CAPITAL MARKETS MONTHLY

CAIM CROWN AGENTS INVESTMENT MANAGEMENT

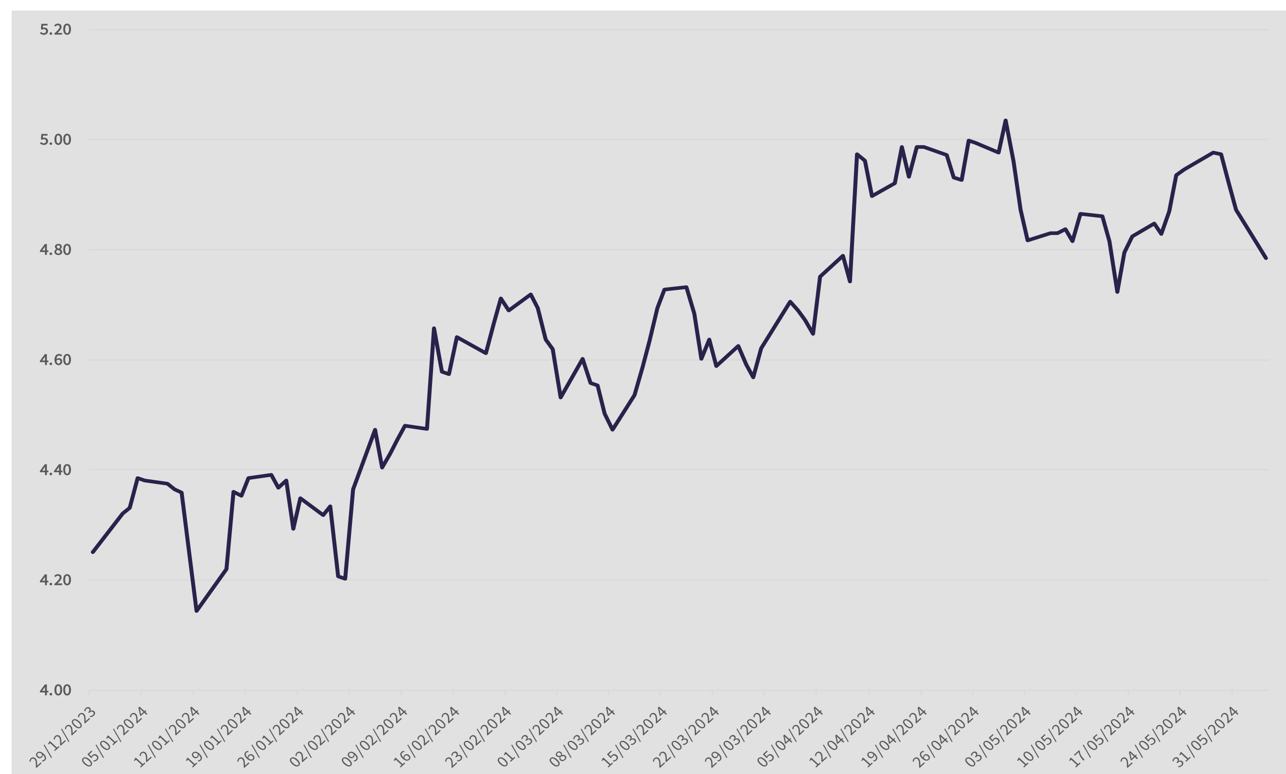
FIXED INCOME COMMENTARY

Inflation uncertainty and a circumspect Federal Reserve create significant yield volatility in May

US Treasury yields were extremely volatile last month. After closing above 5% at the end of April, the US Treasury 2-year yield fell dramatically in the first few days of May, following a weak US employment report. Immediately following this data release, which saw Non-Farm Payrolls advance by a weaker-than-expected 175k, the 2-year note traded at 4.71%, some 33 basis points lower than the previous month end close from two days earlier. Over the next week and a half, 2-year yields traded in a narrow range of 4.80% - 4.85% leading up to the release of US inflation data on 15th May. There was a significant bond market rally when the Bureau of Labour Statistics reported that US CPI increased by just 0.3% month over month. This was in part due to disappointingly high inflation reports in the previous two monthly releases. Core services was the main contributor to the monthly inflation increase, with energy adding 0.08%. Later in the month, a combination of stronger economic data, including a robust S&P Purchasing Managers Index report on 23rd May, and more hawkish Fed commentary resulted in a rising trend in US Treasury yields which persisted until the last two days of the month.

The following chart, using data from Bloomberg, shows the evolution of the benchmark US Treasury 2-year Note yield for 2024 year-to-date.

US Treasury 2-Year Note Yield 2024 Year-to-date



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

During May 2024 there were 14 new issues from 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. The total amount issued was USD 21bn, lower than the previous month. US Agencies and callable SSAs have been excluded from the list. Secondary market price action was mixed. Korea Highway and EDC were the best performing issues, tightening 12bp and 5bp respectively. The Japanese issues from Tokyo and JICA were unchanged on a spread basis, with the Latvia and Qatar government internation bonds performed poorly as yield spreads versus US Treasuries widened materially.

Issuer	Maturity	Issue Spread	Rating
International Bank for Reconstruction & Development	15/05/2028	SOFR+30bp	AAA
Islamic Development Bank	15/05/2029	SOFR+50bp	AAA
Korea Expressway	14/05/2027	T+60bp	AA
Philippine International Bond	14/05/2034	T+80bp	BBB+
Asian Development Bank	21/05/2026	T+10bp	AAA
Caisse d'Amortissement de la Dette Sociale	22/05/2029	T+17bp	AA
Japan International Cooperation Agency	21/05/2029	T+30bp	A+
Oesterreichische Kontrollbank	21/05/2027	T+12bp	AA+
Latvia International Bond	30/07/2034	T+83bp	A
Qatar Government	29/05/2034	T+40bp	AA
Qatar Government Bond	29/05/2029	T+30bp	AA
Tokyo Metropolitan Government	04/06/2029	T+36bp	A+
CDP Financial	05/06/2029	T+31bp	AAA
Export Development Canada	05/06/2034	T+16bp	AAA

Source: CAIM, June 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.

Investors Sell US Dollar in May and Go Away

May marked the first month in 2024 when investors favoured currencies other than the US Dollar. Despite a nearly 1.5% drop in the US Dollar Index (DXY), this decline does not fully capture the sentiment in the foreign exchange market last month. The Norwegian Krone gained almost 5.6% against the US Dollar, making it the best-performing currency in the G10 bloc. The Swedish Krone advanced 4.5%, securing the second spot, while the New Zealand Dollar took third place with a 4% gain.

In Europe, the British Pound led the gains with a 1.9% increase, followed by the Swiss Franc with a 1.7% rise. The Euro appreciated by 1.6%, while the Japanese Yen's value remained almost unchanged (+0.1%). For detailed performance of the G10 currencies, gold, and the Chinese Renminbi, please refer to the table below.

We believe there isn't a single factor responsible for the US Dollar's disappointing performance. An amalgamation of factors, including poorer economic data, a slight downward adjustment to the US interest rate path, earlier bullish positioning on the US Dollar, and technical analysis, likely contributed to the overall poor performance.

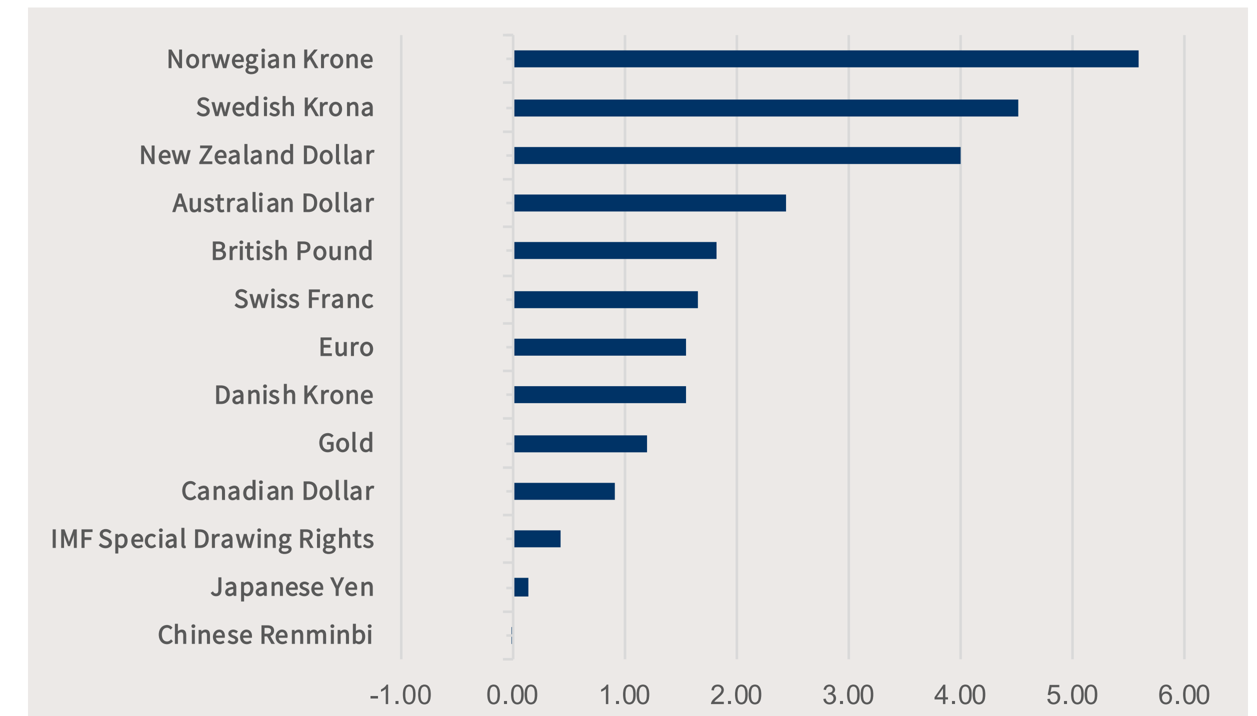
What's Next?

We anticipate that this weakness in the US Dollar will extend into the summer months. Growing concerns about the political shift in the USA, particularly the upcoming presidential elections, will likely drive investors to seek returns outside the USA and the US Dollar. Additionally, we believe that the potential return of Mr. Trump as president will be perceived more like an 'Ouch' factor rather than a 'Wow' factor.

Politics will likely dominate market attention, with the European Parliament elections and the UK elections around the corner. Much of this 'prepositioning' will occur in June and early July, as market liquidity is expected to worsen later in the summer, as it typically does.

Regarding the Chinese Renminbi, the worst seems to be over, with better-than-expected economic data from China indicating a gradual return of international investors. The People's Bank of China (PBoC) has continued its indirect support through the fixing mechanism and is expected to maintain this policy as long as necessary.

May Performance vs. USD (%)



Source: CAIM May 2024.

United States

Reversal in yields and Nvidia's strong numbers promote a market rebound

US equity markets advanced, reaching new highs as many positive catalysts came into play - stronger corporate earnings news, further evidence of inflation deacceleration and the avoidance of a major hawkish signal at the latest FOMC meeting. The early period rally in bond yields was also supportive for MAG 7 stock valuations. However, from around the middle of the month, the market rally began to stall somewhat as more resilient data including inflation prints cemented the "higher for longer" narrative on interest rates, and markets moved to price in a much more gradual cycle of rate cuts.

In terms of monetary policy, the FOMC kept rates unchanged and maintained its implicit easing bias pushing back on the prospect of rate hikes and announcing that they'd be slowing the pace of QT, so there were a few dovish-leaning aspects to the decision. However, there were some hawkish themes, with the press release highlighting the lack of progress to the 2% target and inflation normalisation. It's hard to say it was a dovish meeting but given the recent inflation prints it could have been a lot more hawkish.

In macro news, the April CPI report highlighted the continual decline, with the core inflation level the lowest print in two years but still at uncomfortable levels for the Federal Reserve. PPI data was slightly stronger than expected but the previous month's headline PPI was revised down three-tenths to show a -0.1% decline. In employment news, US payrolls came in softer than expected across an array of indicators including headline, unemployment rate, average hourly earnings and hours worked. The JOLTS report showed that job openings were down to a 3-year low, while the quits rate of those voluntarily leaving their jobs fell to 2.1%, which is its lowest since August 2020, and is a concerning sign given how that indicator is correlated with the strength of the labour market.

Corporate earnings were a support with earnings growth more than double expectations in 1Q, while revenue also beat preseason estimates. Nvidia the bellwether, exceeded Q1 estimates and provided stronger-than-expected guidance for Q2. Any expectations of an air pocket of lower demand was nullified by comments of seeing demand for its products continuing to outstrip supply into next year. The company also announced a 10-for-1 stock split, with its shares moving above the $1000 a share. Apple reported a decline in revenue of -4.3% to $90.8bn, but that was above analysts' estimates, and the company predicted a return to positive sales growth in the current quarter. Otherwise, Apple also raised their dividend and announced a share buyback of $110bn. Outside of technology, Walmart advanced after its Q1 earnings highlighted wealthier customers have begun to turn to the consumer staples giant as necessities are increasingly prioritised over larger discretionary purchases. So good news for the company, but not necessarily good news for the economy, and arguably echoing some of the recent softening in retail and consumer confidence data.

Regarding market performance, following the negative returns in April there was a strong rebound with market breadth turning positive with 10 of the 11 sectors increasing, after 1 gained in April. Information Technology outperformed aided by strength in semiconductors while energy was a laggard on weaker crude prices. In terms of market cap, small cap reversed its recent underperformance outperforming large and mid-cap indices.

Europe

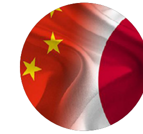
Supportive macro data and Central Bank expectations are positive catalysts

European equity markets gained as investors moved to bring forward the probability of rate cuts, while macro data was generally supportive assisting somewhat in the better-than-expected corporate earnings news.

While the pricing of a June ECB cut rose to 96%, stronger growth data is mitigating the number of cuts priced in by the market, as Euro Area flash PMI for May hit a 12-month high, and wage data from the ECB showed that negotiated pay in Q1 accelerated to 4.7% year-on-year. At the end of the month, data also showed that core CPI had ticked up slightly and so investors had reduced the amount of rate cuts by end of the year.

In terms of earnings, the quarterly numbers were more mixed, with earnings surprising positively, but still down circa -7% y/y. Revenue growth was disappointing, registering a 4% contraction over the previous year with a negative surprise of 1% compared to expectations going into reporting. Notwithstanding the 6% EPS surprise during the quarter, Eurozone earnings projection for the full year aren't inflecting higher.

At the sector level Financial Services, Telecommunications and Real Estate outperformed, while Autos & Parts and Travel & Leisure kept underperforming.



Developed Asia

China policy boosts outweigh concerns over BOJ policy

Developed Asian equity markets generally were positive but softer domestic demand conditions drove late period profit taking.

Japanese markets underperformed their global counterparts with the May 15 meeting between Prime Minister Kishida and BOJ Governor Ueda, along with the BOJ's reduction of JGB purchases and hawkish messaging leading to a rise in long-term interest rates. This weighed on growth stocks, such as those in the semiconductor sector. During the fiscal year results reporting season, bearish guidance for FY2024 put a damper on short-term outlooks, but the acceleration of corporate governance reforms should provide support for Japanese equities in the medium term.

Hong Kong markets advanced early on due to positively received announcements from Chinese authorities over housing support and tougher share sales rule, together with upgrades to full year China EPS. However, there was a retracement due to softer Chinese macro data and a deemed still hawkish Federal Reserve.

Emerging markets

EM equities posted positive returns but was below that of its developed counterparts. EM markets rallied in early May driven by China's supportive policy measures, and optimism on Fed easing. However, markets corrected mid-month highs as US yields rose on still high CPI data and an increasing sense of higher-for-longer from the FOMC. Investor sentiment remained slightly risk-off as investors kept a watchful on elections across three large EM's, India, South Africa and Mexico.

EM Asia outperformed MSCI EM, while LatAm and CEEMEA lagged.

AUTHORS

Charles Thomson
Head of Portfolio Management
charles.thomson@caiml.com

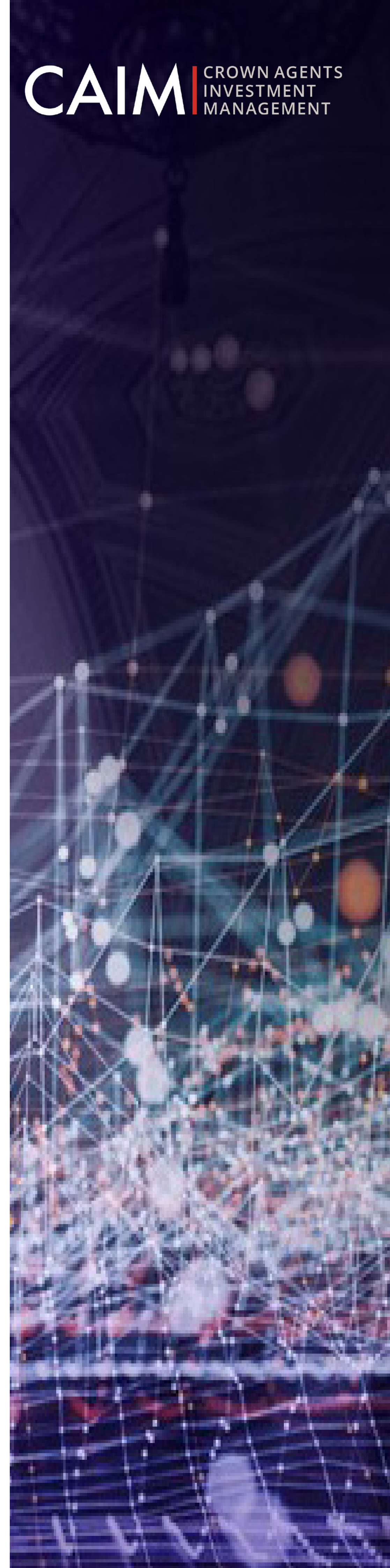
Slawomir Soroczynski
Head of Fixed Income
slawomir.soroczynski@caiml.com

Simon Price
Senior Equity Fund Manager
simon.price@caiml.com

CONTACT

Crown Agents Investment Management
The Rex Building
62 Queen Street
London
EC4R 1EB
United Kingdom

www.caiml.com
CAIMInsights@caiml.com
T: +44 (0)20 3903 2500
F: +44 (0)20 8643 9113



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