FEBRUARY 2024

Monthly Commentary

GOLDENHILL
ASSET MANAGEMENT

How did markets move?

February saw markets lower rate cut expectations after US inflation came in stronger than expected, but risk sentiment improved nonetheless as credit spreads tightened and global equities touched new highs. Bonds fell as US 10Y yields jumped back to Dec highs of 4.30%, but less than proportionately as credit spreads tightened. Global equities climbed as they extended their divergence from bonds, with US and Japan hitting record highs driven by geographic and sector fund reallocation. This month Chinese equities climbed alongside global peers, rebounding from new lows both onshore and offshore as the government rolled out more support for the economy and capital markets. Cryptocurrencies had a record month as the new spot Bitcoin ETFs reignited the digital asset rally and Bitcoin retouched its Nov 2021 highs of USD60,000.

Figure 1: Equity Indices Return (Gross Performance)

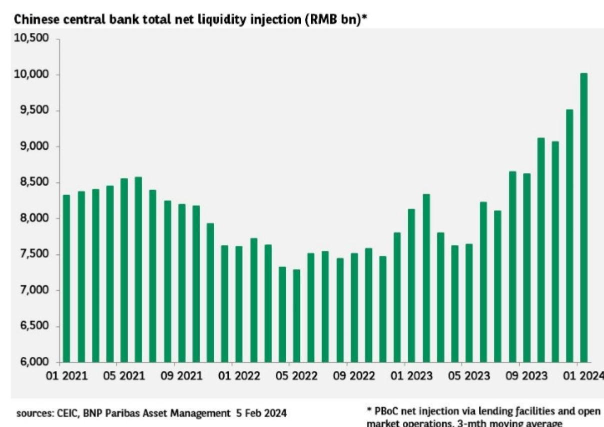
Gross Performance	1M	YTD
MSCI World Index	4.26%	5.34%
S&P 500 Index	5.17%	7.70%
Nasdaq Composite	6.12%	8.42%
CSI 300 Index	9.35%	3.11%
Hang Seng Index	6.63%	(2.69)%
Straits Times Index	(0.35)%	(3.23)%

Key market events

Markets repriced rates after being caught off-guard by the hot US inflation prints, FOMC meeting minutes that emphasised the risk of premature easing and continued hawkish commentary from Fed officials. January's key inflation prints came in above expectations, increasing concerns that inflation is not on track to reach Fed's 2% target. Treasury yields jumped, with 2Y yields surging over 50bps from Jan lows back to Dec highs of 4.69% while 10Y climbed 40bps back to 4.30%. Markets have drastically reduced full-year rate cut expectations from 168bps to 85bps, with the first cut pushed back from May to June.

China rallied too, with CSI300 +9.4%, SHZE +8.1% and HSI +6.6%. Gains were supported by further injection of liquidity into the economy (Fig 2) and the government extending policy support to financial markets after President Xi Jinping was reported to speak with Chinese financial regulators. This included state-backed fund Central Huijin Investment pledging to increase ETF holdings to support the stock market and the banning of selling at market open and closing sessions. More support came for the beleaguered property sector, with PBOC cutting its 5Y loan prime rate by a more than expected 25bps to 3.95%. However the rally was pared at month-end when a winding up petition was filed against Country Garden and Shimao, highlighting the pressure on developers even as they undergo restructuring.

Figure 2: PBOC net liquidity injection over 3Y



Outlook

Markets turning risk-on this month belie underlying economic headwinds beyond US hot inflation prints. Both Japan and UK slipped into technical recessions in 4Q23, complicating policy decisions for BoJ's negative interest rate policy ahead of its April policy meeting and BoE's fight with persistent inflation. EU economic growth prospects remain sluggish too, with S&P flash composite PMIs staying in contractionary territory YTD. Current high valuations have largely been shielded from rates repricing due to fund inflows as a result of geographic and sector reallocation (away from China and into AI). This may not be sustainable moving into 2H as we can see how punitive markets are towards stocks that have fallen out of favour. We remain cautious, but turn slightly more optimistic against the backdrop of a resilient US economy and improved economic support by the Chinese government. We continue to favour bonds given the high absolute yield especially in light of the recent pullback, and prefer equities with sound fundamentals at fair valuations.

Fixed Income

We remained constructive on global investment grade sector, particularly in Asia ex-China on the back of continued fund flows. In terms of benchmarks, markets will continue to be highly sensitive to economic date and official's narratives, and the recent pattern of oscillating around the extent and timing of future rate cuts will likely continue within a 50-75bp range in the near term. Term premium on longer-dated US treasuries is likely to weigh on investors' mind, leading to steepening pressure in the benchmark curves. At the same time, we are cautious on the deterioration of the global commercial real estate sector and its impact on banking sector balance sheet, but took much comfort in the recent earnings report by major global banks which demonstrated strong capital adequacy and resilience. Top quality European banks junior subordinated bonds remained a key component of our diversified portfolio approach towards fixed income investing.

In the face of the recent uptick in inflation patterns and general strong labour and economic outlook in US, some corners of the markets started speculating on the potential of even further rate hikes. Given the fragility of the manufacturing and the commercial real estate, we see this as an extremely unlikely outcome, barring a mind-blowing reversal in inflationary trends. We maintain our house view that Fed will start on a moderate de-tightening trajectory in end of Q2 2024, with expected 75bps reduction over the course of 2024, moving towards real effective interest rates of 2.0-2.5% (nominal 4.25-4.75%) by end of the year.

Equities

Global equities continued to rally despite hot inflation, supported by the resilient economy as GDP growth, payrolls and PMIs beat estimates. Earnings season came in mild, with 73% of S&P500 stocks beating earnings estimates which is below the 5-year average of 77% beat but was largely overshadowed by Nvidia's widely anticipated earnings that smashed expectations again. AI stocks outperformed, with semiconductor index SOX up 10.9% against S&P500's 5.2% return as Nvidia's blowout earnings reiterated the huge potential of the industry. Nvidia has been crowned the most important stock in the world, and has single-handedly driven more than a quarter of the gains for NDX since the beginning of the year. The key point here is that while having the current and future market performance so dependent on a handful of stocks is nothing new, it does not change the fact that this is overcrowding has reached a stage where it looks like the market is perched precariously. In fact, many have come to believe that worrying about market risk is probably something best left undone, and the real worry should be being underinvested given that we are currently at the start of a new bull market. This drove a huge risk rally across US equities, with value and small to mid-cap stocks climbing at month-end in a positive sign of balancing market depth, as the rally had initially been concentrated in tech heavyweights.

However it was a tale of two cities for stocks: investors piled into companies that were profitable and had optimistic growth prospects, and sold companies that could not deliver both. Industry leading names like Teladoc, Grab and even AI beneficiaries like Palo Alto and Snowflake were not spared, diving 20% or more on poor earnings and/or growth outlooks. Pockets of fear emerged around US commercial real estate as NYCB replaced leadership after finding weaknesses in operational risk processes and we continue to monitor the key sector closely. We prefer small-mid cap stocks with reasonable valuations over high-growth mega-cap names, and see better protection in value names against extended rate volatility.

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