CAIM | CROWN AGENTS INVESTMENT MANAGEMENT

JULY 2024

CAPITAL MARKETS MONTHLY

FIXED INCOME

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HEAD OF PORTFOLIO MANAGEMENT

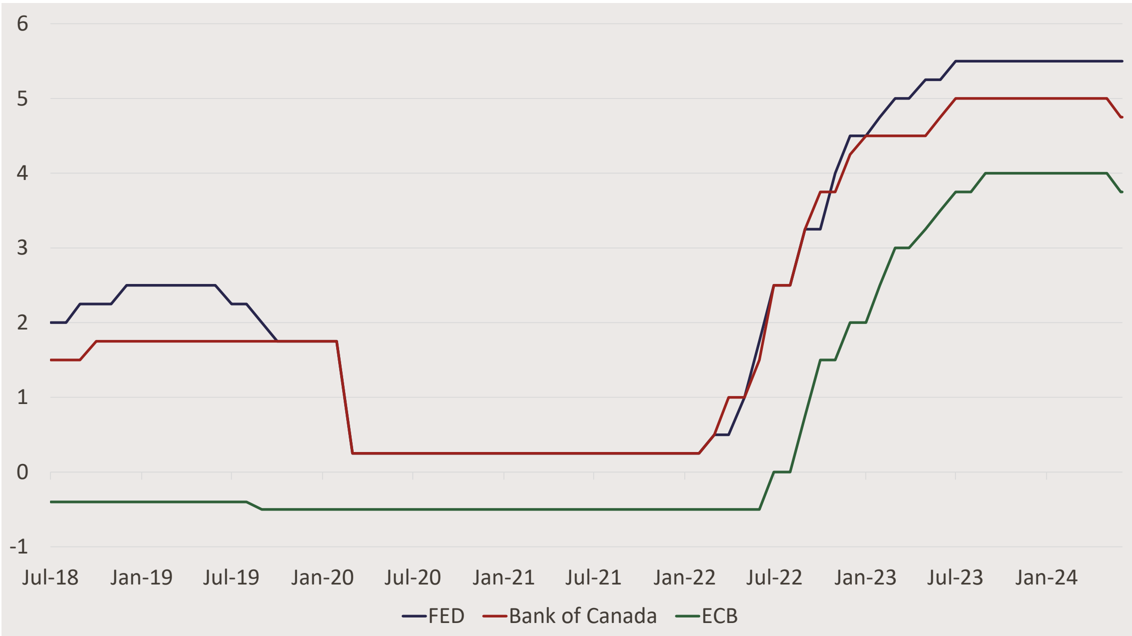
US Treasury yields move lower in June as inflation falls and central banks begin the easing cycle

US Treasury yields ended the month of June 2024 lower than the previous month end despite some significant headwinds from a very robust employment report and a cautious Federal Reserve meeting. This translated into solid index returns as prices increased, adding capital gains to already elevated income rates. The overall US Treasury index advanced by over 1% in June, significantly higher than the return from USD cash interest rates.

The monthly US Employment Report, released on 7th June, showed a very substantial increase in Non-Farm Payrolls of 272,000 compared to a consensus forecast of around 180,000. This initially pushed bond yields higher, and prices lower, as labour market strength is associated with stronger GDP, wages and ultimately inflation. However, the consumer price index data, published on 12th June, showed an unexpected decline in the annual rate from 3.4% to 3.3%, while the core measure (excluding volatile food and energy prices) also declined from 3.6% to 3.4%. Lower inflation provided a strong impetus for a bond market rally, which reversed the negative effects from the employment report data.

Despite a somewhat hawkish amendment to the rate projections at the June FOMC (the new dot plot indicates just a single 25bp cut in the Funds rate by end of this year), optimism around falling inflation allowed the positive price action to continue. Significantly, two G7 central banks began easing monetary policy: the Bank of Canada lowered their Overnight Lending Rate to 4.75% while the European Central Bank followed with a 0.25% cut shortly afterwards.

Both the European Central Bank and the Bank of Canada have started to cut rates. The Federal Reserve is likely to follow later in the year.



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

During June 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 11bn, lower than the previous month. US Agencies and callable SSAs have been excluded from the list. Secondary market price action was anaemic – the Council of Europe USD 1bn 3-year transaction remained at T + 8bp on a mid market basis, allowing for no performance upside. This was a general theme among the tier one issues, except for Norwegian KBN which widened 3 basis points after a highly aggressive initial pricing level. The best performing issues were KDB and Finland, which tightened 2bp and 1bp respectively versus US Treasury yields.

Issuer	Maturity	Issue Spread	Rating
Council Of Europe Development Bank	11/06/2027	UST + 8bp	AAA
International Development Association	11/06/2029	UST + 14bp	AAA
Kommunalbanken	10/09/2027	UST + 11bp	AAA
Province of British Columbia	12/06/2034	UST + 43bp	AA-
Asian Development Bank	20/06/2028	SOFR + 30bp	AAA
Korea Development Bank	26/06/2027	UST + 38bp	AA
Finland Government International Bond	02/07/2034	UST + 16bp	AA+

Source: CAIM, July2024.

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

The US Dollar’s Surprising Recovery Fuelled by External Factors

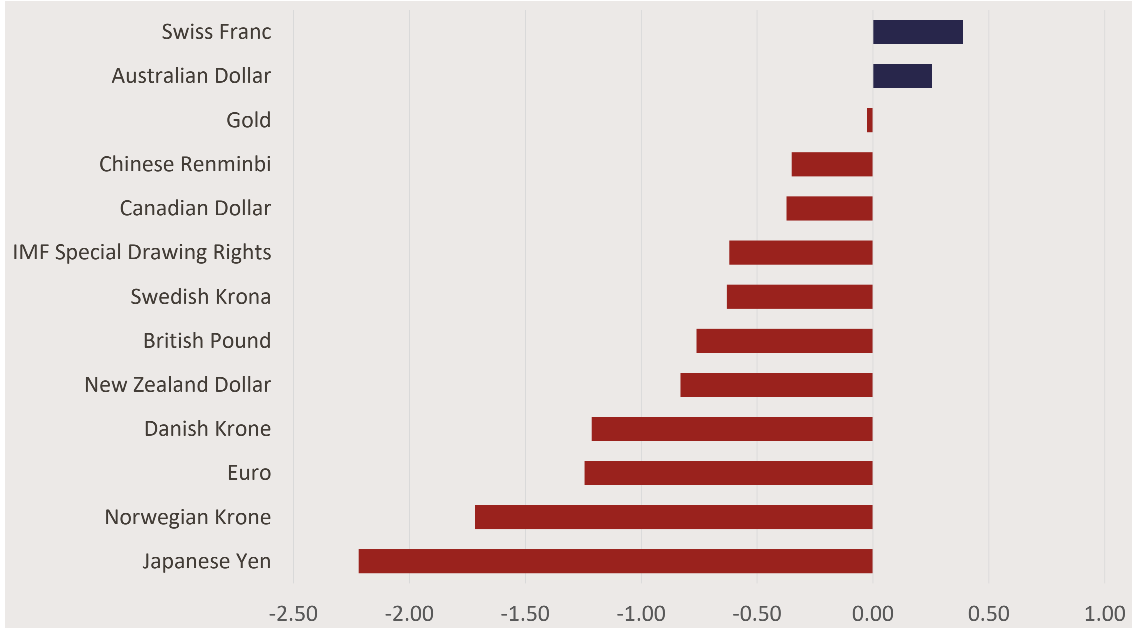
June proved to be a very successful trading month for the US Dollar. The US Dollar Index (DXY) managed to recover most of its underperformance from May. Central bank actions are likely among the key factors fuelling this recovery. The Bank of Canada and the European Central Bank (ECB) decided to lower interest rates, while the Bank of Japan disappointed by maintaining its monetary policy unchanged. Additionally, geopolitical events, such as the French President’s decision to call early elections, fuelled risk aversion. This contributed to the increased relative attractiveness of US Dollar-denominated assets, resulting in higher demand for the US Dollar.

The greenback gained against most of the G10 currencies, with the Australian Dollar and the Swiss Franc being the only exceptions that managed to defend their values. (For detailed performance, please see the chart opposite.) It is worth noting that, despite the US Dollar gaining against most of the G10 FX crosses, the scale of the moves was not dramatic, with the Japanese Yen being a notable exception. The USD/JPY closed the month at 160.88, almost one ‘figure’ higher than the last intervention level. The Yen hit a three-decade low not only against the US Dollar but also the Australian Dollar. Its weakness has been a key headwind for the People’s Bank of China’s FX policy. The PBoC has recently supported the value of the Renminbi, but its fixing mechanism uses the Japanese currency as one of its key basket components. Hence, any devaluation pressure on the JPY has had an indirect negative impact on the Renminbi.

With the USD/JPY breaking above the 160.00 level, it is very difficult to predict the top for the cross. The market now seems to be more focused on the timing of the next intervention rather than the absolute level at which the BoJ decides to intervene. Many expect the next US holiday (the 4th of July) to be the intervention day. However, it is worth mentioning that the market is prepared to continue the ‘fight’ with the Japanese authorities. Unless there is a dramatic change in the BoJ’s monetary policy or a joint effort by central banks to prop up the Yen’s value, a quick turnaround in the Yen’s fortunes is very unlikely.

As for the other G10 currencies, the EUR/USD managed to recover and closed the month very close to its key technical level of 1.0720. The unexpected and, to some, shocking developments in France seemed to have a very limited impact for now. It feels like the political developments in the USA, particularly the first presidential debate between Mr. Trump and President Biden, helped investors adopt a more wait-and-see strategy regarding the EUR/USD cross. Going forward, our main scenario is for the EUR to strengthen and for the EUR/USD cross to move towards 1.1200 by the end of the year. However, the political landscape in Europe should now be regarded as a short-term disturbance. Any further negative surprises from France can put downward pressure on the EUR/USD cross, with 1.0650 serving as the first strong support level, followed by 1.0500, which is seen as the key level for the cross to maintain its upward momentum. As for resistance levels, the key one to watch is located at 1.0800, where the short, medium, and long-term moving average lines cross.

June Performance vs. USD (%)



Source: CAIM, June 2024.

EQUITIES

SIMON PRICE

SENIOR EQUITY FUND MANAGER

United States

Markets reach new highs but market breadth narrows

US equity markets advanced, reaching new highs with the soft-landing scenario gaining greater credibility on reasonable growth and slowing inflation. Investors focused on the headline figure of the CPI data, with core inflation at the slowest since August 2021, leading investors to dial up the chance that the Fed would still cut rates twice this year. Later, the Fed was then a bit more hawkish than expected, and only pencilled in one rate cut over the rest of the year. Market breadth became narrower with the AI theme coming to the fore, with Nvidia for a brief time becoming the largest company in the world, while the equal weighted and small cap indices declined.

In terms of monetary policy, while the FOMC kept rates unchanged, they struck a more hawkish tone than had been expected, with the dot plot now pointing to just one rate cut over the rest of 2024, having signalled three cuts back in March. Alongside that, the median dot for 2025 was up by 25bps as well, and the longer-run estimate of neutral moved up to 2.75%. The inflation forecasts were also revised up a bit for this year and next, while Chair Powell downplayed the CPI print earlier in the day as only one data point and highlighted the solid performance of the economy and the labour market.

Macro news for the most part reinforced the soft-landing scenario, with the inflation data providing the Federal Reserve with a favourable picture. The latest payroll data highlighted a stronger than expected headline figure together with a 0.4% gain in average hourly earnings a tenth higher than expected. The household survey did contain a surprise tenth of a percent increase in the unemployment rate to 4.0%, the highest since November 2021.

Corporate earnings have been a support for markets and quarter two earnings will start shortly. Estimates suggest growth of 8% year on year, the strongest period since 22Q1 for earnings with tech+ and energy expected to report the fastest growth, while materials and telecommunications, the slowest.

Regarding performance, markets continued the momentum from May, however market breadth declined with five sectors in positive territory but only three outperforming the market. Information Technology outperformed aided by strength in semiconductors while energy was a laggard on weaker crude prices. In terms of market cap, small cap reversed its recent outperformance, underperforming large and mid-cap indices.

Europe

Political uncertainty in Europe usurps the Central Bank move

European equity markets declined as political risk rose, as French President Macron called for snap legislative elections after his party trailed in the European Parliamentary (EP) elections, which usurped news that the ECB became the latest central bank to cut rates this cycle.

In terms of the ECB's decision, the rate cut itself was widely expected, so didn't come as much surprise to markets. However, there were some hawkish themes, including they actually upgraded their inflation forecasts for 2024 and 2025. On top of that, in the press conference President Lagarde comments created skepticism from investors that this would kick off a rapid series of rate cuts.

In terms of sectors and themes, political risk impacted French Domestics, with French Banks down 13%, against the backdrop of recent jitters around their public finances, and it was only at the end of May that S&P downgraded France's sovereign credit rating from AA to AA-. Weakness was also seen in materials and basic resources, on metal price declines, whilst Technology and Healthcare were the standouts in Europe. Whilst at the factor level Momentum extended its YTD lead, while the laggard in June was Enhanced Value.

Developed Asia

Weakening currency a positive for Japanese earnings

Developed Asian equity markets were mixed with Japanese markets benefiting from a weaker currency/potential future BOJ activity while Hong Kong declined amid a lack of conviction about the profile of China's economic recovery.

Japanese markets advanced in local currency but saw volatility, with the revised Q1 GDP slightly better than expected but still negative, and the JPY restarting its decline supporting exporters. Funds flowed mainly into the bank and insurance sectors in anticipation of higher interest rates due to rising long-term interest rates and yen depreciation.

Hong Kong markets declined amid lack of conviction about a pickup in China's economic recovery. The latest set of macro data showed a deceleration of profit growth for industrial companies, falling foreign direct investment and declines in home prices. Anecdotal evidence highlights overseas investors pulling circa US$5 billion out of Chinese onshore stocks in June, the largest monthly outflow since October.

Emerging markets

EM equities posted a gain in June, outperforming developed market indices on the back of the AI driven Tech rally, driven by strong performance in Taiwan and Korea together with the post-election strength in South Africa and India. On the flip side, Mexico sold-off post elections on political concerns. An interesting observation was that that the region rallied against dollar appreciation, which is typically associated with weaker EM equities.

EM Asia and CEEMEA outperformed MSCI EM, while LatAm lagged, with the Mexican Peso depreciating by -7.1% on concerns over the anchoring of spending programs that could jeopardize public finances and curb future investments.

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