

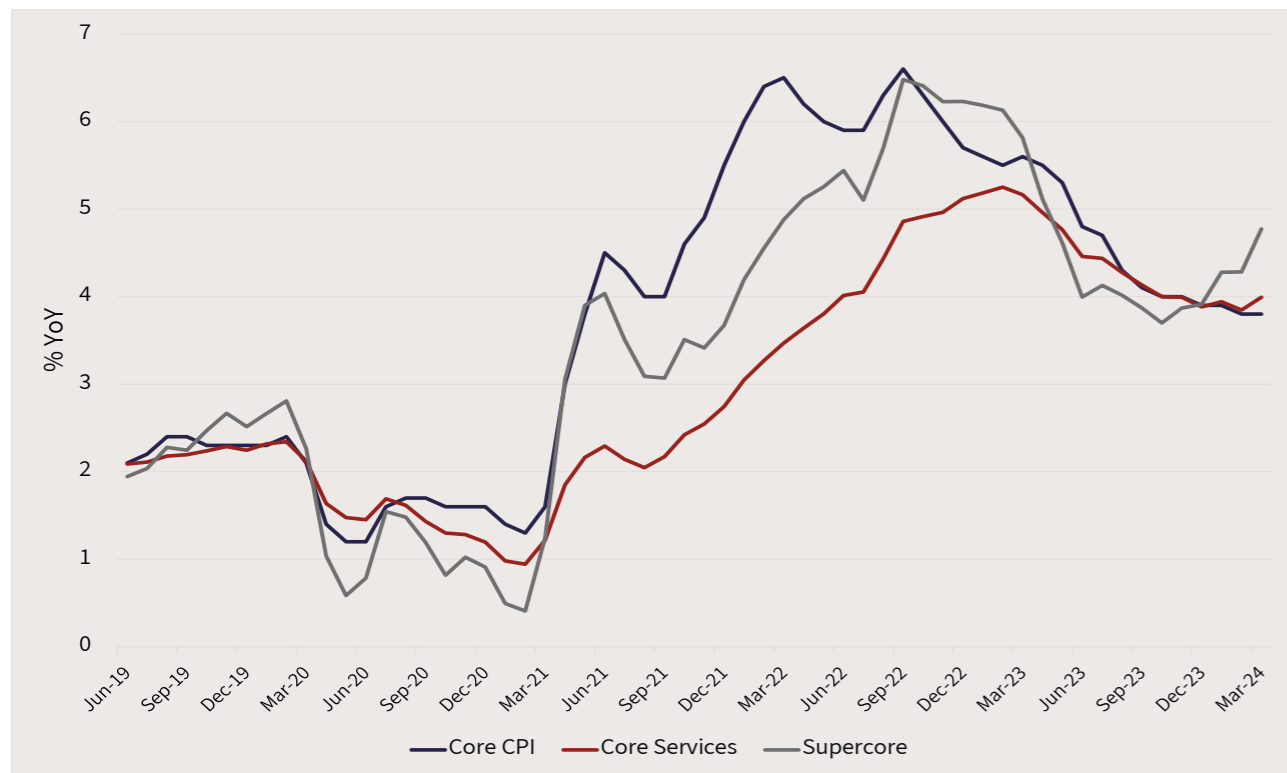
Hawkish Pivot from Federal Reserve after Inflation Disappoints

Last month a considerable number of voting Federal Reserve FOMC members remarked on the recent slow progress towards the Fed’s inflation goals. In this context and following slightly disappointing inflation reports for January and February, there was a general expectation for improvement in the March CPI numbers (released on 10th April). This was based on detailed analysis of some of the higher frequency components of the CPI basket. In the event, US CPI advanced by 0.4% m/m, which was above the consensus forecast of 0.3%. This marked the third consecutive inflation report that exceeded economists’ expectations and therefore had a material impact of the expected path of monetary policy throughout the remainder of 2024. Note that the median projection from March 2024 FOMC Dot Plot suggested three 25 basis point cuts in the Fed Funds rate by the end of this year. Given the lack of progress towards the Fed’s inflation target and with core inflation measures significantly above 2%, it would be reasonable to expect the path of rates to be revised upwards. Some analysis have even suggested the possibility of a rate hike this year by the Fed, although we consider the probability of this outcome to be negligibly low.

US Treasury yields inevitably moved higher over the course of April as rate cut expectations were pared back in line with the poor inflation developments. The benchmark 2-year US Treasury Note closed the month above 5%, the highest level in six months. Long bond yields also backed up by around 40 basis points, reaching 4.78% by month end.

The following chart, using data from Bloomberg, shows the progression of US core inflation. Note the recent strength in ‘supercore’ inflation which measures services inflation excluding food, energy and housing.

US Inflation Developments



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

During April 2024 there were 21 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 37bn, higher 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. The exceptions were the sovereign Abu Dhabi transactions and the British Columbia deals that were issued at somewhat expensive levels.

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

Issuer	Maturity	Issue Spread	Rating
Landeskreditbank Baden-Wuerttemberg	08/05/2026	S+26bp	AA+
International Bank for Reconstruction & Development	10/04/2026	T+9	AAA
Development Bank of Japan	10/04/2029	T+32	A+
Ontario Teachers' Finance Trust	10/04/2029	T+38	AA+
International Bank for Reconstruction & Development	10/04/2031	T+15	AAA
European Investment Bank	15/06/2029	T+11	AAA
Kreditanstalt fuer Wiederaufbau	16/03/2026	T+10	AAA
China Development Bank	16/04/2027	SOFR + 33bp	A+
Landwirtschaftliche Rentenbank	17/04/2029	T+12	AAA
Japan Bank for International Cooperation	17/04/2034	T+33	A+
Kuntarahoitus Oyj	23/04/2027	T+18	AA+
Japan Finance Organization	23/04/2029	T+40	A+
Province of British Columbia Canada	24/04/2029	T+27	AA-
Province of Ontario Canada	24/04/2034	T+40	A+
SFIL	26/04/2027	T+25	AA
Abu Dhabi Government	30/04/2029	T+35	AA

Source: CAIM, May 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.

The Bank of Japan forced to step in

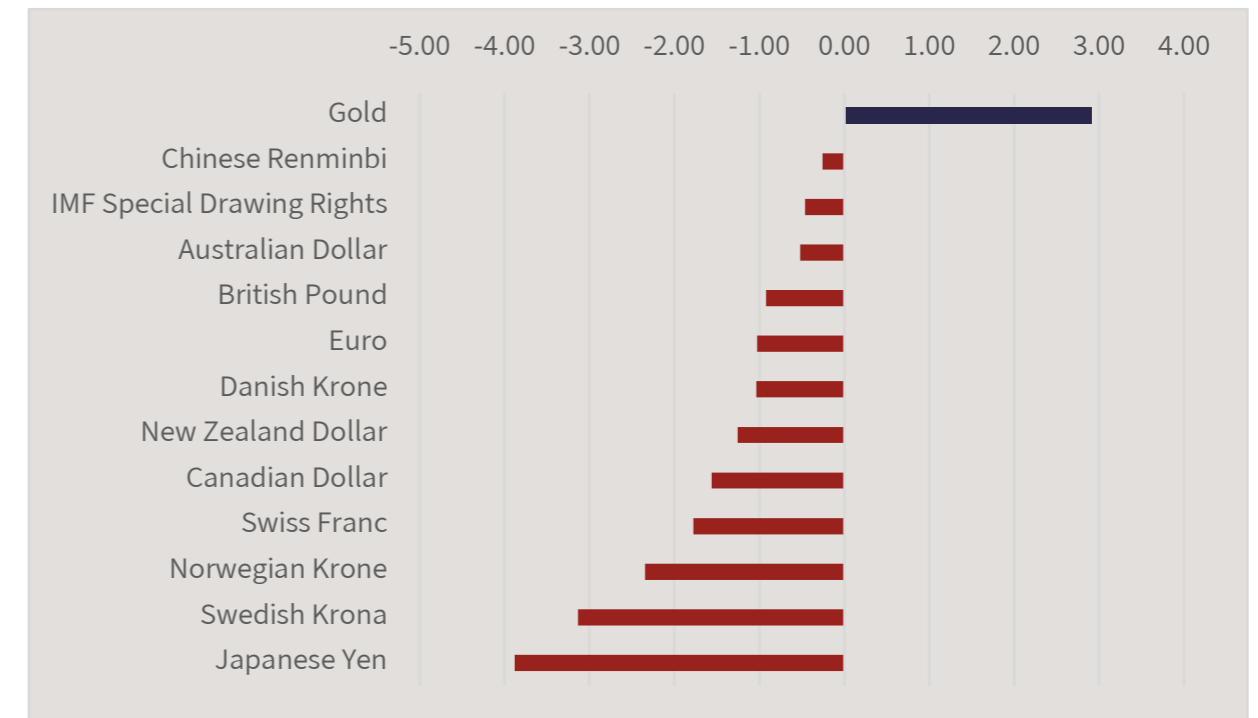
April turned out to be a disappointing month regarding risk. Equities suffered a setback, credit spreads moved wider and the only asset which managed to outperform the US Dollar was gold. The mixed fundamental picture, with data fuelling resurgence of inflation fears, preoccupied investors' debates. This led to some very aggressive repricing of market expectations regarding the FED interest rate path. The January over-optimism regarding the interest rate trajectory (with seven 25bps cuts being priced in for 2024 at one point) has already been forgotten with a meagre one and a half 25bps cuts in being priced in for 2024 as of the end of April. Some analysts assign a high probability of the FED to keep rates unchanged this year! The foreign exchange market fully reflected this atmosphere with the US Dollar dominance being the key theme of the month. Both the traditional high beta and the 'safe haven' crosses disappointed. Most European crosses depreciated 1% against the US Dollar with the Swedish Krona ending as the weakest cross in this time zone; shedding 3.1% against the greenback. (Please see the G10 + Gold + SDR detailed performance in the table below).

The Chinese Renminbi managed to hold its ground despite acute pressure coming from the Japanese Yen, which during the last days of the month experienced extreme selling pressure. The PBoC provided indirect support through the fixing mechanism while the fundamental picture continued to support the view that the economy is gaining momentum. As for the Japanese Yen, the Bank of Japan failed to deliver on the interest rate front and as a result the USDJPY cross dropped to the 32 years' time low testing 160.00! The price action left the BoJ with no choice but to step in (during the Japanese holiday), knocking it down towards 155.00. Japanese officials declined to comment on whether the BOJ intervention was behind this move. The official confirmation will be announced at the end of May. In the meantime, market will be putting pressure and testing the BoJ 'patience', but it seems that without a coordinated support (like the one seen back in 1995) it may be a very difficult task- if not a mission impossible. At the moment, the interest rate differential with other major (developed markets') rates, especially against the US rates, seems to be a factor too important to deter leveraged players. Therefore, unless we see the interest rate gap with other key interest rates narrowing the fundamentals will be regarded as a headwind to the JPY fortunes.

Otherwise, it is worth mentioning that key technical levels across major FX crosses were tested, i.e. for the EURUSD 1.0720, the GBPUSD 1.2500, the USDCAD 1.3850 and AUDUSD 0.6400.

Looking forward, May begins with the FED meeting which, as usual, will be a very closely watched event together with economic data releases as investors will be looking for arguments to support the view that the FED's cutting interest rate cycle is only delayed, not derailed, which is CAIM's view. A start of the interest rate cuts should herald a long-awaited turn to the US Dollar fortunes.

April Performance vs. USD (%)



Source: CAIM May 2024.



United States

'Higher for longer' theme reins in recent gains

US equity markets declined, after five months of positive returns, driven by a succession of hawkish developments. This led to growing questions about how soon the Fed will be cutting rates, particularly given the resilience of both growth and inflation, promoting a sharp rise in yields. The increased geo-political risk in the Middle East also hindered sentiment, with volatility rising. The volatility index rose to 21 before declining by end of month. Corporate earnings were generally positive as we moved through quarter one earnings, however, price reaction was generally lower than average, highlighting some valuation concerns and restrained guidance. The IMF released their latest World Economic Outlook upgrading their global growth forecast for 2024 by a tenth relative to January, and now expect growth of 3.2% this year.

In terms of monetary policy, early in the month Fed Chair Powell stated that recent data did not "materially change the overall picture". However, over the month stronger data became harder to dismiss, with market pricing clearly indicating inflation concerns. In turn, that led investors to price out the chance of rate cuts, which got further support by comments from Fed Chair Powell on April 16, who said that "The recent data have clearly not given us greater confidence and instead indicate that is likely to take longer than expected to achieve that confidence" about inflation.

In macro news, core CPI in March, contrary to expectations, did not slowdown, and it is now the third consecutive month that core CPI has been at 0.4%. It's getting increasingly difficult to dismiss this as just a temporary bump, and the major concern is that inflation will persist above the Fed's target for longer. The March US jobs report showed nonfarm payrolls grew greater than expected and unlike the previous month, the upside surprise didn't come with sharp downward revisions. In other news, a strong US retail sales print offered a fresh reminder about the strength of the US consumer.

As we move through the Q1 2024 earnings review, companies continue to perform well compared to expectations, with both the percentage of S&P 500 companies reporting positive earnings surprises and the magnitude of earnings surprises above their 10-year averages. However, the full year 2024 earnings expectations have seen little changes in estimates. Moving to financials, Q1 earnings were driven by strong markets-related revenues, including investment banking fees and strong wealth management-related revenues, together with better trends in non-interest expenses, offset by continued weak commercial (C&I) loan growth. Moving to technology plus, Microsoft and Alphabet both exceeded revenue and earnings expectations, with Alphabet seeing the larger beat on profitability, as their growth was boosted by demand for cloud computing and AI-related offerings. Meta saw share price weakness even though its Q1 results slightly exceeded revenue and earnings estimates, revenue guidance for Q2 came towards the lower end of analysts' expectations. The company also raised its cost expectations for 2024, seeing capex spending totalling \$35-40bn. Tesla declined after it reported lower-than-expected sales, with its first year-on-year decline in vehicle deliveries since 2020. However, investors had a more upbeat take on the company's strategy going forward, with a focus on "accelerating" the rollout of new cheaper models and later in the month advanced on news reports that Chinese government officials had given the firm in-principle approval for its driver-assistance system.

Regarding market performance, only one sector saw positive performance, which was utilities, with market breadth declining from previous months both in terms of number and actual declines. Real estate was the worst performing sector, while in terms of market cap, large capital outperformed small cap.



Europe

Central Bank expectations mitigate losses

European equity markets saw mild negative returns, outperforming their developed market peers as macro data/corporate earnings have come in better than expected while the ECB added to the signals that they might cut rates at the next meeting.

The latest ECB decision left their deposit rate at 4% as expected. However, their statement suggested that they were moving closer to rate cuts, as it said that if the Governing Council's updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase its confidence that inflation is converging to the target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. The prospect of ECB rate cuts got fresh support as core CPI fell to the lowest since February 2022. One area of caution though is the profile of rate cuts with Bundesbank President Nagel, cautioning that a rate cut in June "would not necessarily be followed by a series of rate cuts."

In terms of earnings, companies are turning incrementally positive on the economic outlook, which is translating to an improving demand outlook and earnings recovery later in the year. Market reaction to earnings has been positively skewed, especially in Financials. In terms of performance, Energy was the best-performing sector on higher commodity prices while information technology lagged, with ASML a laggard as the producer of chipmaking equipment reported a sizeable decline in orders in Q1.



Developed Asia

BOJ policy and currency concerns weigh on Japanese markets

Developed Asian equity markets were generally weaker as the US 'higher for longer' outlook was a negative for market sentiment, while the turnaround in China's corporate earnings helped to lift returns in China and HK.

Japanese markets were hindered by concerns over BOJ policy and FX volatility. The Bank of Japan left their interest rates unchanged at their latest meeting, which assisted with the currency weakness. The decline in the Yen during this period made the market wary of forex intervention, and it also weighed on share prices by depressing dollar-denominated returns from the perspective of global investors. In terms of equities, we saw a sizeable correction in heavily weighted sectors such as electronics, retail, and IT. While in Hong Kong we saw positive returns as there were positive revisions to earnings growth in China- a first since 1H2021- together with rising buyback and/or dividend payouts by internet names. The announcement of China's capital market guideline 3.0 aimed to improve investor returns, while the anticipation of more property easing at the April 30 politburo meeting aided sentiment.



Emerging markets

EM equities consolidated over April, posting flattened returns, considerably outperforming developed markets. Initially we saw selling as the market came to terms with the idea of fewer Fed rate cuts amid stickier-than-anticipated inflation prints. However, EM gained from April lows as strong macro prints, rising commodity prices, and a tilt towards the value theme helped lift sentiment.

EM Asia outperformed due to resilient earnings, stronger China macro (including Q1 GDP growing at an annualised rate of 5.3%), higher than analysts' forecasts of 4.8% and continued policy support. LatAm dragged EM lower and CEEMEA finished marginally negative.

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