STENHAM ASSET MANAGEMENT

Q1 2024 Investment Letter

with Kevin Arenson & Tim Beck

Market Commentary

Equities	Q1 2024	2023
MSCI World (USD)	8.5%	21.8%
MSCI EM (USD)	1.9%	7.0%
S&P 500	10.2%	24.2%
STOXX Europe 600 (USD)	4.4%	16.4%

Fixed Income	Q1 2024	2023
FTSE Global Bonds	-2.4%	5.2%
Investment Grade	-0.7%	9.4%
High Yield	1.3%	12.9%
Bloomberg Global Agg Bond	-2.1%	5.7%

Currencies	Q1 2024	2023
USD (DXY)	3.1%	-2.1%
EUR (vs USD)	-2.5%	3.3%
JPY (vs USD)	-6.9%	-7.0%
GBP (vs USD)	-1.1%	5.5%

Commodities	Q1 2024	2023
Gold	7.9%	13.3%
Oil (WTI)	16.1%	-10.7%
Natural Gas	-29.9%	-43.8%
Bloomberg Commodity	0.9%	-12.6%

Source: Bloomberg as of 31 Mar 2024

2023 ended with an almost universal view that the US (and with it broader developed markets) would experience a soft landing; economic growth would remain robust with inflation moderating to allow interest rate cuts, which would support asset prices. At the start of the year, the market was pricing in close to seven rate cuts in the US during 2024, beginning in March. Q1 2024 saw inflation surprise to the upside, the Fed has not cut interest rates and the market has repriced interest rate expectations significantly, to just three cuts as of end-March 2024 for the rest of the year. Despite this, equity markets are close to highs and credit spreads close to tights. The S&P 500 ended the quarter +10.2%, the MSCI World +8.5%, whilst credit spreads tightened (Investment Grade by 10bps and High Yield by 32bps). High yield spreads reached their tightest levels since 2007. Bonds lost money as interest rates rose with the yield on the US 10-year bond rising 32bps from 3.9% to 4.2%. Commodities were mixed with precious metals performing well (despite yields rising).

Interest rate expectations altered dramatically during the quarter, and further since. This has been driven by higher-than-expected inflation levels, as well as continued strength of the US economy and labour market. At the start of the year, following the Fed pivot in the December meeting, the market was pricing in a high number of interest rate cuts during 2024; the trend was the same, if lower quantum, in Europe. The market was ahead of the Fed, pricing more cuts than indicated by the "dot plots", which show the median rate expectation of the members of the FOMC. This has now reversed with no cut in June and less than 50% probability of a cut in July.

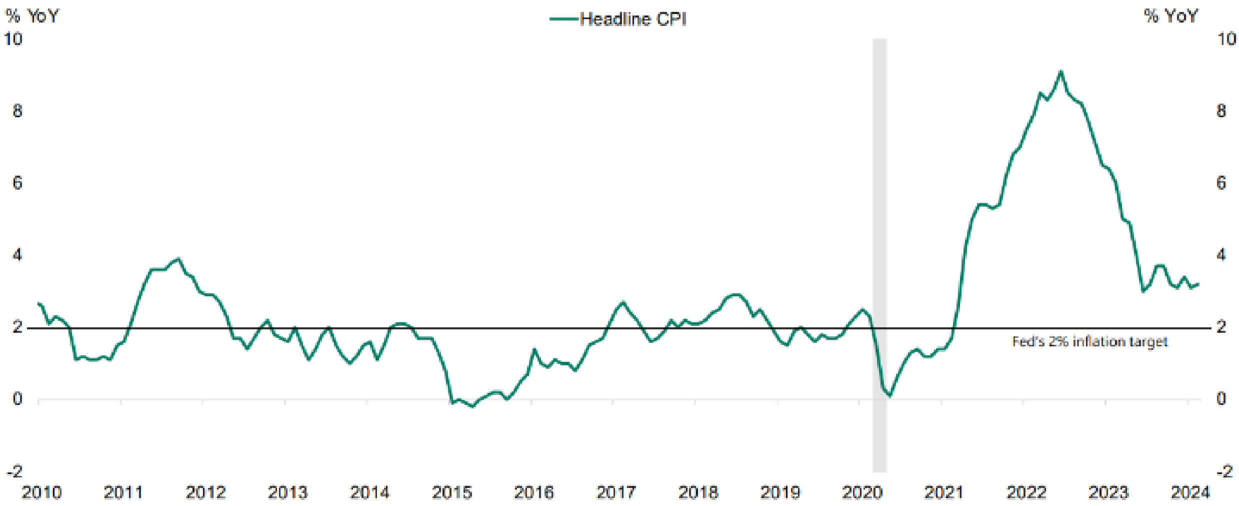
2024 interest rate expectations[1]

	As of 02-Jan	As of 29-Apr
31-Jan 24	5.298	
20-Mar 24	5.111	
1-May 24	4.86	5.324
12-Jun 24	4.607	5.297
31-Jul 24	4.398	5.248
18-Sep 24	4.164	5.148
7-Nov 24	3.988	5.086
18-Dec 24	3.825	4.980
29-Jan 25	3.668	4.910

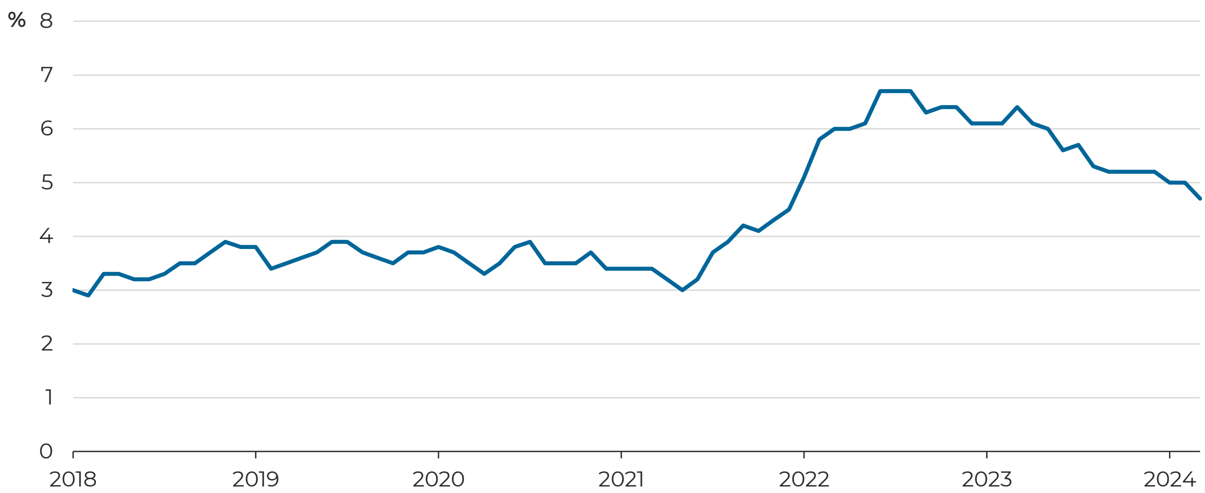
[1] *Source: Bloomberg as of 29 Apr 2024*

Inflation has come in stubbornly higher than forecast, and higher than central banks' targets of 2%, albeit significantly reduced from the high single-digit/low double-digit levels seen last year. Headline CPI is trending towards 3%, which means that the Fed does not have the flexibility to cut rates. A large proportion of inflation is coming from shelter, which may moderate, but nonetheless this limits the ability to act. With economic growth coming in at 2.9% for Q1 following strong retail sales. Wage growth has come down from its peak, but remains at c.5% on a 3-month rolling period.

Inflation is sticky above the Fed's inflation target[1]



Wage growth tracker[2]
3-month moving average of median wage growth, hourly data



The Fed has also come in for criticism in its communication. From pivoting in December, indicating that they thought conditions would allow rate cuts in 2024, there has effectively been another pivot in April with Fed Chair Jay Powell stating that the data did not provide the comfort to cut rates. These do have an impact on actions; with asset classes rallying in the back-end of 2023 and into 2024, the greater wealth effect had the same impact as a rate cut on financial conditions.

[1] *Source: ELS, Haver Analytics, Apollo Chief Economist*
[2] *Source: Federal Reserve Bank of Atlanta as of 1 Mar 2024*

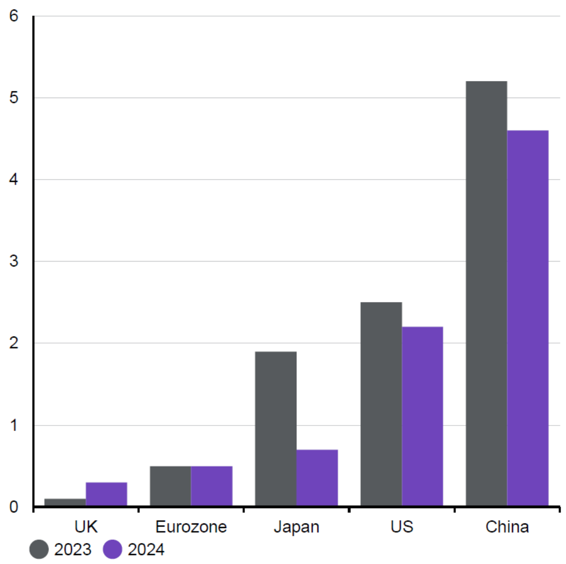
It may be different for other economies with the potential for the eurozone to cut rates ahead of the US, a reflection of weaker economic growth in the region.

Economic growth has generally been positive. The US is the clear outperformer in the developed world. Globally, it seems clear that service sectors are outperforming manufacturing, particularly with less end demand from China. This can be seen from the stronger relative performance in the PMIs[1], as well as the US over Europe with the former's greater service profile. Equally, within Europe, Germany with its large manufacturing basis is suffering.

Manufacturing PMI																					
Region	2022						2023												2024		
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Global	51.1	50.3	49.8	49.4	48.8	48.7	49.1	49.9	49.5	49.6	49.5	48.7	48.5	49.0	49.2	48.8	49.3	49.0	50.0	50.3	50.6
Developed	51.3	50.2	50.1	48.8	47.8	47.3	48.0	48.1	48.4	48.5	47.6	46.3	47.1	46.8	47.4	47.5	47.7	47.0	48.9	49.3	49.3
Emerging	50.5	50.2	49.4	49.8	49.7	49.8	49.9	51.6	50.7	50.5	51.4	51.1	50.2	51.3	50.9	50.1	50.9	50.9	51.1	51.5	52.0
US	52.2	51.5	52.0	50.4	47.7	45.2	45.9	47.3	49.2	50.2	48.4	46.3	49.0	47.9	49.8	50.0	49.4	47.9	50.7	52.2	51.9
Japan	52.1	51.5	50.8	50.7	49.0	48.9	48.9	47.7	49.2	49.5	50.6	49.8	49.6	49.6	48.5	48.7	48.3	47.9	48.0	47.2	48.2
UK	52.1	47.3	48.4	46.2	46.5	45.3	47.0	49.3	47.9	47.8	47.1	46.5	45.3	43.0	44.3	44.8	47.2	46.2	47.0	47.5	50.3
Eurozone	49.8	49.6	48.4	45.4	47.1	47.5	48.8	48.5	47.3	45.8	44.8	43.4	42.7	43.5	43.4	43.1	44.2	44.4	46.6	46.5	46.1

Services PMI																					
Region	2022						2023												2024		
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Global	51.0	49.2	49.9	49.1	48.1	48.0	50.0	52.5	54.3	55.3	55.3	53.8	52.5	51.0	50.7	50.4	50.5	51.5	52.3	52.4	52.5
Developed	49.1	45.7	49.5	48.7	47.5	47.2	48.5	51.7	53.2	54.5	54.8	53.5	51.8	50.1	50.1	49.8	50.0	50.5	51.4	51.8	51.9
Emerging	55.4	54.9	50.5	49.9	49.3	50.0	53.1	54.5	55.7	57.2	56.7	54.6	54.5	53.1	51.9	51.8	52.2	53.8	54.2	53.7	53.8
US	47.3	43.7	49.3	47.8	45.2	44.7	45.8	50.5	52.5	53.5	54.9	54.4	52.3	50.5	50.1	50.5	50.8	51.4	52.5	52.3	51.7
Japan	50.3	49.5	52.2	53.2	50.3	51.1	52.3	54.0	55.0	55.4	55.9	54.0	53.8	54.3	53.8	51.5	50.8	51.5	53.1	52.9	54.1
UK	52.5	50.9	50.0	48.8	48.8	49.9	48.7	53.5	52.9	55.9	55.2	53.7	51.5	49.5	49.3	49.5	50.9	53.4	54.3	53.8	53.1
Eurozone	51.2	49.8	48.8	48.5	48.5	49.8	50.8	52.7	55.0	55.2	55.1	52.0	50.9	47.9	48.7	47.8	48.7	48.8	48.4	50.2	51.5

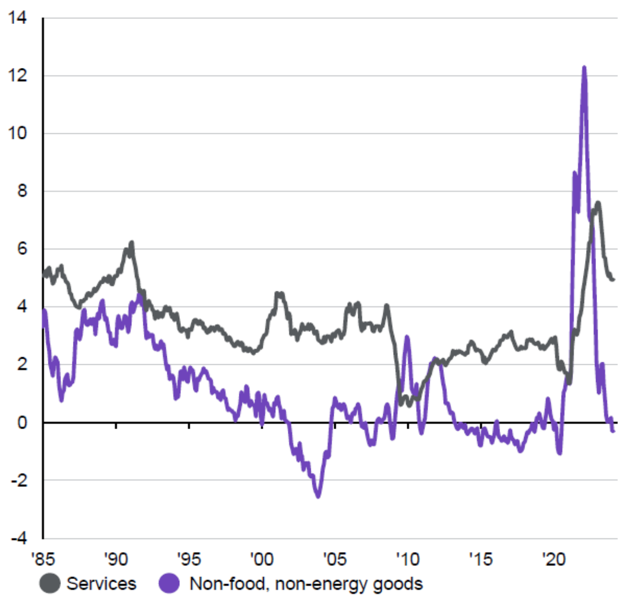
Consensus forecasts for real GDP growth[2]
% change year on year



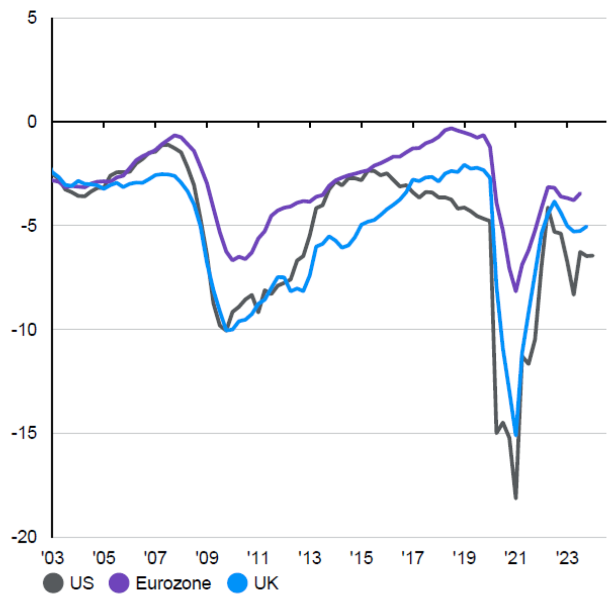
[1] Source: Bloomberg
[2] Source: Bloomberg, JP Morgan Asset Management as of 31 Mar 2024. Forecasts are from Bloomberg contributor composite

Higher interest rates, to state the obvious, will impact any entity with debt, particularly hurting those with heightened debt levels. This is most in focus for corporates and also governments, where debt levels have risen both following the Great Financial Crash and more recently since Covid. It is difficult to see both how these are addressed, but also when they may matter to financial markets. Debt levels are high and governments are running budget deficits; in the US this is over 6% and that at a time of low unemployment. The composition of that deficit has changed though with an increasing proportion taken by interest payments. If interest rates remain high, that will continue. At a time of increased demands on countries spending (such as on defence) it is not clear how this deficit can or will be addressed.

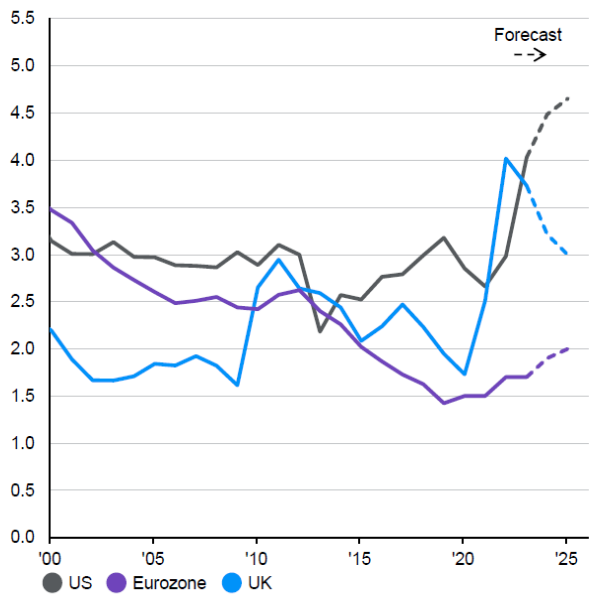
US goods and services inflation[1]
% change year on year



Public sector budget balance[1]
% of nominal GDP



Government interest payments[1]
% of nominal GDP



[1] *Source: JP Morgan Asset Management as of 31 Mar 2024*

Within credit, there is much dispersion. The overall index is at, or close to, historic tights, which is surprising given an increase in defaults and upcoming maturity walls facing companies which will have to refinance their debt. However, for the worst quality names, 'CCC' rated credits, spreads are much wider. This reflects, to some extent, the lower proportion 'CCC' credits are now within the index, but also the slow moving approach into a default cycle we are experiencing. As opposed to 2008/9, when there was a major event with significant uncertainty, which led to all spreads widening, this default cycle is seen as being driven by rates and whether companies can refinance their debt when it is due. Not to downplay the massive change from an environment of zero interest rates to 4-5%, investors believe this is analysable and, therefore, are differentiating between those companies which have a high chance of restructuring and those where that is unlikely.

We have seen the beginning of a default cycle. Ratings agency S&P Global recorded 29 corporate defaults worldwide in Jan and Feb, the most for those two months since 2009. Moody's speculative grade default rate rose to 5.1%. This has included large capital structures such as Altice, the telecom and media conglomerate. Increasingly, the analysis has been less about the pure value of the business and more about how companies can move assets (and value) away from existing creditors, often favouring one over another, so called 'creditor on creditor violence'. Following a decade of covenant-lite issuance, with fewer and fewer constraints on the actions a company can take, we fully expect this to continue.

We feel we are potentially seeing too much exuberance in markets. The economic outlook remains uncertain and there is heightened geopolitical risk, with the potential of escalation of global conflicts, most obviously in the Middle East. There is limited margin of safety in credit spreads being their tightest since 2007 or in record highs in equity markets when inflation and interest rates have both surprised to the upside.

Strategy Allocations

We maintain limited directionality across our core portfolios. We feel this is the best way to navigate an uncertain environment, especially a higher interest rate environment. Many of the less directional strategies we invest in have a natural increase in expected returns when interest rates are higher. Merger arbitrage and fixed income relative value spreads are all priced off the risk-free rate. We have started to allocate to convertible arbitrage, which now offers both positive carry, limited or no at-the-money equity or credit risk and, we feel, would benefit from stronger capital markets activity, which we anticipate. Our portfolios are designed and aiming to deliver high single-digit annualised returns in this environment with limited equity, credit or fixed income beta, which we feel is a compelling offering.

Discretionary and Systematic Global Macro

Discretionary macro, relative value, commodity and systematic strategies were all profitable during the first quarter with tail risk strategies a small detractor. Systematic strategies were the clear outperformer.

Discretionary macro remains our largest allocation. Returns were mixed across our macro managers. Outperformers included a manager who has, for some time, been positioned for resilience in the US economy, fading interest rate cuts that were priced in by the market. Short positions in fixed income, long positions in the US dollar and a tactical net long bias to US equities drove gains. We also saw good performance from an Asian manager who has been positioned long US dollar, and an emerging markets macro fund which benefitted from long themes in CEEMEA and LatAm sovereign credit and rates. Some macro managers who had been positioned long fixed income entering the year, believing that the market will deliver on the rate cuts predicted, suffered particularly in February as stronger US economic data challenged their positioning. Risk was reduced during the quarter by these managers.

Relative value strategies were profitable, but more muted compared to previous quarters. Leverage levels dropped slightly. Fixed income relative value strategies saw mixed performance. We are paying attention to increasing crowdedness in this space. Our managers believe Japanese fixed income arbitrage affords the most opportunities, with the US and Europe outlook more cautious.

Systematic strategies were the highlight of the quarter. Our top performer was an equity statistical arbitrage manager we added earlier this year. The start of 2024 was exceptionally strong for both momentum and reversion strategies. We also saw strong gains from a systematic futures manager and a multi-strategy quantitative platform. We had one slight detractor, a manager focused on liquidity provision who tried to fade more crowded themes.

Commodity trading was profitable overall with gains primarily generated in March. Our top performers were more directional funds who participated in various themes including copper, cocoa and gold. The opportunity set for these managers once again looks interesting given rising geopolitical tensions and questions around the last mile in US inflation.

Tail risk strategies were negative during the quarter as credit spreads tightened, and currency volatility and interest rate volatility declined. We continue to believe our tail risk funds offer good asymmetry, especially in an increasingly complex macro and geopolitical environment.

Equity Long/Short

Our allocation to equity long/short managers contributed positively to performance in Q1.

Equity indices in the US, Europe and Japan made new all-time highs, all ending the quarter up strongly. Emerging markets continued to underperform, mostly driven by Chinese equities which were negative through Q1.

Stenham's investments in long-only funds and more directional hedge funds did well to capture market upside. This was particularly true for managers with long exposure to AI-related companies, such as semiconductor manufacturers and data center operators. While AI continues to be a key theme, several of our managers have noted a broadening of performance to other areas of the market during the first few months of this year, which has created a generally better environment for stock picking. Our allocation to more hedged strategies also proved additive. Our utility focused managers had a decent start to the year, as did our allocation to multi-manager platform funds.

Healthcare/biotech is an area where we continue to have meaningful exposure. This has been a tough space in recent years, but green shoots emerged during Q4 2023 and we saw continued strength in the sector during the quarter. One of the key drivers has been improved M&A activity between pharma and biotech. Several of our managers have benefitted from this, having had portfolio companies acquired for solid premiums during the last few months.

There have not been any wholesale changes to positioning. We continue to favour strategies which can generate positive returns regardless of market direction, such as low net specialist managers or multi-manager platform funds. Healthcare/biotech is another area where we believe outsized alpha is on offer for managers with specialist skills. Looking forward, we are considering an investment in a highly sought after global long/short fund which has offered us capacity.

Event Driven

Our event driven allocation was positive in Q1, but overall performance was muted with good performance from our lower-risk manager being offset by losses from our higher-risk manager; there was no marked performance from either though. Our lower-risk manager generated returns with no major outliers through general accretion to take-out value for their positions. Encouragingly, this manager has seen the level of exposure rise during the quarter; a key focus is on fixed income securities related to a merger which often have less downside than the equity exposure, similar expected return and can benefit from delays in the process from additional coupon payments. Companies had been shying away from acquiring companies with significant debt outstanding due to the potential difficulty in refinancing that debt. As credit markets have opened, this is less of a concern and the manager has now found more opportunities in which to invest. Our higher-risk manager saw spread widening in some of the larger deals; notably Nippon Steel's offer for US Steel and Exxon's offer for Pioneer Natural Resources. The manager holds conviction in the outcome for both these deals and has a high level of investment.

Credit

Our credit allocation was positive in Q1, with returns generated by longs in companies which refinanced their debt. With a lot of debt issued with low coupons, in a higher interest rate environment, this mathematically makes the debt trade with a below par price. The timing of a refinance is often uncertain and should it occur ahead of expectations, this then generates a faster-than-priced-in appreciation to par, and so stronger returns. Much of this has played out, but does continue to be a theme within our funds.

With the increase in default rates and the impending maturities over 2-4 years, we think there will continue to be a very strong opportunity in long/short credit; there will be a lot of catalysts for companies to out/underperform expectations.

Distressed opportunities are also set to rise as defaults increase. Historically, this strategy has offered compelling returns and we think this is set to be a very attractive environment. Combined with stressed issues within Commercial Real Estate in particular, and the ability to provide solutions to companies approaching or entering default, we see growing opportunities offering significant absolute returns.

Summary

We are very positive on the opportunity set and return potential of our portfolios. Our core portfolios are taking limited beta to broad markets and we believe the return potential of high single digits with limited downside and low sensitivity with broader markets (be they equity, credit or fixed income) is very attractive given the uncertainty and risks in the world.

Thank you for your ongoing confidence in Stenham. Please contact us if you would like to hear more about our strategies or funds. Further information can also be found on our website.

Kevin Arenson
Chief Investment Officer

Tim Beck
Senior Investment Executive