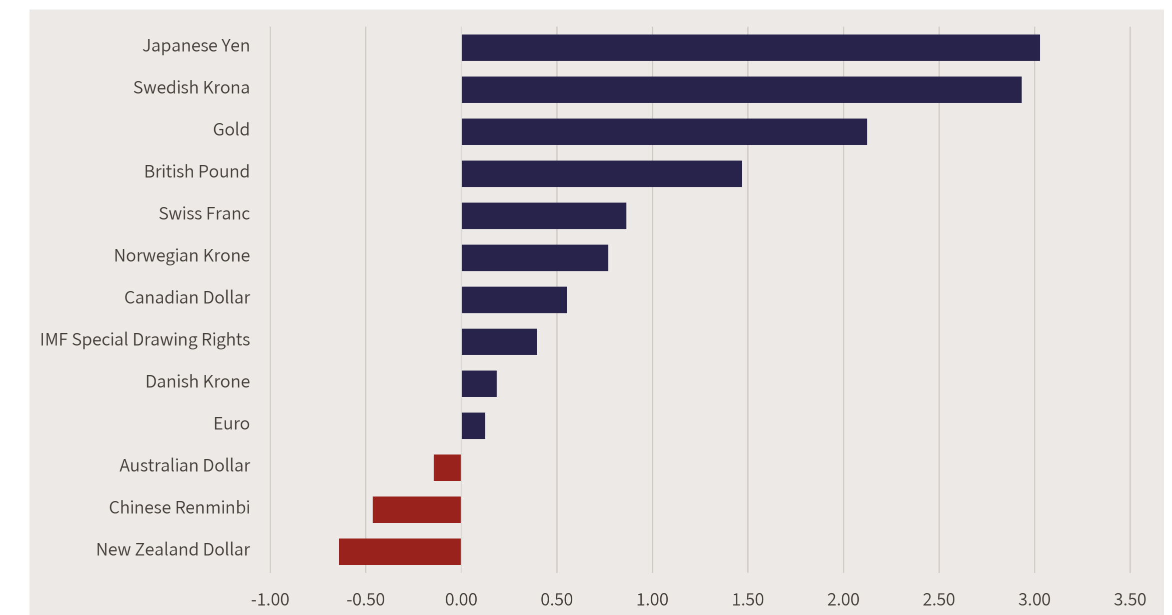
## This risk reduction was fully reflected in the FX market.

The Japanese Yen emerged as the best-performing currency in the G10, with leveraged positions unwound, sending its value up 3% against the greenback. The Swiss Franc also saw a modest advance of 0.90%, likely due to its already high valuations. Meanwhile, gold reached a fresh all-time high of $2,956 per troy ounce. However, gold failed to maintain levels above $2,900 as the last few days of the month saw an aggressive reversal of the main themes observed earlier in February. Nevertheless, these should be seen as short-term corrective moves within the broader context, where the key investment themes tied to the new US president are being reversed.

Regarding other G10 currencies, the Swedish Krona delivered solid performance, gaining almost 3% against the US Dollar, while the British Pound claimed third place in February, managing to close the month above a key support level of 1.2520. As for the month's underperformers, the New Zealand Dollar was the worst-performing G10 currency, although its underperformance was relatively modest at 0.60%. The Australian Dollar also showed a weak performance, with its value contracting by a mere 0.15%. Please refer to the G10 + Gold + SDR performance below.

As for the Chinese Renminbi, the Lunar New Year brought the expected widening of the offshore and onshore trading ranges, which was quickly adjusted once the onshore market returned to full activity. There was a noticeable improvement in international investors' perception, with inflows not only into Chinese equities but also into Dim-Sum bonds, where a marked tightening of spreads was observed. In terms of the currency, the Renminbi remained within the 7.20-7.30 range established after the release of the US presidential election results. Looking ahead, the price action across the G10 currencies and beyond supports our view that the risks are skewed toward a weaker US Dollar.

### February performance vs. USD (%)




Source: CAIM, February 2025.

# EQUITIES

**SIMON PRICE**

SENIOR EQUITY FUND MANAGER

## United States

*Risk-off tone developed as tariff and AI exhaustion concerns increase*

US equity markets experienced heightened volatility, reaching new highs following a last-minute tariff extension for Canada and Mexico and the potential positive outcome of US-Russia negotiations over Ukraine. However, the risk of further tariffs increased, which, combined with growing inflation fears, sparked concerns. Additionally, the negative fallout from Deepseek's launch of its latest AI models contributed to the decline in sentiment, particularly for the "Magnificent 7", which posted their worst month since December 2022, dragging down broader US equities. In terms of monetary policy, Fed Chair Powell's semi-annual testimony was a key highlight. He emphasised that the Fed didn't need to rush into rate cuts and that policy restraint could persist if the economy remains strong and inflation doesn't make significant progress toward the 2% target.

Regarding the macro environment, although headline and private payroll gains were below expectations, net upward revisions of 100k for the previous two months, along with a declining unemployment rate and rising average hourly earnings, pointed to a hawkish labour market report. Inflation data remained troubling, with both headline and core inflation exceeding the Fed's targets on an annual basis. There are growing concerns that this inflation is not just a temporary spike, as CPI has been running at an annualized pace of 4.5% in recent months. Later in the month, the Fed's preferred PCE measure was weaker, though still the fastest since March 2024, leaving inflation lingering above the 2% target at 2.5%.

On the corporate earnings front, Q4 2024 showed strong earnings beats, particularly in discretionary, financials, and communication services sectors. However, there were negative results in energy and industrials. On the negative side , there were some downgrades in 2025 earnings estimates due to policy uncertainty and tariffs. For the "Magnificent 7," the earnings picture was mixed. Alphabet missed sales expectations due to slowing cloud business growth, while Amazon posted solid earnings but was weighed down by slower cloud growth, capacity issues, and weaker guidance for Q1. Both companies announced higher-than-expected 2025 capex plans. Nvidia's earnings showed the smallest revenue beat in two years, which underwhelmed some investors who were accustomed to bigger surprises. Outside the tech sector, Walmart's weaker-than-expected profit forecast, following disappointing US retail sales, hurt sentiment.

In terms of performance, major US indices fell as stretched positioning and elevated valuations led to a rotation out of US equities, particularly mega-cap tech stocks, and into international equities. The pullback was worsened by a slowdown in retail buying-the-dip behaviour. Overall, defensives outperformed cyclicals, with consumer staples, real estate, and utilities advancing, while consumer discretionary and communication services underperformed. This was driven by softening macro data, risk-off sentiment, and growing concerns about AI fatigue, as headlines highlighted AI capex concerns and warned of potential "bubble-like" conditions in the market.

## Europe

*The beneficiary of international equity market rotation*

European equity markets advanced, bolstered by news that the US would begin negotiations with Russia to end the war in Ukraine, as well as the expected results of Germany's recent election. The center-right and center-left parties are expected to have enough seats to form a grand coalition; however, they remain short of a two-thirds majority, making any future reforms to the debt break challenging and likely requiring compromise and negotiation. Corporate earnings provided further support, with earnings surprises coming in stronger than anticipated. Industrials and healthcare sectors outperformed, while energy, materials, and consumer discretionary sectors underperformed. Sales in Europe surged, partly due to a weaker euro, but the gap between earnings per share (EPS) and sales beats reached record lows, signaling potential margin compression.

Among the S&P Europe 350 sectors, Financials was the best performer, continuing its strong showing from January. Information Technology was the worst-performing sector, primarily due to weakness in the semiconductors industry amid concerns over potential new U.S. chip restrictions.

## Developed Asia

*HK advances on domestic tech sector gains, while Japan declines on macro concerns*

The performance of developed Asian equity markets was mixed. Hong Kong saw strong gains, driven by the AI supply chain within the tech sector and the auto industry seeing market share gains and new product launches. Sentiment improved following the meeting between President Xi and business leaders, along with expectations of stimulus during the upcoming two sessions.

In contrast, Japan lagged due to several factors, including concerns over US tariff headlines, rising interest rate expectations, cost-push inflation, and yen appreciation. Despite macro data being supportive, Q4 GDP significantly exceeded consensus estimates, consumer discretionary stocks declined, while banks underperformed despite rising interest rates. Exporters and auto stocks were among the main underperformers, weighed down by both a stronger yen and ongoing tariff concerns.

## Emerging markets

EM equities consolidated in February 2025, outperforming DM equities, as strong initial gains led by China were reversed towards month-end amid incremental tariff reports. Regionally, EM Asia and CEEMEA posted marginal gains while LatAm declined by -2.3%, hindered by weaker commodity prices.

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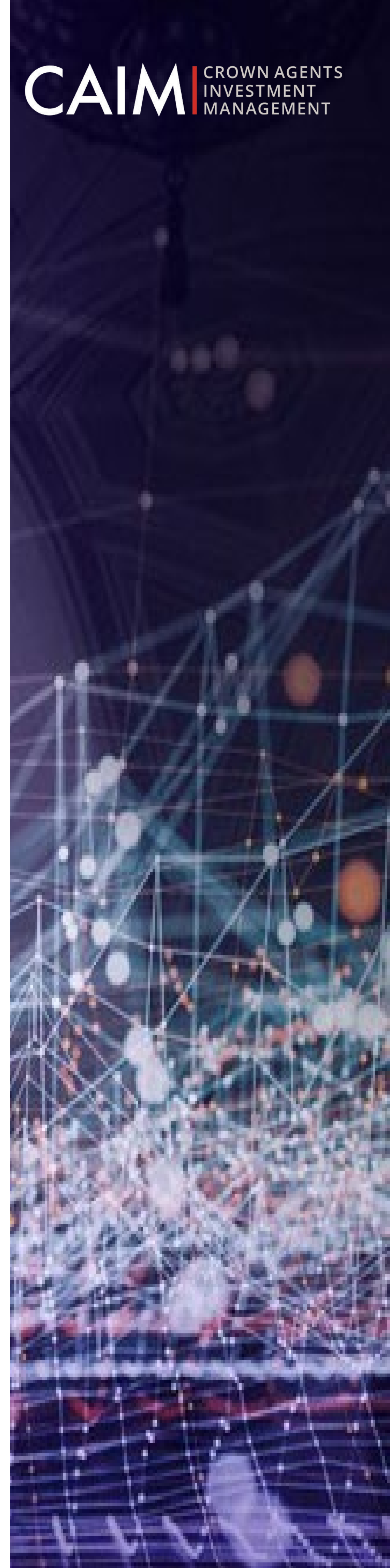


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