CAIM | CROWN AGENTS INVESTMENT MANAGEMENT

SEPTEMBER 2024

CAPITAL MARKETS MONTHLY

FIXED INCOME

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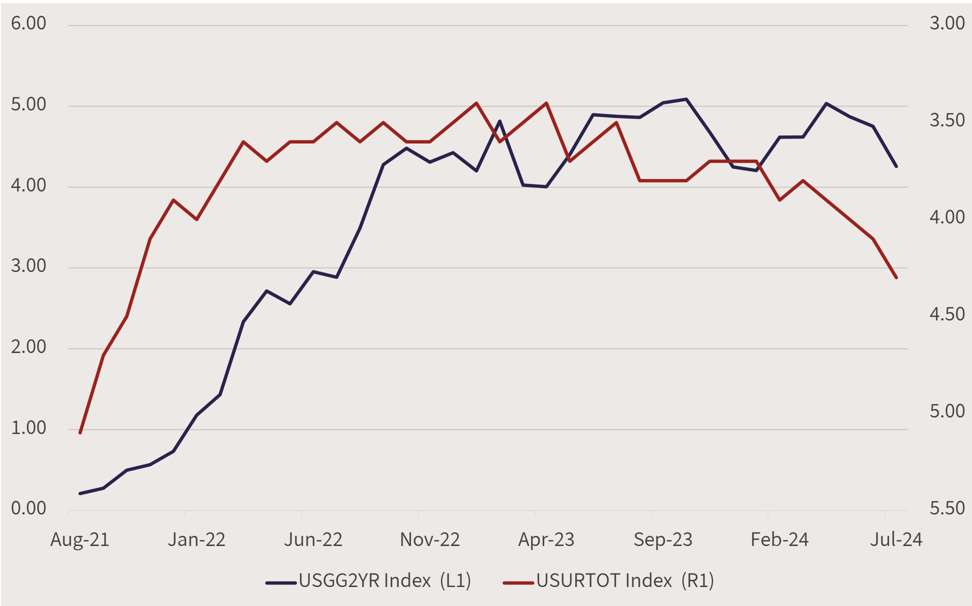
Weaker US Employment Report Builds a Stronger Case for Rate Cuts

Positive price momentum in global fixed income markets continued throughout August 2024. The Bureau of Labour Statistics published their monthly employment report on 2 August, which indicated a substantial slowdown in growth of US employees on Nonfarm Payrolls. The July NFP added just 114,000 jobs (versus a consensus estimate of 175,000) while the June number was revised downwards from 206,000 to 179,000. Additionally, the labour force participation rate increased 0.1% to 62.7% resulting in a material increase to the unemployment rate. The 4.3% UR is the highest since October 2021, and 0.9% above the cycle low (see the chart below). The 'Sahm Rule' recession indicator breached the 0.5% threshold which has previously indicated that the US economy is in the early stages of a recession. This rule states that when the 3-month average unemployment rate increases by 0.5% from the 12-month low then the US economy is in recession. Note, however, that the recent volatility in US employment data may reduce the reliability of this historical relationship.

Markets immediately reacted to this development with an aggressive bull steepening of the US Treasury yield curve. The benchmark 2-year note traded 31 basis points lower in yield, from 4.15% to 3.84%, marking the largest intraday move this year. Interest rate futures moved to fully price a rate cut at the September FOMC meeting. This was later all but confirmed by Federal Reserve chairman Powell's speech at the Jackson Hole Symposium.

US unemployment rate has risen from 3.4% to 4.3% since 2023 Q2



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

During August 2024 there were ten 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 22.55 billion. Generally, issue spread levels versus US Treasuries were very narrow then broadly widened in subsequent trading. This was particularly true of the tier-1 issues from EIB, ADB and World Bank. However, the small USD 300m AIIB long 2-year sustainability bond tightened marginally – although several large blocks remained offered suggesting limited upside for this transaction. Additionally, the USD 2bn AGFRNC issue performed reasonably well with bonds offered around 4 basis points tighter in secondary trading.

Issuer	Maturity	Issue Spread	Rating
Development Bank of Japan	28/08/2027	UST +29bp	A
European Investment Bank	15/11/2029	UST +9bp	AAA
World Bank	28/08/2034	UST +14bp	AAA
World Bank	27/08/2026	UST +7bp	AAA
Asian Development Bank	28/08/2029	UST +10bp	AAA
Asian Infrastructure Investment Bank	15/01/2027	UST +23bp	AAA
International Finance Corporation	28/08/2028	SOFR+31bp	AAA
Export Development Canada	07/09/2027	UST +7bp	AAA
Province of Quebec	05/09/2034	UST +45bp	AA-
Agence Francaise de Developpement	15/06/2027	UST +28bp	AA-

Source: CAIM, September 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.

FOREIGN EXCHANGE

SLAWOMIR SOROCZYNSKI

HEAD OF FIXED INCOME

Market Hopes for a Dovish Fed Send the US Dollar into Reverse

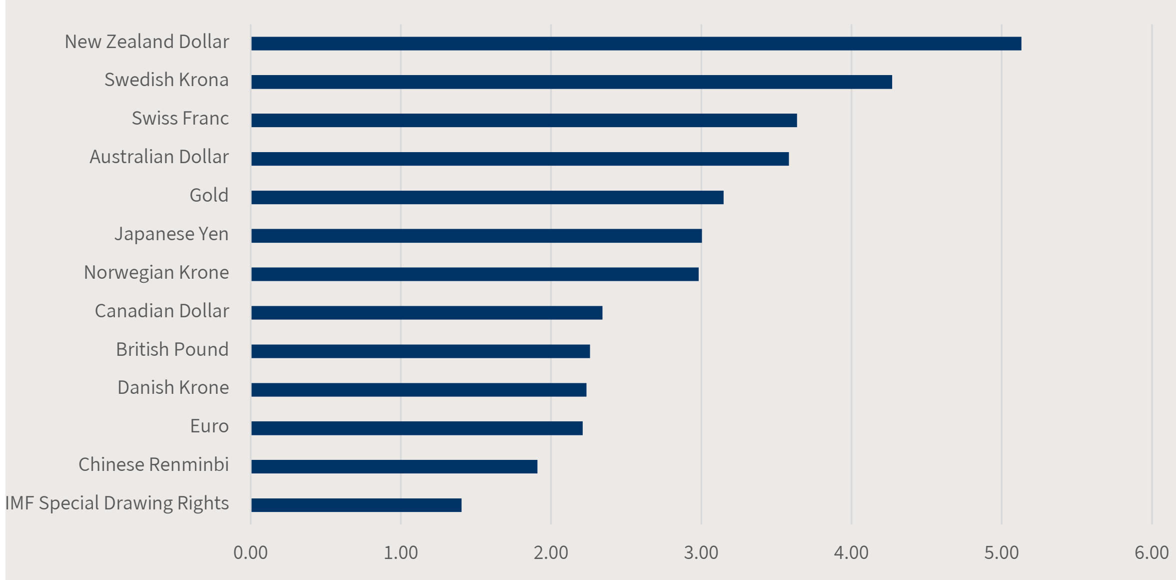
August market events have brought back memories of October 1998, when movements in the Japanese Yen (JPY) gave foreign exchange traders an unforgettable lesson. After a stellar July in which the JPY gained over 7% against the US Dollar, many anticipated a period of stabilization. They couldn't have been more wrong. As we discussed in last month's publication, negative price momentum for the USDJPY pair was building. July's close below the key trend support, defined by the 200-Day Moving Average, forced speculative short-JPY positions to be closed. The low liquidity typical of summer holidays only fuelled panic, driving the USDJPY from 150.50 (July close) to 141.70 in less than 72 hours of trading.

Because the JPY has been widely used as a funding currency for high-beta assets, this led to a frantic reduction in risk exposure. The resulting domino effect spread across the market, pushing the VIX index—a measure of implied volatility in S&P 500 stocks—to 65.00, a level unseen since the COVID crisis. The "earthquake" triggered by the JPY caused most government bonds to fall to new lows, putting the rates market ahead of central banks. However, the panic was short-lived, and it seems that market expectations regarding monetary policy—particularly from the Fed, which is the last G7 central bank yet to begin easing—restored calm, with risk appetite making a strong comeback in the final days of the month.
For foreign exchange markets, August is a month US Dollar supporters will want to forget. The US Dollar index (DXY) fell by 2.5%, making it the worst-performing currency in the G10. It depreciated by over 5% against the New Zealand Dollar and lost 3% or more against the Japanese Yen, Australian Dollar, Swiss Franc, and Swedish Krona. The Chinese Renminbi recovered by 1.90%, turning positive on a year-to-date basis, while gold prices tested $2,500 per troy ounce. (For detailed performance please see the table)

Looking ahead, market expectations regarding central bank monetary policy, reflected in the high valuations of most financial assets, are elevated. Any disappointment on this front could result in significant asset repricing. Furthermore, September and October are historically not favourable months for risk. As a result, we expect further volatility, particularly in the foreign exchange market.

For the remainder of the year, we anticipate the US Dollar will remain vulnerable and have adjusted our May forecasts for end-of-year price targets accordingly. We now expect the DXY index to reach 97.00 (down from 101.00), EURUSD to rise to 1.1500 (up from 1.1200), USDJPY to fall to 142.00 (from 152.00), GBPUSD to reach 1.3200 (up from 1.3000), and USDCNH to drop to 7.005 (from 7.1200).

September Performance vs. USD (%)



Source: CAIM, September 2024.

EQUITIES

SIMON PRICE

SENIOR EQUITY FUND MANAGER

United States

Macro mixed messages plus seasonality promote more questions

US equity markets advanced despite early volatility, with a 6% decline in the first week, in what has to be recognised as an environment of weak volumes and liquidity. Recession fears from a weak manufacturing ISM report and disappointing jobs data, along with an unwinding of the yen carry trade, pushed the VIX to 60 intraday. However, the market rebounded with strong macro data, including retail sales, declining unemployment claims, and a stronger than expected 2Q GDP report. AI growth concerns rose with the Nvidia numbers not meeting high-end expectations, preventing new market highs.

The Federal Reserve left rates unchanged, but Fed Chair Powell hinted at a possible September rate cut, citing progress on inflation and rising unemployment. Powell's speech at Jackson Hole reinforced expectations for rate cuts, with scenarios ranging from zero to several cuts in 2024.

Economic news supported a September rate cut, with soft headline payrolls but modest gains in private payrolls and average hourly earnings. The latest CPI print supported the disinflation narrative, though some concerns remains, such as higher owners' equivalent rent. Easing producer price pressures boosted confidence in future rate cuts.

Corporate earnings generally beat estimates, with revenues, margins and buybacks all contributing positively to YoY growth. While the Big 6 EPS outpaced the market, they surprised less than expected. Nvidia's results slightly beat expectations, but their share price fell as it missed some higher estimates. Revenue outperformance was the smallest in six quarters. Meta saw strong ad revenue growth and better-than-expected Q3 guidance. Amazon's shares slipped due to lower-than-expected Q3 profit guidance, and Intel fell by 19% after a major outlook downgrade and planned job cuts.

Outside technology, Walmart raised its sales and profit outlook for the year, noting robust consumer spending despite a focus on essentials and deals. Home Depot cut its full-year sales outlook, indicating weakening consumer spending strength.

Despite a weak start, broad markets produced positive returns with strong market breadth for the month. Defensives led gains, with Staples, REITs, and Health Care performing well, while energy lagged. Large caps outperformed small caps due to decelerating fundamentals and declining EPS momentum in small caps. Seasonality contributed to increased market volatility, raising questions about the role of cyclical factors and whether central banks can promote stability amid conditions they helped create.

Europe

Some stability in macro plus perceived interest rate cuts aid sentiment

European equity markets like most markets saw increased volatility but ended up in positive territory as the mix of Euro Area growth and inflation data improved, despite 2Q/1H earnings results confirming demand headwinds especially in cyclical and consumer-related sectors, adding some hurdles to the European earnings recovery path.

In macro news the PMIs were noisy, but confirmed growth ex Germany is stabilising, suggesting a services rebound post the drop in June-July, while the EA unemployment rate dropped to 6.4%. On the inflation side, price expectation data from the EC survey still hint at lower domestic price pressures, while negotiated pay growth declined which all assisted in expectations for a further rate cut in September.

In terms of performance, defensives outperformed cyclicals with some notable strength in communication services and healthcare. Within cyclicals, some of the sectors/themes more challenged during the 2Q earning season did well including autos, retail and travel and leisure, while technology and basic resources notably underperformed.

Developed Asia

Hawkish stance from the BOJ sees Japanese underperformance

Developed Asian equity market performance was mixed with Japan underperforming due to the early August correction due to the changes in the BOJ/Fed outlook, the unwinding of the yen carry trade together with fears of US recession in what was seasonally illiquid trading conditions. Hong Kong benefited from resilient second quarter earnings from the large-cap internet names, while the high yielder names benefited from rising expectation of a US Fed rate cut. Sentiment improved late on with reports that China is considering allowing homeowners to refinance cUS$5trn mortgages to lower borrowing costs revived market speculation on stimulus.

Japanese equities saw a bear market correction in early August following a hawkish rate hike by the Bank of Japan together with dovish tones coming from the US which saw the Japanese Yen strengthen to levels last seen in March, at 149.41. The unwinding of the initial volatility following BOJ's Deputy Governor Shinichi Uchida sending a strong dovish signal by playing down the chances of near-term rate hikes, together with stronger US macro data saw a pullback in JPY strength which saw equities recover 70-80% of their declines. Outside of this Japanese Prime Minister Fumio Kishida announced that he will step down next month.

Emerging markets

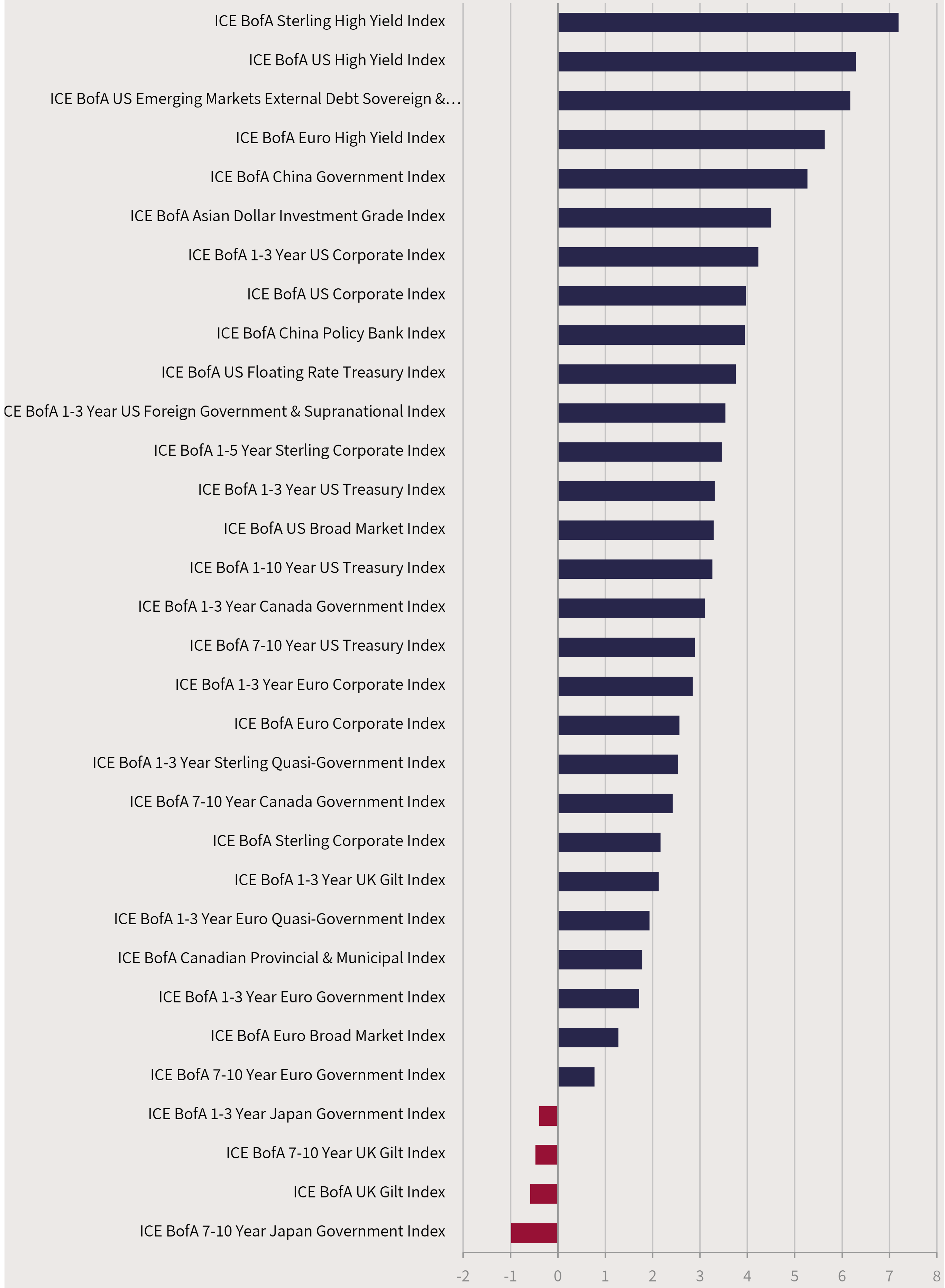
EM equities posted modest gains, slightly underperforming developed markets. Initially there was a sharp equity sell-off driven by the weaker-than-expected US labour market report, raising recession fears, and a surprise hawkish BOJ rate hike that led to a sharp appreciation of the JPY and a carry trade unwind. Despite these initial shocks, EM markets recovered as US recession fears eased with better growth and inflation data, while the declining US dollar provided a tailwind for EM.

At the regional level, LatAm outperformed in August, while EM Asia performed in-line and CEEMEA was flattish.

Market Performance, %	Aug 2024	YTD	12M
Aggregate Bond Indices:			
ICE BofA US Broad Market Index	1.43	3.29	7.35
ICE BofA Euro Broad Market Index	0.45	1.28	5.69
ICE BofA Asian Dollar Investment Grade Index	1.60	4.50	9.37
ICE BofA US Emerging Markets External Debt Sovereign & Corporate Plus Index	2.11	6.17	11.99
Government Bond Indices (1-3 Yrs):			
ICE BofA 1-3 Year US Treasury Index	0.90	3.32	5.88
ICE BofA 1-3 Year UK Gilt Index	0.43	2.13	5.47
ICE BofA 1-3 Year Euro Government Index	0.50	1.71	3.82
ICE BofA 1-3 Year Japan Government Index	0.15	-0.39	-0.36
ICE BofA 1-3 Year Canada Government Index	0.58	3.10	5.85
Quasi Government Bonds (1-3 Yrs):			
ICE BofA 1-3 Year US Foreign Government & Supranational Index	0.94	3.54	6.20
ICE BofA 1-3 Year Sterling Quasi-Government Index	0.47	2.54	6.09
ICE BofA 1-3 Year Euro Quasi-Government Index	0.54	1.94	4.18
Government Bond Indices (1-10 & 7-10 Yrs):			
ICE BofA 1-10 Year US Treasury Index	1.09	3.26	6.26
ICE BofA 7-10 Year US Treasury Index	1.41	2.89	6.07
ICE BofA 7-10 Year UK Gilt Index	0.32	-0.48	7.35
ICE BofA UK Gilt Index	0.53	-0.58	6.87
ICE BofA 7-10 Year Euro Government Index	0.45	0.77	5.60
ICE BofA 7-10 Year Japan Government Index	1.55	-0.98	-0.46
ICE BofA 7-10 Year Canada Government Index	0.75	2.43	7.29
ICE BofA Canadian Provincial & Municipal Index	0.53	1.78	7.66
Investment Grade Corporate Bond Indices:			
ICE BofA 1-3 Year US Corporate Index	0.94	4.23	7.32
ICE BofA 1-5 Year Sterling Corporate Index	0.34	3.46	9.32
ICE BofA 1-3 Year Euro Corporate Index	0.48	2.85	5.57
ICE BofA US Corporate Index	1.53	3.97	9.45
ICE BofA Sterling Corporate Index	0.29	2.16	10.88
ICE BofA Euro Corporate Index	0.30	2.57	7.33
China Indices			
ICE BofA China Government Index	0.16	5.27	6.34
ICE BofA China Policy Bank Index	-0.09	3.95	4.92
High Yield Corporate Bond Indices:			
ICE BofA US High Yield Index	1.59	6.29	12.48
ICE BofA Sterling High Yield Index	1.16	7.19	15.82
ICE BofA Euro High Yield Index	1.17	5.63	11.86
Other			
ICE BofA US Floating Rate Treasury Index	0.32	3.76	5.61

Source: ICE. Performance for the period ending 30 August 2024 (Local Currency, Total Returns).

YTD performance (percent)



Source: ICE, 30 August 2024.