

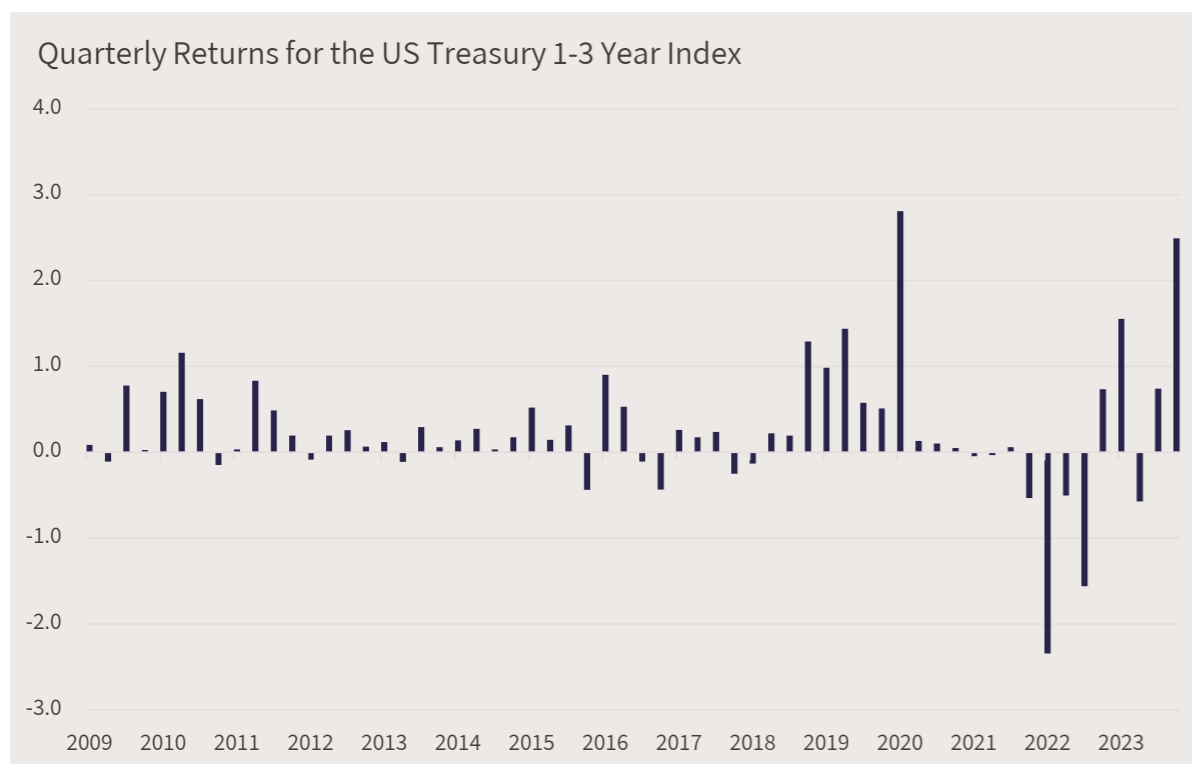
### Bond rally continues, generating one of the strongest quarterly returns since 2008

Macroeconomic developments and central bank communications continued to provide strong support for the bond market rally last month. In the United States, inflation data, released on 12th December by the Bureau of Labour Statistics, showed a deceleration in the annual consumer price index from 3.2% to 3.1%. The monthly CPI increase of just 0.1% was held down by negative contributions from both energy and core goods components. Core CPI inflation remained at 4.0% while core PCE (the Federal Reserve’s preferred measure) decelerated from 3.5% to 3.2%. Additionally, forward looking indicators of inflation, such as the University of Michigan 1-Year Inflation Index, declined sharply.

The Federal Open Market Committee meeting, which concluded on the 13th December, provided an additional endorsement for the bond market rally. The FOMC dot plots were revised significantly lower, with the median projection indicating 75 basis points of monetary policy easing in 2024, taking the Fed funds rate to 4.625% by December 2024. This compares to a median forecast of 5.125% at the September FOMC meeting. Short-dated bond yields declined sharply, taking the curve inversion between Fed funds and 2-year Treasury notes to an extreme level of -125 basis points. Futures contracts now imply substantially more rate cuts in 2024 – the December Fed funds futures contract FFZ4 implies a rate of 3.82%, equivalent to over 150 basis points of cuts over the next twelve months.

Any upcoming disappointment in inflation data releases or other economic developments such as a firming employment market may significantly alter the outlook for the path of interest rates.

The following chart shows the quarterly returns of the US Treasury 1-3 Year Index since the end of 2008. Last quarter was the second strongest performance in the last fifteen years. In the first quarter of 2020 the Federal Reserve cut the funds rate by 150 basis points. By contrast, the Fed hiked rates by 100 basis points during 2023.



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

During December 2023 there was only a single new issue 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. Inter-American Development Bank issued a USD 1.5bn long 3-year note. These securities were priced at a somewhat aggressive level of mid swaps plus 35 basis points, which was equivalent to a spread of 6.5 basis points versus the Treasury 3-year note. However, the inverted curve between 15-Nov-26 and 1-Feb-27 was approximately 3 basis points, resulting in a G-spread of around 9 basis points. Nevertheless, these securities did not perform well in secondary market trading on a relative value basis. The lead managers for this transaction were BNP Paribas, Nomura and TD Securities.

Issuer	Maturity	Issue Spread	Rating
Inter-American Development Bank	01/02/2027	CT3 + 6bp	AAA

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.

## The end of year investors' euphoria sends US dollar valuations lower

The last month of the year brought many surprises, yet it is difficult to isolate a single factor behind the price action observed across many different asset classes. The key investment theme was “buy risk and don’t worry”. First government bonds continued to see buying flows which aggressively re-priced the interest rate paths in developed markets. These fuelled buying patterns in the credit space where many indices marked fresh year to date records. Equities followed suit closing the year at a near all-time high. These themes were fully reflected in the foreign exchange market where earlier underperformers such as the Norwegian Krone or the Australian Dollar delivered abnormally high returns.

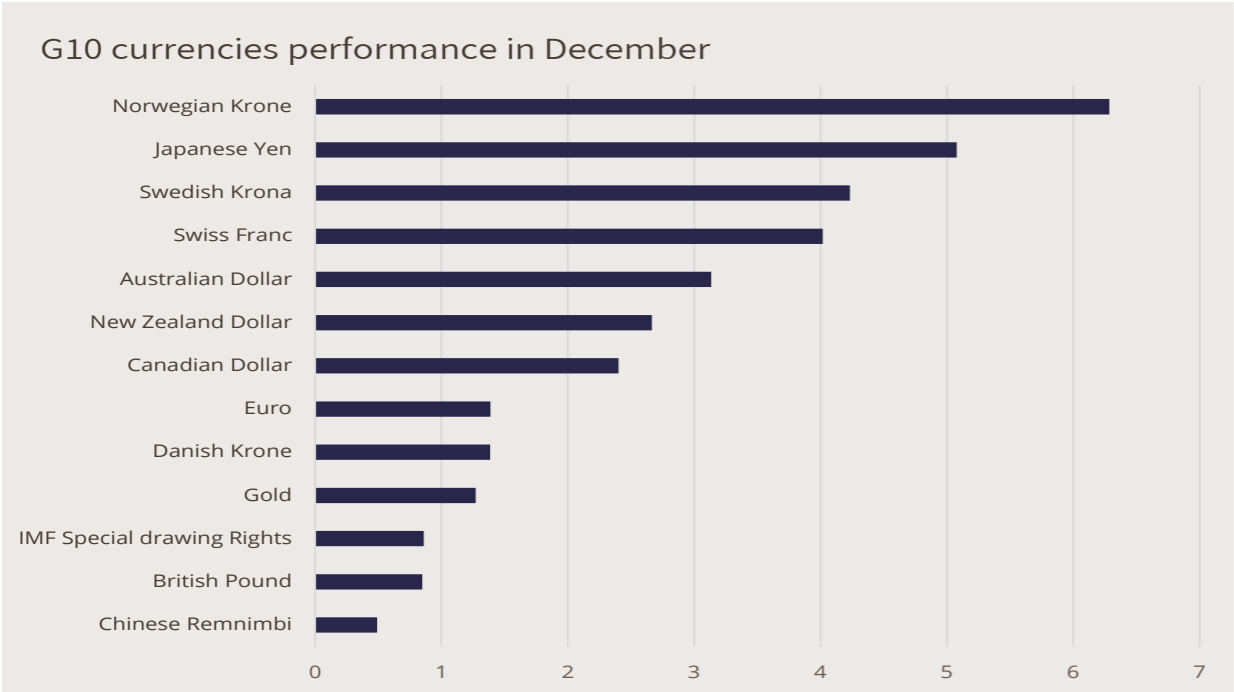
The pro-risk mood left its mark on the US Dollar which again disappointed. The US dollar index (DXY) opened December trying to recover the November loss but was unable to break through the 104.00 level. It failed there twice during the first few days of trading and continued downward move towards 101.00; the level which offered good support on a few occasions this year. The DXY got there during the last week of trading from where it sharply rebounded, closing the year above 102.00. The USDJPY was the main cross contributing to the DXY price momentum in December with the aggressive JPY buying observed in the second part of the month. The price behaviour suggested speculative positions being reduced, which, given poor liquidity conditions resulted in abnormal JPY gains seen in December. The JPY advanced almost 4% against the greenback.

As far as the Euro is concerned, it gained 1.4% with the less crowded positioning and the technical picture limiting its gains against the USD at 1.1050.

A very similar picture was observed in the GBPUSD cross where the “technical” are set to any positive price momentum above 1.2750, forcing the GBP to close the month with a very modest gain of 0.2%.

For the detailed G10 currencies performance in December please see the table below.

As far as the Renminbi is concerned, it failed to sustain strong positive momentum from November. Nevertheless, despite some headwinds coming from the real economy, it managed to advance against the USD in December, strengthening by 0.6%. What is worth noting here is a very adverse behaviour of the CNY/CNH basis on the last day of trading. After a few consecutive days of tightening, it widened to the tune of 0.025 on the last day of the year. Going forward, we expect the USD to try to recover some losses it experienced during the last few weeks of the year, but on balance, we see more headwinds for the greenback in the New Year and expect the DXY index, after failing at the 104.50 level, to resume its downward trend.



Source: CAIM January 2024.

# EQUITY MARKET COMMENTARY



## United States

### The Fed provides a Christmas present?

US equity markets continued their rebound, with the FOMC doing its best to give investors an early Christmas present. The latest dot plot now suggests 75bp of rate cuts in 2024, up from 50bp previously. One change to a dot plot doesn't automatically signal a complete change of policy, but the risks that the Fed would stubbornly hold rates at high levels, lagging behind a recovering economy, appears to have been reduced given the change in tone. Along with recent stronger retail sales and employment data, more fuel was added to the soft-landing narrative.

The number of Fed officials seeing risks to inflation as biased to the upside went down from 14 to 8 (out of 19), with most now seeing risks as "balanced". In the FOMC's statement previously hawkish comments on inflation and economic activity were given a new, more dovish, slant. The word "any" was significantly added to its consideration of "the extent of any additional policy firming that may be appropriate".

Headline inflation fell 0.1% to 3.1%, however core CPI remained unchanged at 4%, which is still too fast for the Fed to be comfortable. Non-farm payrolls were stronger than expected, while the unemployment rate fell back to 3.7%. The average hourly earnings did rise to a monthly 0.4% for the first time since July however, so that'll particularly be one to keep a wary eye on in terms of its implications for inflation. On the other side, the JOLTS report in the US showed that job openings were down to 8.733m in October, the lowest they've been in the last two-and-a-half years.

A month ago many seemed to be questioning the November rally. However, by late December many were embracing a more positive view for 2024, propelled by a continuation of the economic expansion and a more dovish Fed. In terms of positioning, we have seen a strong short-covering rally with factors more risk based seeing a sharp rally, the exact opposite from October. In terms of flows, hedge funds have been positive contributors, supportive of the rebound in the smaller cap exposures, whereas retail investors have been strong buyers of single-stock names.

Market breadth at both the sector and company levels remained relatively strong compared to earlier in the year. Mid and small caps outperformed, benefitting from the prospect of lower interest rates in 2024. At the sector level real estate and industrials outperformed, while utilities and energy were laggards.



## Europe

### Investors focus on ECB rather than growth picture

Thanks largely to positive inflation news, European equity markets advanced over the month as investors ratcheted up the likelihood of the ECB cutting rates as early as their March meeting. This was in spite of news that euro area Q3 GDP saw a -0.1% quarterly decline.

The ECB kept rates on hold in December, as widely expected, and acknowledged the better inflation picture. Wording from previous statements that inflation was set "to stay too high for too long" was dropped. However, they didn't echo the more dovish remarks from the Fed, and President Lagarde said that "we should absolutely not lower our guard" and that "we did not discuss rate cuts at all". Alongside that, the ECB also announced that they would reduce the PEPP portfolio by €7.5bn per month on average over H2 2024 and discontinue reinvestments under PEPP by the end of 2024.

The flash CPI reading for November saw the headline annual inflation rate down to its lowest level since July 2021, and almost back at the ECB's 2% target. Core inflation remained more elevated, but this also surprised clearly on the downside, enhancing the marked slowdown in the economy and wage growth in the past three months.

European equity markets advanced in December with most sectors showing positive returns. Real estate was a top performer, benefitting from lower yield expectations and consequent cost of financing, whilst defensive names such as telecoms and consumer staples underperformed; as did energy due to lower commodity prices.



## Developed Asia

### Fed relief promotes some upside

Developed Asian equity markets followed their global counterparts higher driven by a rapid shift in market expectations from "higher for longer" to a "US goldilocks", namely disinflation which would allow interest rate cuts without significant growth deterioration in the US.

Moving to Japan, aiding market gains was news that the announced stimulus package would be worth more than \$100 billion, higher than consensus expectations, including income and residential tax rebates to low-income households. In terms of performance growth and semi-conductor stocks advanced while a decline in U.S. long-term interest rates, weighed on financial stocks, and a rise in the yen, weighed on automotive names and other external-demand value securities.

Hong Kong was a relative underperformer advancing early on rising expectations of Fed rate cuts ahead and China's new housing policy aids. Optimism fell in the second half as several index heavyweights and widely held names reported 3Q results that were below market expectations including Alibaba and Meituan.



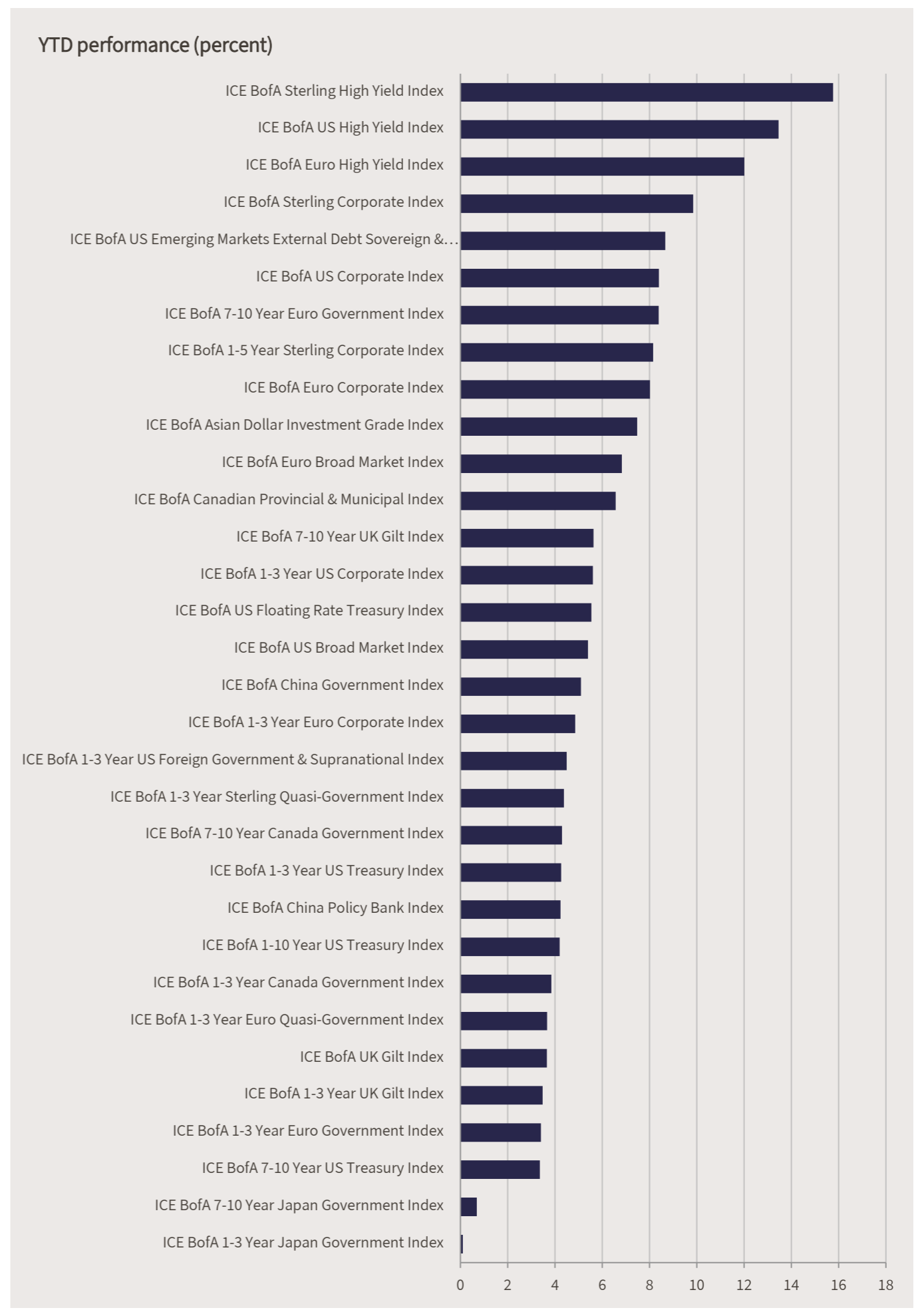
## Emerging markets

EM equities advanced for the month, slightly underperforming their developed market counterparts. The suggested Fed pivot to lower rates going forward and the weaker USD were both supports for emerging markets

The LatAm region performed most strongly, followed by CEEMEA and EM Asia. Asia underperformed due to the large index weighting to China, which saw relative weakness on worse-than-expected retail sales, and a CPI that had yet again turned negative y-y. Many were puzzled by the rationale and timing of draft regulations regarding online gaming, although Beijing's approval of 105 domestic games on the following Monday helped to stabilise confidence somewhat.

Market Performance, %	Dec 2023	YTD	12m
<b>Aggregate Bond Indices:</b>			
ICE BofA US Broad Market Index	3.71	5.39	5.39
ICE BofA Euro Broad Market Index	3.34	6.83	6.83
ICE BofA Asian Dollar Investment Grade Index	3.06	7.47	7.47
ICE BofA US Emerging Markets External Debt Sovereign & Corporate Plus Index	4.01	8.67	8.67
<b>Government Bond Indices (1-3 Yrs):</b>			
ICE BofA 1-3 Year US Treasury Index	1.12	4.26	4.26
ICE BofA 1-3 Year UK Gilt Index	1.47	3.47	3.47
ICE BofA 1-3 Year Euro Government Index	1.07	3.40	3.40
ICE BofA 1-3 Year Japan Government Index	0.02	0.08	0.08
ICE BofA 1-3 Year Canada Government Index	0.84	3.85	3.85
<b>Quasi Government Bonds (1-3 Yrs):</b>			
ICE BofA 1-3 Year US Foreign Government & Supranational Index	1.14	4.50	4.50
ICE BofA 1-3 Year Sterling Quasi-Government Index	1.46	4.37	4.37
ICE BofA 1-3 Year Euro Quasi-Government Index	1.11	3.66	3.66
<b>Government Bond Indices (1-10 &amp; 7-10 Yrs):</b>			
ICE BofA 1-10 Year US Treasury Index	2.02	4.19	4.19
ICE BofA 7-10 Year US Treasury Index	3.85	3.36	3.36
ICE BofA 7-10 Year UK Gilt Index	5.09	5.63	5.63
ICE BofA UK Gilt Index	5.78	3.65	3.65
ICE BofA 7-10 Year Euro Government Index	3.91	8.39	8.39
ICE BofA 7-10 Year Japan Government Index	0.52	0.67	0.67
ICE BofA 7-10 Year Canada Government Index	3.63	4.29	4.29
ICE BofA Canadian Provincial & Municipal Index	3.78	6.57	6.57
<b>Investment Grade Corporate Bond Indices:</b>			
ICE BofA 1-3 Year US Corporate Index	1.32	5.61	5.61
ICE BofA 1-5 Year Sterling Corporate Index	2.58	8.16	8.16
ICE BofA 1-3 Year Euro Corporate Index	1.21	4.86	4.86
ICE BofA US Corporate Index	4.04	8.40	8.40
ICE BofA Sterling Corporate Index	4.96	9.84	9.84
ICE BofA Euro Corporate Index	2.76	8.02	8.02
<b>China Indices</b>			
ICE BofA China Government Index	1.15	5.10	5.10
ICE BofA China Policy Bank Index	0.95	4.23	4.23
<b>High Yield Corporate Bond Indices:</b>			
ICE BofA US High Yield Index	3.69	13.46	13.46
ICE BofA Sterling High Yield Index	2.82	15.77	15.77
ICE BofA Euro High Yield Index	2.90	12.01	12.01
<b>Other</b>			
ICE BofA US Floating Rate Treasury Index	0.37	5.54	5.54

Source: ICE. Performance for the period ending 31 December 2023 (Local Currency, Total Returns).



Source: ICE, 31 December 2023.

## 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

Crown Agents Investment Management Limited.  
Registered in England & Wales. No: 2169973.  
Vat Reg No: GB 377 614565.  
Authorised and regulated by the Financial Conduct Authority in the UK.

All data sourced from CAIM and Bloomberg unless specified otherwise. Information contained in this report is compiled from industry sources which we believe to be accurate and reliable. This information does not constitute accounting, tax, legal, investment, consulting or other professional advice or services. CAIM accepts no liability for the impact of any decision made based on the information provided in this document.

You agree not to copy, modify, reformat, download, reproduce, transmit or redistribute any data or information found herein, or use any such data or information in a commercial enterprise without obtaining CAIM's prior written consent.