CAIM | CROWN AGENTS INVESTMENT MANAGEMENT

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# CAPITAL MARKETS MONTHLY

# FIXED INCOME

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## Round Trip: US Treasury 3-year note yield is back to where we started the year

US Treasury yields remained somewhat volatile in November as both macroeconomic developments and the US presidential election impacted valuations. Nevertheless, by the end of the month, yields were back to where we started the year.

The Bureau of Labor Statistics released their monthly employment report on 1st November. A combination of industrial action and weather issues materially distorted the change in Nonfarm Payrolls, which collapsed to just 12K – the lowest level since December 2020. The weak headline figure in the employment report initially caused Treasury yields to decline – the benchmark 3-year note yield moved from 4.16% to 4.03%. The United States presidential election on 5th November resulted in a clear win for the Republican party, which was generally regarded as a potentially negative development for US Treasuries. Proposed tax cuts and ongoing budget deficit concerns pushed yields higher and prices lower. The 3-year note yield traded at 4.35% on 15th November, 32 basis points higher than the prevailing level immediately after the employment report.

However, the last week of November proved to be more constructive for the US Treasury market. President-elect Trump's nomination of Scott Bessent, founder of hedge fund Key Square Group, as US Treasury Secretary was widely seen as positive development given his credibility in financial markets and his commitment to maintaining a prudent limit on the budget deficit. Interestingly, as shown in the chart below, the 3-year note yield ended November close to the yield as at the very start of the year.
During November 2024 there were just six 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 8 billion, significantly lower than the previous month. Secondary market performance was mixed.
The two Chinese Government International Bonds were priced at extraordinarily tight levels of just +3bp and +1bp despite initial price guidance of around T + 25bp. Nevertheless, these bonds performed exceptionally well in secondary trading and ended the month at around US Treasuries minus 30 basis points! The two floating rate notes from NRW and IBRD performed poorly. In the case of IBRD, these securities widened by around 10 basis points to SOFR + 38bp. The largest issue was the IDA / World Bank 5-year deal which was priced at T+14bp and remained at approximately this spread level in secondary trading.
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.

### US Treasury 3-year Yield

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

| Issuer | Maturity | Issue Spread | Rating |
|---|---|---|---|
| China Government | 20/11/2029 | UST + 3bp | A+ |
| China Government | 20/11/2027 | UST + 1bp | A+ |
| World Bank | 18/11/2027 | SOFR + 28bp | AAA |
| International Development Association | 27/11/2029 | UST + 14bp | AAA |
| L-Bank | 15/02/2028 | UST + 14bp | AA+ |
| NRW Bank | 02/12/2027 | SOFR + 37bp | AA |

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

# FOREIGN EXCHANGE

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## US Dollar Valuations: Signs of Overextension

November brought the announcement of the new US president, a development that was largely anticipated by the market. Nevertheless, the result bolstered market risk appetite, driving US equities to record highs. Credit spreads in both investment-grade and speculative-grade sectors tightened to levels not seen since the Lehman Brothers collapse over a decade ago.

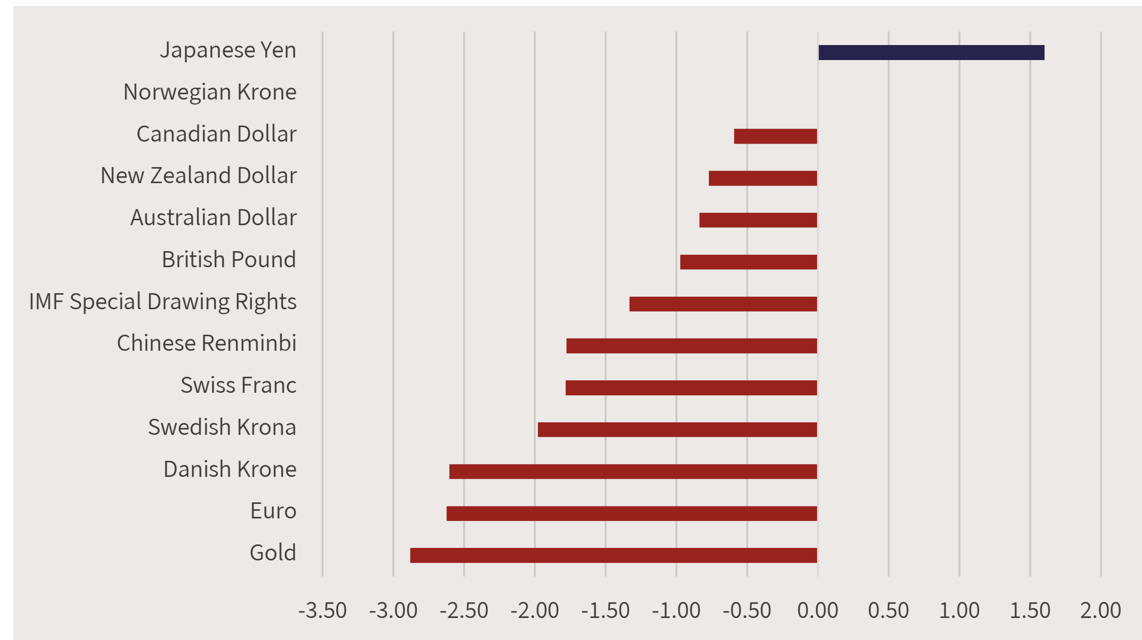
Yields on US government bonds initially rose, exerting upward pressure on US dollar valuations. Meanwhile, demand for traditional safe-haven assets waned. Gold prices experienced a nearly 3% correction, while the Swiss Franc depreciated by approximately 2%. Interestingly, the Japanese Yen was the only traditional safe-haven currency to appreciate in November, a movement we attribute to a correction of its previously overbought conditions in October.

However, the November risk-on sentiment observed across many asset classes was not mirrored in the foreign exchange market. High-beta currencies depreciated against the US Dollar. The New Zealand Dollar and Australian Dollar both declined by 0.8%, while the Canadian Dollar fell by 0.6%. This depreciation can partly be explained by geopolitical factors, including trade tariff threats from the new US administration targeting Canada, Mexico, and China. Additionally, broader US Dollar strength against major currencies contributed to this trend.

Surprisingly, the Euro (EUR) emerged as the weakest currency within the G10 bloc (refer to the accompanying chart for detailed performance comparisons of G10 currencies, gold, and the SDR). The Euro's decline was driven by underwhelming economic data releases and heightened political uncertainty. Events such as Germany's early elections and France's budget crisis added pressure to the EUR/USD pair, which tested a key support level of 1.0350 during the month. Although it recovered to close above 1.0520, many market participants began speculating about the possibility of parity in the near future. This is not our base scenario. We believe much of the negative sentiment has already been priced in, and we anticipate that the new US president's policies could usher in a weaker US Dollar era. For context, during the first Trump administration, the EUR/USD pair climbed from 1.0600 to 1.2100.

Turning to the Chinese Renminbi (CNY), the US election outcome pressured the currency, pushing the USDCNY pair to test the critical resistance level of 7.2500. Looking ahead, we expect the Chinese economy to regain upward momentum, which should strengthen the Renminbi. However, given the prevailing political headwinds affecting the region, we have revised our long-term target for USDCNY from 6.75 to 6.95.

### November Performance vs. USD (%)




Source: CAIM, November 2024.

# EQUITIES

**SIMON PRICE**

SENIOR EQUITY FUND MANAGER

## United States

*Clarity over the election result overwhelms future policy uncertainty*

US equity markets reached new highs as clarity around the US election result of a Red Sweep and the potential for deregulation, tax cuts, and changes in trade, tariffs, and immigration boosted returns. Equity markets were further supported by solid macroeconomic data, with strong business surveys corroborated by Fed Chair Powell. However, there was a slight concern as inflation measures ticked higher, with a hot October core PCE price report following higher readings on CPI and PPI, raising questions about future interest rate policy. Tech EPS surprises rebounded to double digits, providing further support and enabling volatility to decline, which supported sentiment.

Turning to monetary policy, as expected, the Federal Reserve cut rates by 25 basis points, taking the target range for the fed funds rate down to 4.50-4.75%. The language in the FOMC statement was largely unchanged, and Fed Chair Powell avoided sending any signal about the December meeting, emphasizing data dependency. However, the overall tone of the meeting leaned slightly hawkish, as Powell mentioned that recent data pointed to “diminishing downside risks” and that “the economy remains strong.”

Despite the solid macro picture, employment and inflation painted a mixed picture. Nonfarm payrolls grew by just 12,000 in October, marking the weakest growth since December 2020. The number was only positive thanks to an increase in government payrolls, as private payrolls fell by 28,000. The report was impacted by weather-related disruption from Hurricane Milton and recent strikes. However, the previous two months were also revised down, and the three-month average is the weakest of this cycle so far. Turning to inflation, markets were relieved we didn’t get the feared +0.4% print. Nonetheless, it’s the third consecutive core reading rounding to +0.3%, making the three-month annualized rate of core CPI now stand at +3.6% year-on-year, up from just +1.6% three months ago. Core PPI reading was stronger than expected, adding to fears that inflation could remain above the Fed’s target.

Turning to corporate earnings, with most companies having reported, both earnings and sales are projected to set a new quarterly record, with margins remaining high at 11.89%. Forward estimates have held their levels, and each quarter through 2025 is expected to post additional records. The ongoing divergence in EPS growth between Tech (especially Big Tech) and the rest of the S&P 500 was starkly apparent this reporting season, as negative operating leverage made a comeback for SPX ex-Big Tech. Nvidia’s results drew a tepid reaction despite a solid Q3 beat, as its guidance failed to match some of the loftiest expectations. Target had a weak earnings release after cutting its earnings outlook.

Regarding performance, major indices rebounded from the October losses, with small caps, seen as beneficiaries of the Trump presidency, outperforming the large-cap indices. Market breadth was strongly positive, with all sectors showing positive performance, and cyclical groups performing best on a perceived fiscal policy shift and potential further interest rate cuts. Discretionary and Financials delivered the strongest returns, while Health Care, Materials, and Communications rose the least.

## Europe

*Geopolitical headwinds generate investor concerns*

European equity markets consolidated over the period as the combination of the Trump win, potential increased tariffs, and geopolitical concerns in France and Germany created headwinds. In Germany, Chancellor Scholz called for a confidence vote on December 16, with snap elections likely to follow in February as the current coalition has been at odds over the budget and use of the debt brake. In France, there remain serious concerns about the budget situation and a potential government collapse.

In corporate earnings news, Q3 results failed to demonstrate top-line growth due to volume challenges and forex headwinds, except in financials. Technology companies that lowered outlooks saw the largest cuts to their 2025 EPS consensus, dragged by ASML, STMicro, and Infineon, as chip makers signalled demand headwinds will carry into 2025.

In terms of performance, cyclicals continued to outperform defensives, though a rotation into defensives post-PMIs reversed earlier gains. EU Banks ended lower while Financial Services gained, as the former was dragged by Periphery Banks, LatAm exposure in Spain, lower EUR rates, and M&A in Italy, which reverberated on country-level indices. Meanwhile, in Germany, the major indices reacted favourably to the news of upcoming elections on February 23, 2025, as a change in leadership opens the possibility of a pro-growth policy turn and easier fiscal policy.

## Developed Asia

*Potential US trade policies hurt sentiment*

Developed Asian equity market performance was negatively impacted by perceived trade policies following the US election. Hong Kong equity markets declined as the National People’s Congress stimulus package disappointed market expectations due to a lack of direct fiscal stimulus, combined with concerns over potential tariff hikes from Trump’s Red Sweep.

Japanese equities saw volatility, advancing early on due to the risk-on mood following the US election result, the Fed’s additional rate cut on November 7, and robust US economic indicators. However, amid announcements of cabinet appointments for the Trump administration, the market gave back the Trump trade gains due to uncertainty about future US policy and growing concerns about possible additional tariffs and semiconductor export restrictions on China.

## Emerging markets

EM equities had a challenging month, underperforming developed markets. The region faced headwinds from the news of a Trump presidency, increased tariff threats, and a strengthening US dollar. The threats of imposing 25% tariffs on Canada and Mexico, along with a 10% increase for China, further dented already depressed EM investor sentiment. The USD gained an additional 1.7% this month, adding pressure to the EM narrative. All EM regions finished lower, with LatAm underperforming, while EM Asia performed in line and CEEMEA declined the least.

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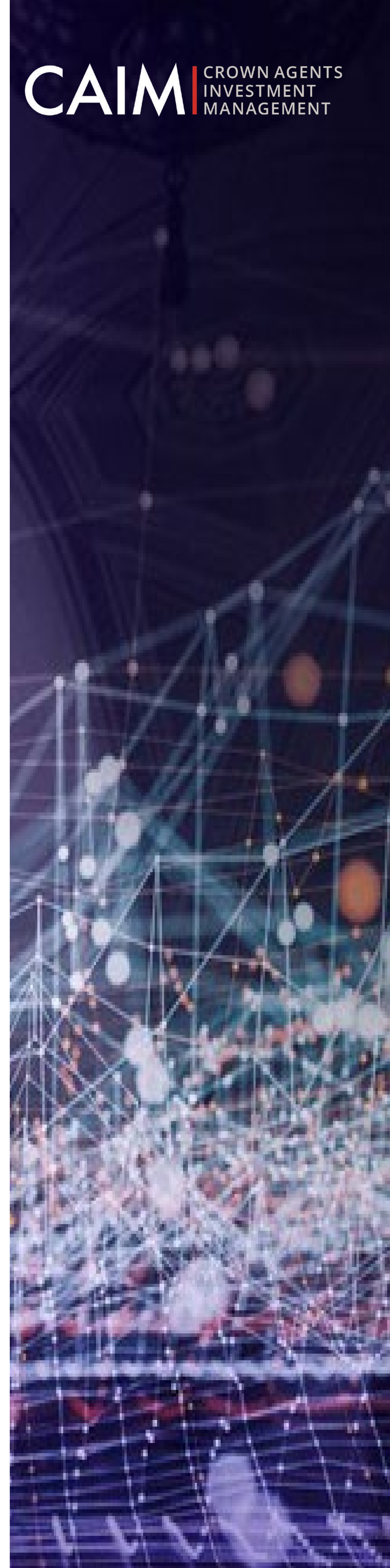


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