CAIM | CROWN AGENTS INVESTMENT MANAGEMENT

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CAPITAL MARKETS MONTHLY

FIXED INCOME

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Bond yields rise as economic outlook improves and deficit concerns remain

US Treasury yields increased significantly last month pushing bond prices lower. The Bureau of Labour Statistics released their monthly employment report on 4th October, which showed a very robust 254K increase in Non-farm Payrolls. This surprise recovery in employment growth, following several months of disappointing payroll growth, had a major impact on the US Treasury yield curve. The benchmark 2-year Note yield increased from 3.5% in late September to 4.0% after the employment report. For the remainder of the month yields continued to drift higher, reaching 4.2% by the end of October. This substantial repricing of the 2-year Note yield impacted the return of fixed income indices. The US Treasury 1-3 Year Index returned -0.59% in October, which was the weakest monthly performance since February 2023.

Longer dated US Treasuries also repriced as yields increased by around 50 basis points. This translated to a monthly return of -2.5% for the ICE Bank of America US Treasury Index.

The expected path of short-term interest rates was also materially revised last month. In early October, futures markets implied around 75 basis points of rate cuts by year end. By the end of the month this had been revised to around 40 basis points suggesting a 25bp cut at the 7th November FOMC meeting and a 50% probability of a further rate cut on 18th December.

The upcoming US Presidential election on 5th November may have material implications for the Treasury market. A Harris victory would generally be viewed as a positive outcome for the Treasury market whereas a Trump led Republican administration would like lead to higher inflation, via tariffs, and increased Treasury supply to fund tax cuts.

The following chart shows the backup in 2-year US Treasury yields from 3.5% to 4% in October, along with the upper band of the Fed funds rate.

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

During October 2024 there were seventeen new issues from Sovereign, Supranational and Agency borrowers in USD with amount outstanding of at least USD 250m, credit rating at least BBB- and maturity between 1 and 10 years. The total amount issued was USD 21.7 billion. Secondary market performance was generally strong as spreads tightened. The USD 1.75bn Canadian Pension Plan 3-year issue and the USD 1bn Finish Municipality Finance 5-year bond performed well, tightening 3bp and 6bp respectively. The Export Import Bank of China 3-year FRN was priced at a ridiculously expensive SOFR +38bp compared to initial price guidance of SOFR +80bp. Inevitably, these securities did not perform well in secondary trading.

Issuer	Maturity	Issue Spread	Rating
CPPIB	08/10/2027	UST + 21bp	AAA
Kuntarahoitus Oyj	09/10/2029	UST + 16bp	AA+
Nederlandse Financierings	10/10/2029	UST + 15bp	AAA
Kazakhstan Government International Bond	09/04/2035	UST + 88bp	BBB-
World Bank	16/10/2029	UST + 9bp	AAA
ISDB	15/10/2029	UST + 19bp	AAA
Korea Development Bank	16/10/2027	UST + 37bp	AA
Sharjah Sukuk Program Ltd	17/04/2035	UST + 140bp	BBB-
Nederlandse Waterschapsbank NV	16/10/2026	UST + 14bp	AAA
Export Finance & Insurance Corp	23/10/2029	UST + 15bp	AAA
Korea Land & Housing Corp	22/10/2027	UST + 55bp	AA
Landeskreditbank Baden-Wuerttemberg	22/01/2027	UST + 9bp	AA+
International Finance Facility for Immunisation	29/10/2027	UST + 21bp	AA
Kommuninvest	01/07/2026	UST + 12bp	AAA
Export-Import Bank of China	05/11/2027	UST + 38bp	A+
Svensk Exportkredit	05/05/2027	UST + 35bp	AA+
New Development Bank	07/11/2027	UST + 53bp	AA+

Source: Bloomberg Finance L.P., as at November 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

The market has already voted for the new US President

October brought a dramatic change of fortunes for the U.S. Dollar, reversing its downward trend from the summer months. The U.S. Dollar emerged as the best-performing G10 currency, depreciating only against gold. Several factors contributed to this strong performance:

1. Interest Rate Differential: U.S. yields experienced upward pressure as the market adjusted its interest rate path from four to only two 25 basis point cuts this year.
2. Stronger Economic Data: Better-than-expected economic data fuelled a more optimistic forecast for the U.S. economy.
3. Presidential Election Polls: Polls suggested that the Republican candidate, Donald Trump, might become the next U.S. president, which the market linked to a stronger U.S. Dollar.

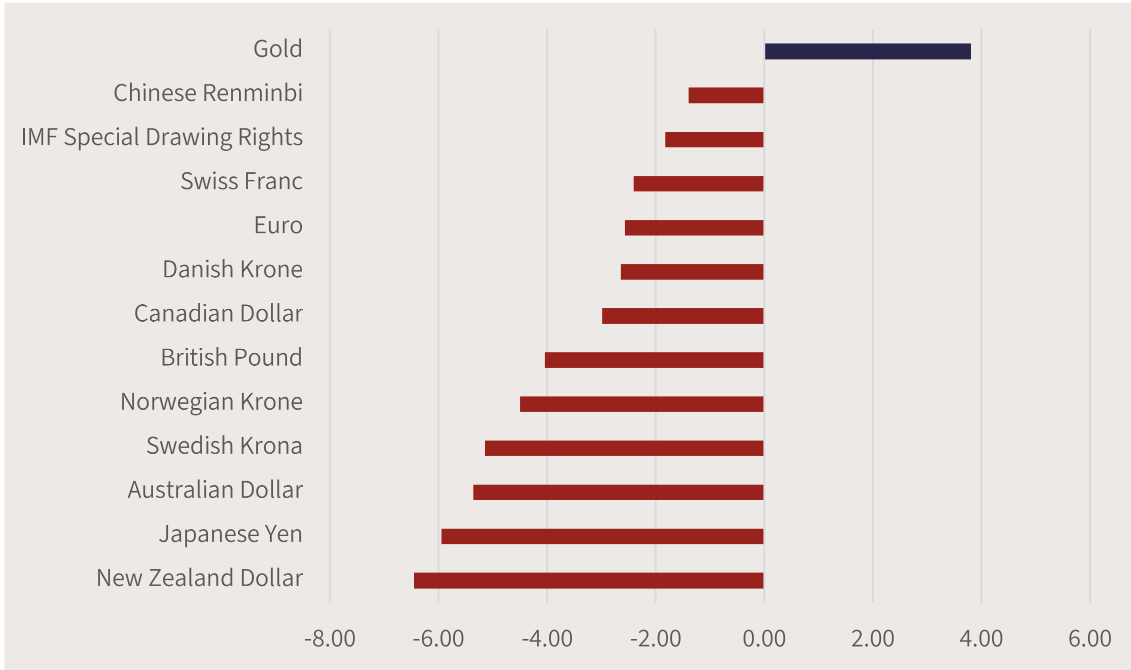
Additionally, the technical picture provided extra momentum to the U.S. Dollar. The U.S. Dollar Index (DXY) had been in a clear downward trend since late June, moving from 106.00 to the 100.00 area by the end of September. This 100.00 level offered strong psychological support, helping the DXY move towards 102.00 in the first week of October. The DXY effortlessly broke through the first resistance defined by the 50-day Moving Average line, and the strong upward momentum carried it through the 100-day and 200-day Moving Average lines. As a result, the DXY managed to recover most of its summer underperformance, closing October at 104.00. The U.S. Dollar performed particularly well against the Japanese Yen. The new Prime Minister expressed clear support for the Bank of Japan's wait-and-see monetary policy, which seemed to invite 'old carry players' to sell the Japanese Yen en masse, pushing the USD/JPY cross above the 150.00 level. The USD/JPY technical picture closely mirrored the DXY, moving from deeply oversold territory in August to an overbought zone.

Looking ahead, from a global capital flow perspective, the Yen will likely remain the most volatile G10 currency. The Euro lost 2.5% against the USD, with the market pushing it from the 1.1000-1.1200 area back inside the old trading range of 1.0780-1.0900. The British Pound experienced a deeper correction, shedding over 4% against the USD, largely due to market concerns about the government's fiscal plans. Traditional high-beta currencies suffered the most, with the New Zealand Dollar depreciating by almost 6.5%, making it the worst-performing G10 currency in October. The Australian Dollar and the Nordic currencies depreciated by an average of 5%.

Regarding the Chinese Renminbi, the September euphoria fuelled by large foreign capital inflows into the Chinese equity market evaporated, pushing the Renminbi back towards 7.15, a level that raised concerns from the PBoC. Initially, the CNY/CNH basis widened, but once the USD/CNH cross tested 7.15, it narrowed, closing the month near parity.

Looking forward, with market expectations for the Fed to deliver 25 basis point cuts in November and December, the U.S. election will likely be the most important factor affecting market valuations. Our preferred scenario is for the U.S. Dollar to weaken, with September's levels serving as initial targets.

November Performance vs. USD (%)



Source: CAIM, November 2024.

EQUITIES

SIMON
PRICE

SENIOR EQUITY FUND MANAGER

United States

US: Doubts over interest rates halt market advance

US equity markets reached new highs, buoyed by upbeat economic data, but then declined, losing ground for the first time in six months. A notable sell-off on the last day of the month, amidst disappointment in some big tech earnings, combined with positive macro data surprises that alleviated fears of a sharper downturn, led investors to reduce the likelihood of rapid rate cuts. Fiscal policy risks also came back into focus globally, particularly with the upcoming US election in November, while geopolitics was in the spotlight due to events in the Middle East.

Economic news was generally supportive, with 3Q GDP growth at 2.8% q/q annualized and robust September retail sales. September payrolls were strong, while the unemployment rate declined by a tenth to 4.1%. Investors grew more concerned about inflation, with the headline rate stronger than expected. However, what concerned investors more was the core CPI number, which came in at a monthly +0.31% in September, pushing the year-on-year number up to +3.3%.

Turning to corporate earnings, at this stage of the Q3 earnings season, reported earnings are higher than forecast at the end of the third quarter, with both EPS and sales surprises above average. Banks saw particularly strong performance with supportive NII, mixed trading revenue trends, but strong recovery in investment banking and strong wealth management-related fees, and generally stable capital ratios. Turning to the Magnificent 7 group, it is a more mixed picture: Alphabet delivered solid sales and earnings beats amid strong cloud computing growth. Amazon also shone as its high-margin businesses continue to drive greater profitability while continuing to invest. Tesla provided strong guidance on deliveries in 2025 and margins. Apple, while delivering record revenue for the September end, surprised with soft Q1 2025 guidance, highlighting that the AI solution will take time to materialize. Microsoft delivered an upbeat Q3 performance but announced a weaker forecast for cloud revenue growth, while Meta's narrow beat was overshadowed by its warning of still rising losses from its Reality Labs division, which focuses on AI and augmented reality.

Regarding performance, with major indices down for the month, small caps underperformed large-cap indices, while market breadth also declined. At the sector level, Financials outperformed on positive EPS momentum and expanding multiples as several big banks posted positive earnings surprises. The only other sectors with positive returns for the month were Communication Services, where positive EPS momentum overcame multiple contraction, and Energy, where positive multiples narrowly exceeded negative earnings. On the negative side, defensives, including Healthcare and Consumer Staples, underperformed.

Europe

Europe: Growth concerns and US election uncertainty hinder sentiment

European equity markets ended lower as macro data was mixed, and increased odds of Trump winning the US election raised the risk of trade tensions next year.

In macro news, 3Q GDP surprised positively against expectations, while the Euro Area composite PMI fell into contractionary territory for the first time in seven months. Inflation continued to fall, dropping below the ECB's 2% target for the first time in over three years.
As expected, the ECB delivered a 25bp cut in their deposit rate, taking it down to 3.25%. The move was widely expected, but it's the first back-to-back rate cut of this cycle, as they previously moved at a quarterly pace in June and then September.

European 3Q results have so far failed to show accelerating earnings growth, with persistent demand pressure and currency headwinds pushing recovery expectations into 2025. In terms of performance, semiconductors underperformed following ASML's results, with the company reporting Q3 bookings of EUR 2.6bn, around half of what analysts expected, and lowering its 2025 guidance amid more cautious demand for its advanced chip-making equipment and more restrictions on where it can export. Consumer products were hurt by disappointing results from luxury giant LVMH, as weaker demand in China saw the company's key luxury unit post its weakest revenue growth since the early phase of the Covid pandemic. Banks did relatively well amid robust earnings delivery and higher yields.

Developed Asia

Developed Asia: Japan continues to experience high volatility

Developed Asian equity market performance was mixed in October, with Japanese markets gyrating but ending up in positive territory, while Hong Kong markets corrected as stimulus specifics disappointed, and the Trump trade set in with higher tariffs promoting higher inflation with consequent higher-for-longer state.

Japanese equities saw volatility initially falling and the yen appreciating on worries about financial income taxation and fiscal tightening by the new Ishiba administration following the LDP presidential election on September 27. Japanese stocks then rebounded slightly as US interest rates stayed high and the yen started depreciating, against a backdrop of receding expectations for major rate cuts by the Fed due to strong US employment data. The main event in the second half of the month was Japan's Diet Lower House election on October 27. Japanese stocks fell despite the yen weakening as election day approached due to concerns over the ruling coalition (the LDP and Komeito) losing their Lower House majority. The ruling coalition duly lost its majority in the election, but Japanese stocks rebounded toward the end of October on further yen depreciation and a rebound in semiconductor stocks in response to firm US economic indicators, as well as stronger expectations for fiscal expansion and continued monetary easing owing to a possible alliance between the ruling coalition and the Democratic Party for the People. Investors slightly favoured external demand-related sectors as the yen returned to a depreciation trend, and the likes of autos, transportation equipment, and machinery performed strongly.

Emerging markets

EM equities declined, significantly underperforming developed markets. The combination of a potential Trump presidency, with higher tariffs, together with China's rally stalling as policy announcements underwhelmed, promoted the headwind of a gain in the USD.

At the regional level, CEEMEA declined the least, EM Asia performed in line, while LatAm underperformed.

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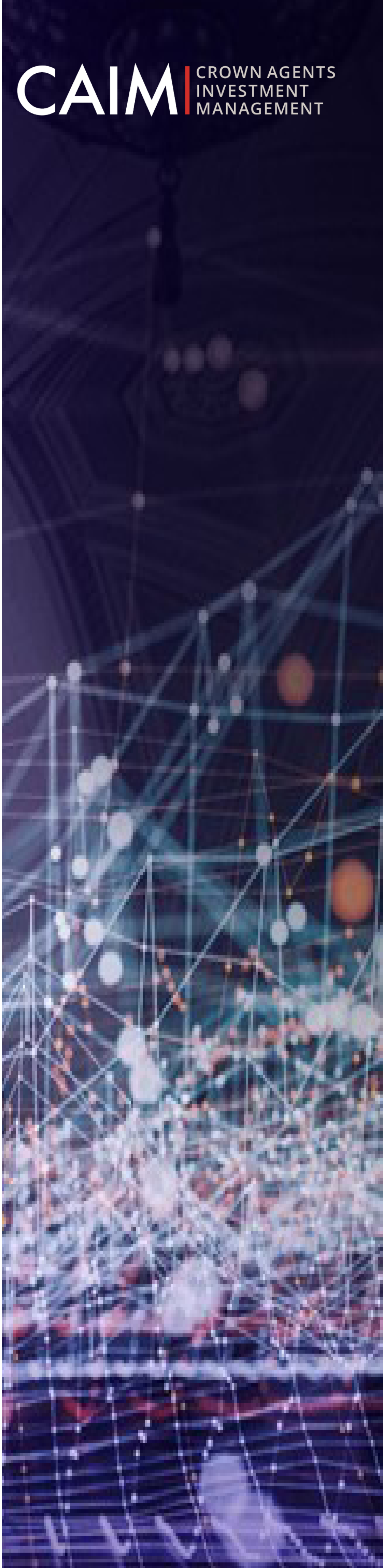

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