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CAPITAL MARKETS MONTHLY

FIXED INCOME

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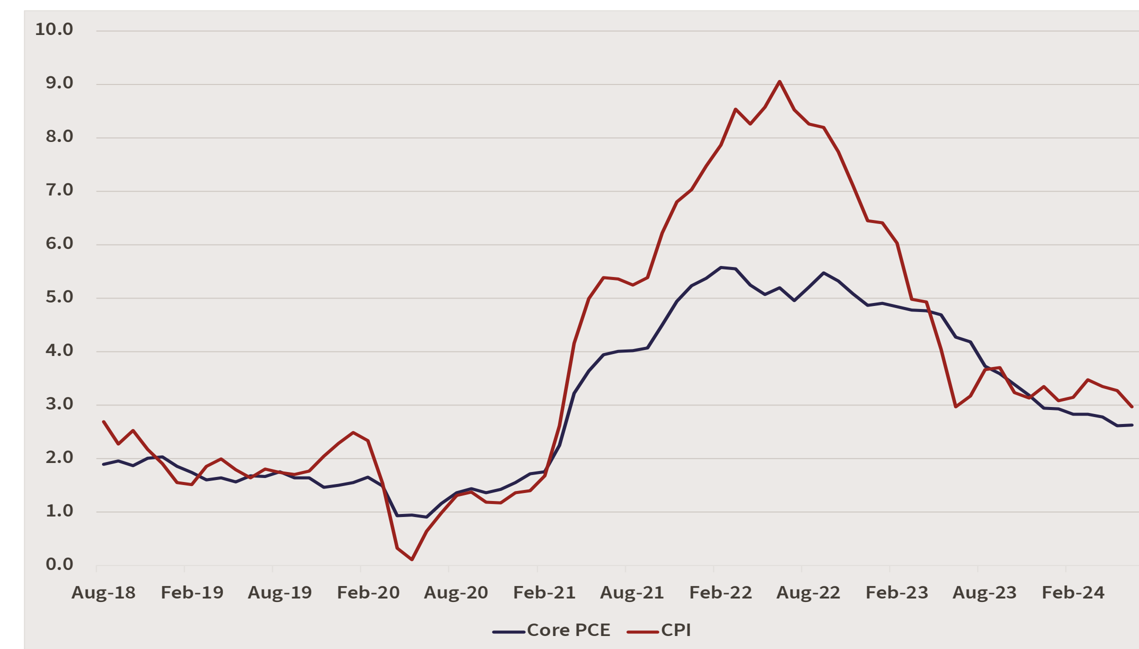
The Global Bond Rally Continues as Inflation Outlook Improves

Global bonds performed strongly in July as yields moved lower in response to further central bank easing and a more benign outlook for inflation. The full duration US Treasury Index returned 2.24% in July, the strongest monthly return so far in 2024. The US Consumer Price Index report, from the Bureau of Labour Statistics, showed that US CPI declined 0.1% last month as both energy and core goods components fell. The inflation measure preferred by the Federal Reserve, the Core PCE Index, remained 0.4% below the CPI at 2.6% y/y. The Bank of Canada cut their Overnight Lending Rate from 4.75% top 4.5% at the July 24 BOC meeting representing their second rate cut since June. The European Central Bank cut rates by 0.25% in June, as we reported last month, and the Bank of England is expected to cut the Target Rate from 5.25% to 5% at their monetary policy committee meeting on August 1.

In the United States, the Federal Reserve's Federal Open Market Committee meeting concluded on July 31. As expected, there was no change to the Funds rate, which remained in the 5.25% to 5.5% range. The interest rate on reserve balances remained at 5.4%. Importantly, there were changes to the FOMC policy statement regarding inflation and unemployment. The statement noted that inflation had eased over the past year but remained 'somewhat' elevated. The inclusion of the word 'somewhat' is a clear signal that the FOMC are taking note of recent improvements to inflation. Similarly, the language around the unemployment rate was amended to sound more accommodative. Additionally, the statement noted that the US economic outlook remain uncertain, and the Fed is attentive to the risks to both sides of its dual mandate. The implications of these changes strongly suggest that the first 0.25% rate cut will commence at the September 18 FOMC meeting.

It should be noted that the Bank of Japan unexpectedly increased interest rates from 0.1% to 0.25% at their meeting on July 31. Additionally, the BOJ announced that their bond purchasing programme will be reduced to around JPY 3 trillion per month, around half the current level. Inevitably Japanese Government Bond yields increased, and the Japanese yen appreciated in value significantly.

US Inflation has fallen materially for both Consumer Price and Core Personal Consumption Expenditure Indices.



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

During July 2024 there were only seven 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 12.5 billion. Generally, fixed rate spread levels versus US Treasuries were very narrow but continued to tighten. The USD 4bn EIB 7-year transaction was prices at T + 11 basis points but tightened to T + 6 basis points in secondary trading. Similarly, the Hong Kong Government USD Bond was expensive, being issued at T + 12bp but tightened by 8 bp. The JBIC 3-year transaction was priced at an aggressive level then widened from T + 23bp to T + 24bp. The Canadian CPPIB appeared to be fair value and its spread versus UST was unchanged. The two floating rate notes issued from World Bank and IADB both tightened by around 1 basis point versus SOFR.

Issuer	Maturity	Issue Spread	Rating
European Investment Bank	10/10/2031	UST + 11bp	AAA
Inter-American Development Bank	17/07/2034	UST + 16bp	AAA
Japan Bank for International Cooperation	22/07/2027	UST + 23bp	A+
International Bank for Reconstruction & Development	15/06/2027	SOFR + 27bp	AAA
Hong Kong Government International Bond	24/07/2027	UST + 12bp	AA+
CPPIB Capital	27/07/2026	UST + 30bp	AAA
Inter-American Development Bank	01/08/2029	UST + 37bp	AAA

Source: CAIM, August 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

No 'Indian Summer' for the US Dollar

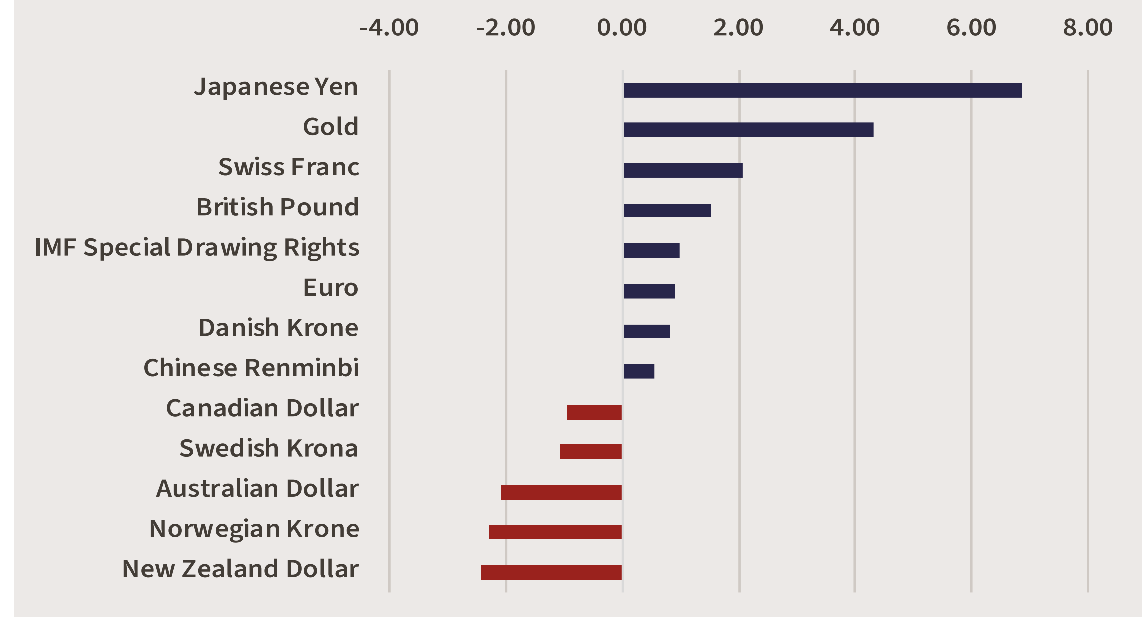
July brought anything but a summer lull. Geopolitical events, sudden changes in the upcoming US elections, central bank actions, and a mix of economic data releases fuelled volatility across various asset classes globally. Dramatic shifts in the Japanese Yen, the primary funding currency, disrupted many leveraged strategies. Investors began favouring fixed income markets, which experienced one of their best months this year, over less hawkish central bank monetary policies. The 'risk-off' sentiment was evident in the foreign exchange market, where traditional 'high beta' currencies retreated, with antipodean currencies suffering 2% losses against the US dollar, while 'safe haven' currencies recorded gains. However, the overall gains and losses within the G10 currencies were moderate (see the chart opposite).

There was one exception – the Japanese Yen, which, after months of underperformance, soared. The Yen gained almost 7% in July, followed by Gold, which advanced 4.5%, and the Swiss Franc, which rose 2%. The Yen started the month above 160 and initially seemed poised to rise towards 170.00. However, this weakness was short-lived. After hitting 161.95 in the first few days, rumours of Bank of Japan intervention helped it reverse course to 157.00, where it found support at the 50-day Moving Average (MA) line. It stayed there briefly before dropping to another support level, the 100-day MA at 155.00. The strong downward momentum led many to recall its behaviour from September 1998, anticipating further declines towards the key trend line at the 200-day MA located at 151.50. Despite initial resistance around 151.70, the Yen rebounded towards 155.00. However, on the last day of the month, the BoJ's decision to increase interest rates by 0.15% (a hawkish move by Japanese standards) caused the USDJPY to plummet over 3%, erasing long-term stops and ending the month at 150.40.

Looking ahead, the downward momentum for the Yen is expected to continue, with key levels to watch at 146.00 (the SVB-related low from January-February), followed by 143.50 and 140.00. Among the currencies that benefited from this USDJPY move, the Chinese Renminbi is noteworthy. The short-Renminbi trade, a popular Yen-related strategy, saw gains. The Yen's July 'victory' was a welcome development for the PBoC, which, despite disappointing political and economic developments, managed to advance against the US dollar by 0.6%, closing the month at 7.22, a level not seen for weeks. We believe that further unwinding of leveraged positions, driven by the USDJPY downturn, will support the Renminbi's recovery and normalize the CNH/CNY basis.

Going forward, we expect other G7 currencies to gain positive momentum against the US dollar. In August, the Jackson Hole conference is likely to fuel volatility and weaken the US dollar, as many anticipate Chair Powell will solidify expectations for the Fed to begin an interest rate-cutting cycle in September. Economic indicators of a slowdown will be closely monitored, alongside the race to the Capitol.

July Performance vs. USD (%)



Source: CAIM, July 2024.

EQUITIES

SIMON PRICE

SENIOR EQUITY FUND MANAGER

United States

Rate cut expectations outweigh positioning and sentiment sell off

US equity markets advanced, with the latest US CPI print surprising on the downside leading to growing hopes that inflation was finally being tamed. This led investors to fully price in a rate cut by the September meeting, which gained greater credibility at the latest FOMC meeting. The prospect of rate cuts saw a strong rotation away from mega cap stocks towards small cap in July. With positioning and sentiment at extreme levels some of this move looks to be an unwinding, rather than fears over fundamentals. Geo-political news came to the fore as speculation turned to reality as President Biden withdrew from the US election and endorsed VC Kamala Harris, while Republican nominee Donald Trump survived an assassination attempt. With all this the VIX index advanced to over 16, marking its biggest monthly increase since March 2023 during the week of SVB's collapse.

In terms of monetary policy, as widely expected, the Fed kept rates unchanged for the 8th meeting in a row. However, Chair Powell clearly, if conditionally, pointed markets in the direction of a September rate cut. While there was "no decision about future meetings", Powell noted that the FOMC started to discuss rate cuts at the July meeting and said that "if do get the data that we hope we get, then a reduction in the policy rate could be on the table at the September meeting"

Macro news for the most part was slightly weaker with headline CPI for June declining month on month, the biggest outright decline in prices since May 2020 during the Covid-19 pandemic. The declines were driven by several factors, but there was a meaningful step lower in shelter inflation. The latest employment report on Friday was mixed with a strong month but the last two months of revisions were negative while the unemployment rate edged up a to 4.1%.

Turning to corporate earnings, we are over halfway through the Q2 earnings season, with over 80% beating EPS estimates, surprising positively by 5%. A breakdown of the earnings indicates, cyclicals like Energy, Materials, Industrials and Discretionary have printed negative earnings growth, while Healthcare, Financials, Tech, Communication Services and Utilities are coming in stronger. Within the financials, money centre banks should see still strong trading revenues on increased volatility. Outside of that the large cap banks see satisfactory fundamentals, with net interest income stable, credit quality metrics normalising while loan growth remains tepid and entities increasing capital ratios, but potentially an improved regulatory outlook. Moving to technology, the mega cap stocks that have reported so far have provided a mixed picture with Microsoft reporting in-line results, but its 1QFY25 guidance was slightly below consensus. However, capex was stronger than expected supporting the AI story. Alphabet did post a modest revenue and earnings beat, boosted by cloud computing and advertising growth, but its shares declined on concerns over capex spend and upcoming expense pressures. Meanwhile, Tesla fell as it missed earnings expectations for a fourth consecutive quarter and delayed its Robotaxi event until October.

Regarding performance, July marked a rotation from large caps, growth, and TECH+ stocks, toward smaller companies, value, and more cyclically oriented sectors. Small cap got a boost from the strong Q2 US GDP report, which was greater than expected and higher than Q1. This pushed back on a building narrative of recent days, which basically implied that the US economy was about to turn sharply lower, and that the Fed needed to cut rates swiftly to prevent that. Given we've had a long run of gains, in many respects that leaves markets more vulnerable right now, as historically it's unusual to see such a prolonged run of gains maintained for much longer. On top of that, equity positioning was already elevated by historic standards, and we're about to enter the toughest part of the year on a seasonal basis, with markets often struggling in the late-summer period.

Europe

Interest rate cuts outweigh some growth concerns

European equity markets advanced as investors believe there will be further interest rate cuts, while political gridlock in France was seen by some as a positive to markets on expectations as it avoided any major policy shifts. In macro news there was limited evidence of a pickup in domestic demand, with Euro Area composite PMI barely above the 50 mark that separates expansion from contraction. While still early in the corporate earnings season, earnings beats have indeed declined as companies are sounding more cautious on the economy.

In terms of the ECB's decision, as widely expected, they left their deposit rate unchanged at 3.75%, but maintained an implicit direction towards further easing after the first cut last month. The statement and President Lagarde's Q&A played down potential hawkish angles, with "one-off factors" cited for the recent inflation uptick while strong wage data was seen as slowing into 2025-26.

In terms of performance mid and small caps outperformed large cap, while at the sector level defensives including Personal care and utilities outperformed, whereas technology and cyclicals including materials underperformed.

Developed Asia

Gyrations over domestic China stimulus remain at the fore

Developed Asian equity market performance was mixed seeing early declines on increasing geo-political risk from US election risks and stimulus concerns from China. A slightly more upbeat sentiment arose late on with the Politburo meeting, which highlighted boosting domestic consumption, addressing overcapacity, and aligning non-economic and economic policy action.

Outside of the uncertainty over the US presidential election Japanese equities were weighed down by the potential impact of a US economic slowdown on exports and the likely negative impact of a strong yen, which promoted overseas selling. At the sector level, performance was strong for defensive sectors and for banks and insurers, which benefited from BOJ interest rate hikes and QT and for sectors with low overseas sales weightings such as construction and real estate. Conversely, sectors with high overseas sales weightings underperformed due to strong yen concerns, including autos and electric appliances.

Emerging markets

Emerging market equities consolidated over the period, resuming its underperformance to developed markets as the lack of stimulus policies in China following the Third Plenum and concern over the rationale for the PBOC's surprise interest rate cuts hurt sentiment. A further headwind was the US election cycle and headlines regarding tariffs and its impact on FX volatility.

At the regional level, CEEMEA outperformed, followed by Latam, while EM Asia recorded losses, hindered by the lack of policy stimulus and the pull-back in the tech rally even as EPS estimates were revised higher.

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