Alpha Beta PARTNERS

INVESTMENT UPDATE

APRIL 2024

FOR PROFESSIONAL INVESTORS ONLY

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The first quarter 2024 has been positive for investors in Alpha Beta Partners portfolios. March witnessed some important milestones – the Bank of Japan raised interest rates for the first time in 37 years and the Swiss National Bank effectively kicked off the all-important interest rate cutting cycle for other developed market economies with a 0.25% easing. At home, inflation surprised on the downside for once, pleasing domestic markets. Broader implications for investors and drivers for our investment strategy are discussed in some detail in the update that follows. Let's dive in.

Treasury issuance and demand remains positive. The recent downward trend in yields has been held up by inflation which is stubbornly refusing to fall below the 3% level.

US treasuries ended March where they began, yielding around 4.2%. Treasury issuance and demand remains positive. The recent downward trend in yields has been held up by inflation which is stubbornly refusing to fall below the 3% level. Core inflation in America has certainly plateaued with housing costs in particular refusing to subside.

This was borne out in the end of month Producer Prices data which acts as a leading indicator. The journey lower will be a grind, as we have set out before. Implications for US interest rate policy was made clear by the Federal Reserve – we can still anticipate 3 cuts in 2024 but the likelihood of further easing in 2025 is far from certain.

The chart below shows US interest rate probabilities.

CME FEDWATCH TOOL - MEETING PROBABILITIES									
MEETING DATE	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550
5/1/2024				0.0%	0.0%	0.0%	0.0%	0.9%	99.1%
6/12/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.6%	62.3%	37.1%
7/31/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.2%	21.0%	54.0%	24.8%
9/18/2024	0.0%	0.0%	0.0%	0.0%	0.1%	13.5%	42.1%	35.3%	8.9%
11/7/2024	0.0%	0.0%	0.0%	0.0%	5.3%	24.6%	39.5%	25.1%	5.5%
12/18/2024	0.0%	0.0%	0.0%	3.6%	18.2%	34.6%	29.9%	12.0%	1.8%
1/29/2025	0.0%	0.0%	1.6%	10.1%	25.5%	32.5%	21.9%	7.5%	1.0%
3/19/2025	0.0%	0.9%	6.2%	18.5%	29.3%	26.7%	14.0%	3.9%	0.5%
4/30/2025	0.3%	2.8%	10.7%	22.4%	28.4%	22.1%	10.4%	2.7%	0.3%

Source: CME Fedwatch

As at 3 April 2024

The promise of lower interest rates coupled with a Presidential election are reasons enough for US markets to feel more optimistic. Supplementary to the positive narrative we can add solid economic growth, a robust labour market which drip feeds money into credit card spending via optimistic consumer confidence. All of this is important but is overshadowed by the ample liquidity supporting risk assets. Liquidity is the essential lubricant for the risk asset engine to run smoothly and thus to power portfolios higher. The issuance of shorter dated Treasury Bills has been ongoing, and we expect a resumption following the Quarterly Refunding Analysis at the end of April. This debt issuance does not inflate the Fed's balance sheet further whilst the steady erosion of the defensive Reverse Repo facility adds further to positive sentiment and available liquidity.

We expect Quantitative Tightening to be tapered back later this year, adding a further positive stimulant. The Dollar Index has fallen lower over recent months, which is supportive of progress, but has remained a little firmer during March. No doubt sticky inflation and uncertainty around longer dated interest rates will be a cause. Industrial commodities and gold have enjoyed a stronger month with the oil price also moving up. The US economy does now appear robust enough to absorb borrowing costs higher than the near zero rates of the past decade or more.

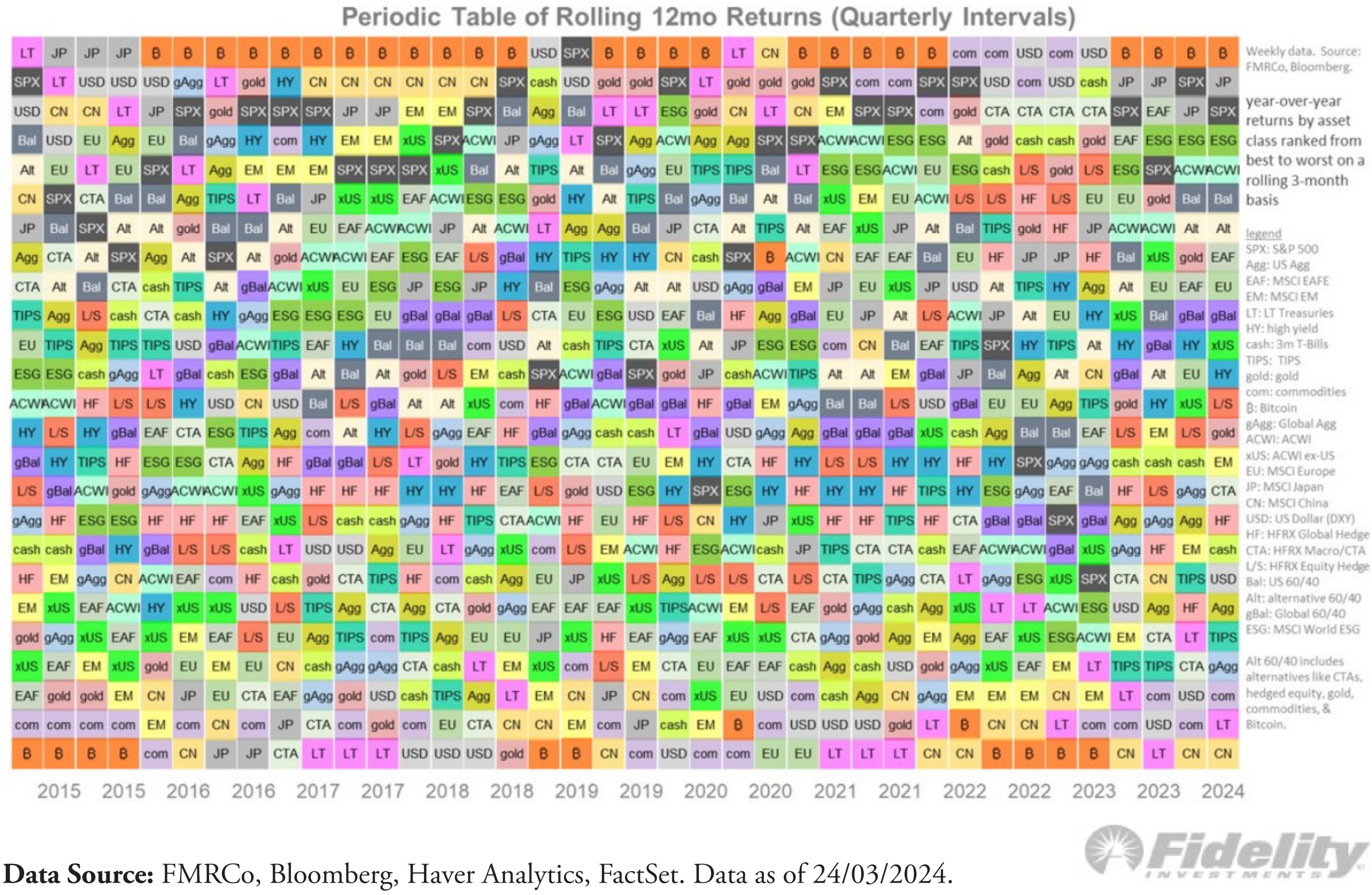
The Federal Reserve stands ready to support banks whose collateral, typically in the form of commercial real estate, has seen a sizeable downward rerating. Of course, risks remain here, and we maintain ongoing scrutiny of important indicators. For now, the equity market rally remains intact with subdued volatility and witnessing a healthy broadening to more cyclical sectors beyond the important realms of artificial intelligence centric giant technology stocks. Using traditional metrics US larger companies, particularly technology firms are undeniably expensive. Corporate earnings have so far proven to be resilient.

Chinese equities and those of the emerging world had a much quieter March and ended the month broadly unchanged, held up by a slightly firmer dollar. We note Chinese demand for copper has spiked dramatically higher – usually an indicator for manufacturing demand. Deflation in China is a real phenomenon and will no doubt open the gates, supported by a weaker Yuan, to a flood of cheap exports impacting western markets.

We have observed the progress of Chinese battery electric vehicle manufacturers now able to construct products for as little as $5,000 before adding their mark up to around $11,000 and exporting to western markets which will no doubt double the price with duties, tax, and profits. Yet when compared to locally manufactured products the Chinese cars will turn heads based on price alone.

After a protracted 37 years, an end to Japan's negative interest rate policy did little to boost the Yen, which in turn kept up the momentum positively behind Japanese equities. The MSCI Japan and Nikkei 225 indices made new highs last week. Due in part to the weak Yen, Japanese corporate earnings are growing. The momentum in Japanese equities has put the MSCI Japan index near the top of the asset class leaderboard over the past year, just behind Bitcoin but importantly above the S&P 500 (local currency).

The "Japanification" of the developed world whereby interest rates and bond yields trended to zero or lower seems to have moved away, at least for now.



Data Source: FMRCo, Bloomberg, Haver Analytics, FactSet. Data as of 24/03/2024.
Past performance is no gurantee of future results.

Source: Twitter.com/TimmerFidelity

As at 24 March 2024

Meanwhile in Europe, the European Central Bank might well be under pressure to cut interest rates and ease the burden on struggling Eurozone economies. Instead, it was the Swiss National Bank who seized the initiative cutting local rates 0.25%, effectively kicking-off the interest rate cutting cycle for northern hemisphere developed markets. The manufacturing malaise in Germany, discussed here previously, remains a feature, along with an over reliance on Chinese demand and Russian energy. In the UK we were all pleased to see inflation falling back and offering an overdue positive surprise. Buoyed by the news and the promise of lower rates perhaps later this year, UK equities enjoyed the strongest month since November 2022, up more than 4.5%.

Geopolitics remains complex with the Middle East tinder box unstable as Israel has seemingly ignored demands, including those of Joe Biden, for a ceasefire in Gaza. The Russo Ukraine conflict persists too – funding blockages in the US Congress have undoubtedly caused issues on the battlefield for Ukraine. We note the unofficial arrival of some French and British boots on the ground, and we are monitoring developments as closely as possible.

Alpha Beta Partners portfolios have delivered positive returns across the board during the first quarter 2024. Our recognition of the important sentiment shift and provision of ample liquidity in the United States late last year being well rewarded.

Remaining invested in Europe despite economic headwinds described here has also bolstered returns and a timely fillip from UK equities at the quarter end has been most welcome.
The passive and partial currency hedged approach deployed in US equities has offered benefits to portfolios. The weaker dollar has been hedged around 50% and exposure to "Magnificent Seven" technology behemoths has been rewarding as their valuations ramped higher. Our overweight position in Japanese equities has performed strongly and we continue to monitor progress as our proprietary momentum indicator suggests a change may be required in due course.

We are on the cusp of a regenerative interest rate cutting cycle across developed markets (excluding Japan). Ample liquidity lubricates the economic engine which continues to motor in robust fashion in America. Corporate earnings have proven resilient so far, despite heightened expectations and lofty valuations of the dominant players. Inflation does not appear to be totally beaten, although a deflationary wave from China is enroute, bringing disinflationary impacts to the West. Geopolitics is the one area of short-term potential to upset an optimistic outlook. Notwithstanding this, we are minded to maintain a risk-on positioning in portfolios at this stage, aiming to capture further upside during the year ahead. We remain vigilant to apparent risks.

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All sources Bloomberg unless otherwise stated

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