CAIM | CROWN AGENTS INVESTMENT MANAGEMENT

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CAPITAL MARKETS MONTHLY

FIXED INCOME

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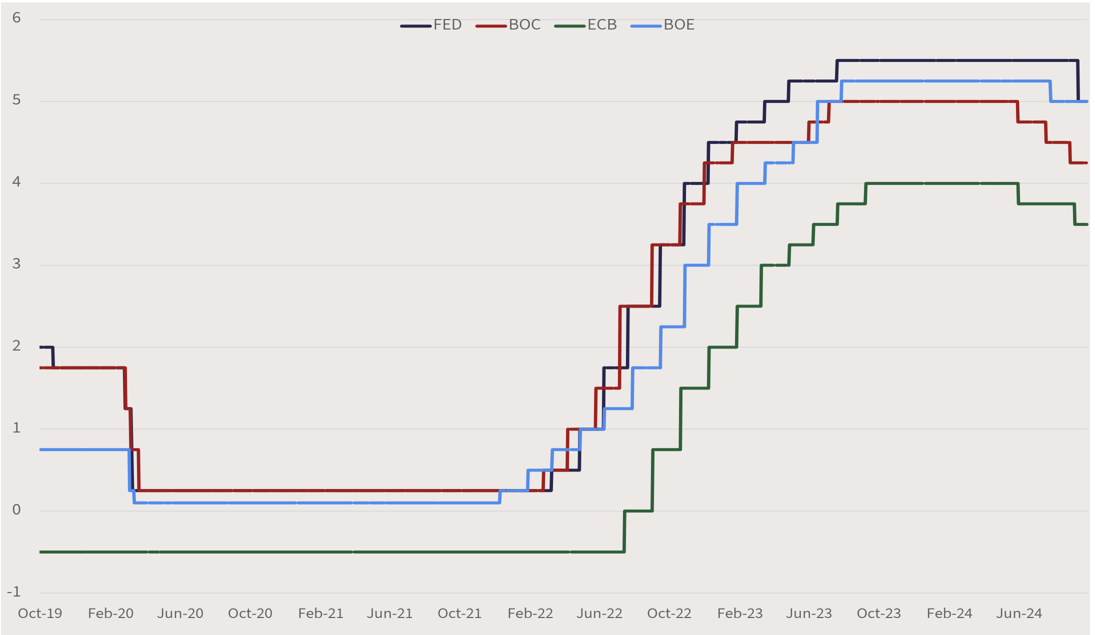
HEAD OF PORTFOLIO MANAGEMENT

Federal Reserve Begins Easing Cycle

Following the conclusion of the September Federal Open Markets Committee meeting on 18th September, the Fed lowered the funds rate by 50 basis points, taking the target range from 4.75% to 5.00%. This marks the start of what is now expected to be a series of further cuts towards the neutral rate. The longer-run dot was revised upwards from 2.75% to 2.875% while the projections showed a 75 basis point reduction for 2025. Both the median estimates for 2026 and 2027 were reduced to 2.875%. The 2024 dot moved down to 4.375%, consistent with another 50 basis point by year-end. Just one dot made the difference between the 2024 projection implying 25bp or 50bp of additional cuts this year.

The implication from the dot plot is that the 50bp start is expected to be followed by 25bp in November and 25bp in December, although market expectations, based on Fed funds futures, imply a further 75bp of cuts by then end of the year. The Fed left QT in place, which leaves the announcement of the end of QT as another potential dovish move by year-end. Regarding the standard economic projections, GDP was revised to 2.0% for 2024-2027. The Unemployment Rate was revised higher to 4.4% in 2024 and 2025, then seen moderating to 4.3% in 2026, and 4.2% in 2027. Projected Core-PCE in 2024 declined from 2.8% to 2.6% and for 2025 was down from 2.3% to 2.2%. The Core PCE for 2026 was unchanged at 2.0%.

The following chart shows the path of official short-term rates for G7 central banks, excluding the Bank of Japan.



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

During September 2024 there were nineteen 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 26.7 billion. Secondary market performance was generally strong as spreads tightened. The USD 1bn CAF was the best performing issue, priced at a generous 80bp versus SOFR, equivalent to a US Treasury spread of 56bp. There were several Korean multi tranche issues from EIBKOR and KOROIL which also performed strongly. The most expensive issue was the USD 3bn KFW 3-year, which was issued at UST + 8bp, although these did tighten marginally in subsequent trading.

Issuer	Maturity	Issue Spread	Rating
Corp Andina de Fomento	07/01/2028	UST +56bp	AA
Export-Import Bank of Korea	11/09/2029	SOFR +82bp	AA
Export-Import Bank of Korea	11/09/2029	UST +55bp	AA
Export-Import Bank of Korea	11/09/2027	UST +43bp	AA
Caisse d'Amortissement de la Dette Sociale	12/09/2027	UST +17bp	AA-
Svensk Exportkredit	13/09/2027	UST +15bp	AA+
International Development Association	12/09/2031	UST +14bp	AAA
Korea Housing Finance Corp	12/03/2028	UST +63bp	AA
African Development Bank	18/09/2029	UST +11bp	AAA
Inter-American Development Bank	17/09/2031	UST +14bp	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.

FOREIGN EXCHANGE

SLAWOMIR SOROCZYNSKI

HEAD OF FIXED INCOME

US Dollar – Too Early to Call Retreat

The Fed finally delivered a long-awaited interest rate cut, the first since 2020. According to media reports, it was a surprise cut, however, judging by the market reaction with bond prices falling, this would suggest that the market was already positioned for a 50 basis point cut. The initial market reaction was textbook: interest rates fell, especially on the short end of the curve, high-beta assets outperformed, and the US Dollar weakened. But this did not last long. The following day, upward pressure on yields resurfaced, and the US Dollar Index (DXY) recovered all post-decision losses. The post-decision euphoria disappeared as quickly as it had emerged.

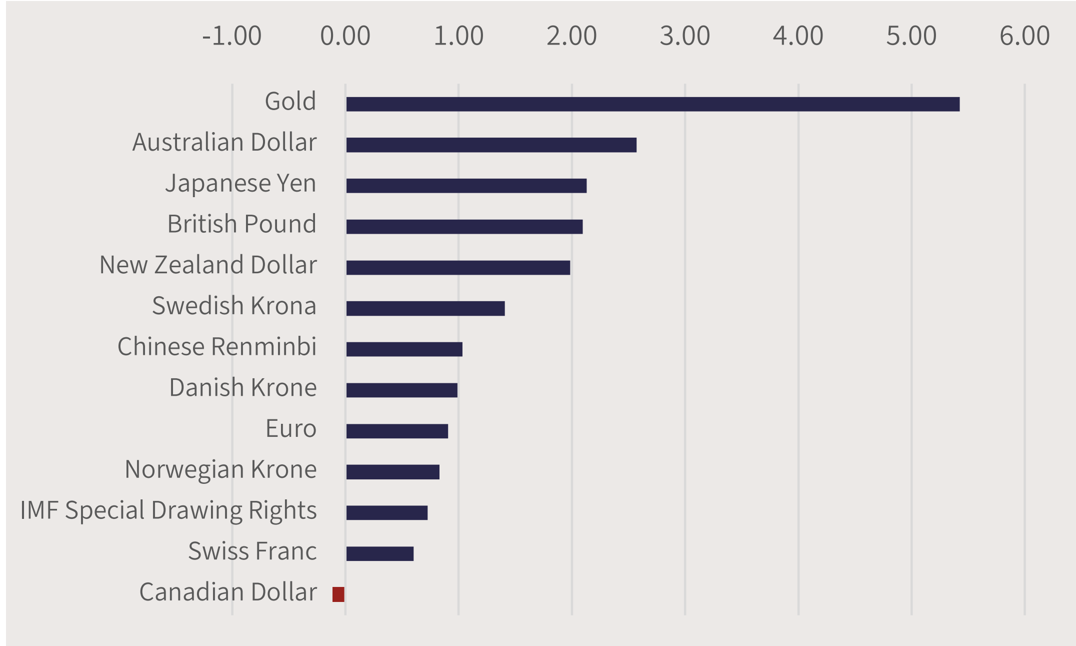
The new Fed funds projection (the DOTS chart) was likely the main factor interrupting market festivities. According to the new projection, the majority of voting members expect now the Fed funds rate to be lowered twice this year by 25 basis points. The market had expected more ambitious actions from the Fed, anticipating two 50 basis points cuts in 2024. In our opinion, market pre-positioning is the single most important factor explaining the price actions observed after the interest rate cut. In one word – it was muted. The price action across many financial assets (except for gold) was subdued, with price volatility stable.

Looking at the foreign exchange market, it provided a good reflection of the broader market picture. The US Dollar Index (DXY) advanced by 0.90% - the smallest move seen since June. Despite the main contributor, the USD/JPY cross, moving by 2%, the other basket components' advances were far more contained. While monetary policy and fundamentals affected valuations in September, the technical picture was probably equally important. For the world's main cross, EUR/USD, the 1.1200-1.1220 range efficiently capped upward pressure, while GBP/USD kept failing to break through 1.3450. As for USD/JPY, the 140.00 level was tested but the cross immediately bounced off and moved above 142.00, which in our view should be regarded as the main medium-term support.

Elsewhere, it is worth mentioning that recent developments in the USD/JPY cross offered great support to the Chinese Renminbi, which managed to recover some ground against the US Dollar. Not only did outright valuations move close to the psychological level of 7.00, but the CNH/CNY basis also suddenly moved from a premium to a discount, suggesting large foreign inflows. We see the recent price behaviour as a function of previous bearish speculative positioning and surprise at the aggressive economic support package launched by Chinese authorities.

Looking forward, as mentioned above, the fundamental picture will be closely monitored and should affect short-term price actions. However, the US Dollar's medium-term outlook will depend on geopolitics, predominantly the US elections, which should have a major effect on the US Dollar's fortunes in the last quarter of 2024. Many regard the election results as the 'last straw that breaks the camel's back'. We see the outcome of the White House race as the main factor weakening the US Dollar beyond medium-term support levels.

September Performance vs. USD (%)



Source: CAIM, October 2024.

EQUITIES

SIMON PRICE

SENIOR EQUITY FUND MANAGER

United States

Macro data provides assurances for now

US equity markets reached new highs, driven by growing optimism over a soft landing, due to a pickup in US economic data and a dovish cut of 50bp by the FOMC, which seemed to reassure investors that they would react quickly to any sign of economic deterioration. News of significant stimulus announcements from China further supported sentiment into month end. The early period turmoil saw volatility rise, before declining back to average levels for the period.

In terms of monetary policy, the Fed finally reversed course, delivering a 50bp cut, lowering the fed funds target to the 4.75-5.00% range. This was an 11-1 decision with Governor Michelle Bowman becoming the first Fed Governor to dissent since 2005, favouring instead a 25bp cut. The larger cut came amid a dovish shift to the Fed's inflation and unemployment projections compared to June. The Summary of Economic projections also showed a notable shift in the balance of risks, with a clear majority of the FOMC now seeing unemployment risks weighted to the upside but inflation risks as broadly balanced.

Economic news was generally supportive with headline CPI coming in as expected, with the year-on-year rate the lowest since February 2021. There was an upside to core CPI, but this was largely down to a rise in owners' equivalent rent, which came in at a 7-month high for the month. The US jobs report for August on Friday, was mixed, with the positives that payrolls rebounded in August but the previous couple of months saw payrolls revised meaningfully lower. The unemployment rate retraced some of its prior rise with average hourly earnings increasing alongside a one-tenth increase in the working week.

Turning to corporate earnings, 3Q earnings season begin shortly with reports from the large financials. Expectations for broad market EPS are for growth of 4.7%, which based on the historical pace of surprises, suggest EPS likely grew by 8.5%, with 20% growth for megacap TECH+, but a -20% contraction for Energy. The figure of 8.5% compares with 2Q growth of 11.6%.

Regarding performance, broad equity markets reached new highs with large cap outperforming small cap. At the sector level rotation away from tech and toward some of the index's less-loved groups continued in September as the rates landscape shifted. This meant consumer discretionary and utilities advanced while energy fell the most along with health care and financials. There was limited dispersion at the factor level, with quality the leader, while low volatility and value were laggards.

Europe

China stimulus and potential further ECB cuts mitigate domestic growth

European equity markets saw volatility but ended the month with mild losses as economic growth concerns and lower inflation expectations lead investors to dial up the chance that the ECB would accelerate their rate cuts and move again at the next meeting in October. News that Chinese authorities unveiled a package of larger than expected stimulus measures with rate cuts, mortgage downpayment relaxations and liquidity support lifted sentiment towards beaten stocks and markets leveraged to the region, particularly Europe.

In macro news the drop in EA PMI was larger than expected moving into contraction territory, promoting downgrades in GDP forecasts. Germany remained the weakest link, as growth concerns are accompanied by a slump in the PMI employment index. Meanwhile, country news on inflation hinted at a significant decline in September Euro area headline CPI.

As expected, the ECB delivered a 25bp rate cut, marking their second cut of this cycle after an initial move in June, and markets continue to anticipate further cuts over the months ahead.

In terms of performance, earlier defensive strength on volatility declined thereafter on higher long-end yields and China stimulus. Within Cyclicals, sectors exposed to China on the announced stimulus benefitted but with some notable dispersion. Basic Resources was the top performing sector while Autos the worst after various profit warnings from Stellantis and VW.

Developed Asia

China stimulus supports Hong Kong outperformance

Developed Asian equity market performance was mixed with Hong Kong markets benefitting from a combination of stimulus from Chinese financial authorities and a surprise Politburo meeting call for stronger stimulus. Japan saw losses on JPY strength while there was increased political concerns on the LDP leadership election.

The rally in Hong Kong equities started on Sep 24 after financial authorities' policy combination of rate cuts and lending facilities for equity purchases and buybacks. This was re-enforced by a Politburo meeting calling for stronger housing/fiscal stimulus on Sep 26. Housing policy followed with tier-1 cities removing purchase restrictions by varying degrees.

Japanese equities were lower as JPY strength weighed on exporters while domestic demand sectors were generally in the green. There was some volatility on equities and JPY post Ishiba's victory at LDP election as markets were pricing in a greater chance of dovish candidate Takaichi.

Emerging markets

EM equities significantly outperformed developed markets, driven by several positive macro catalysts. The Federal Reserve commenced its easing cycle with a greater than expected 50bps rate cut, weakening the USD. Leveraging the Fed's move, EM Central banks including China's PBoC implemented comprehensive monetary easing, and the September Politburo meeting caught the market by surprise with its focus on key economic issues and urgent policy action going forward.

At the regional level, EM Asia outperformed MSCI EM, aided by China's stimulus package, which was more significant than expected while CEEMA and LatAm lagged.

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