SECOR ASSET MANAGEMENT

Q1 2024 Rates Outlook

January 2024

Interest Rates Flat to Lower in 2023

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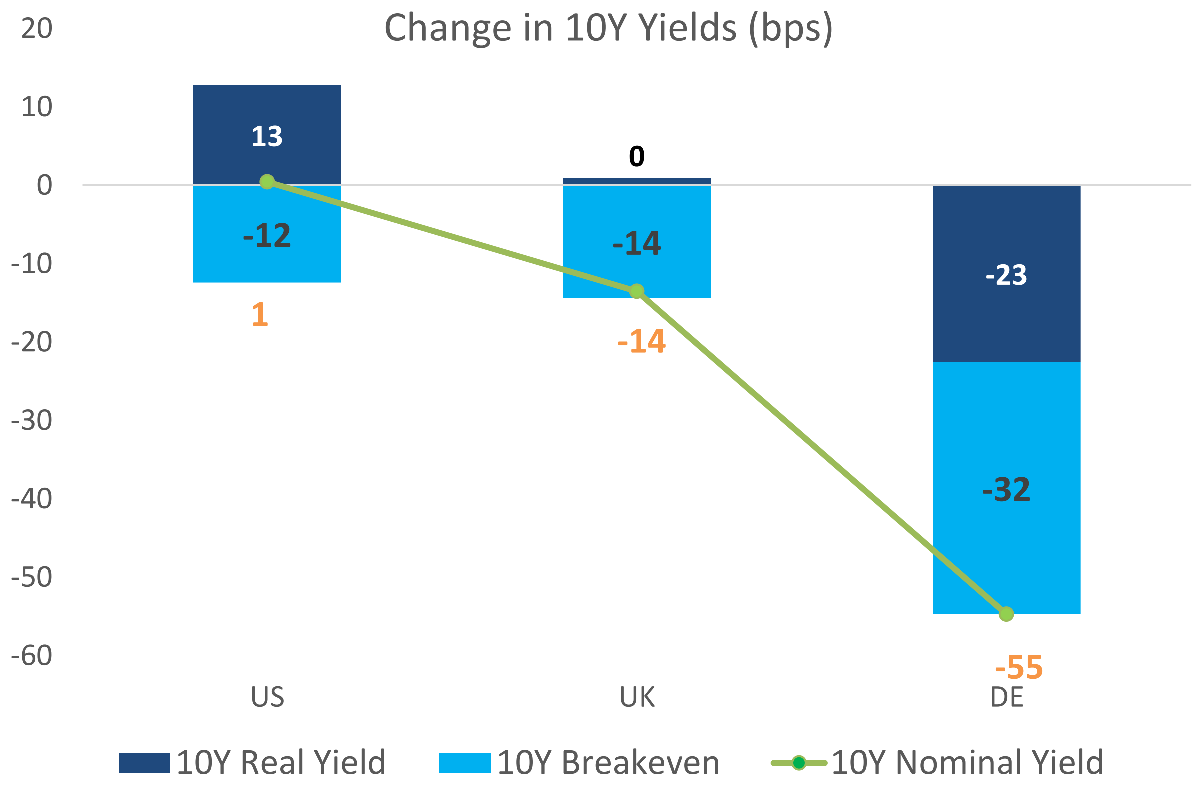
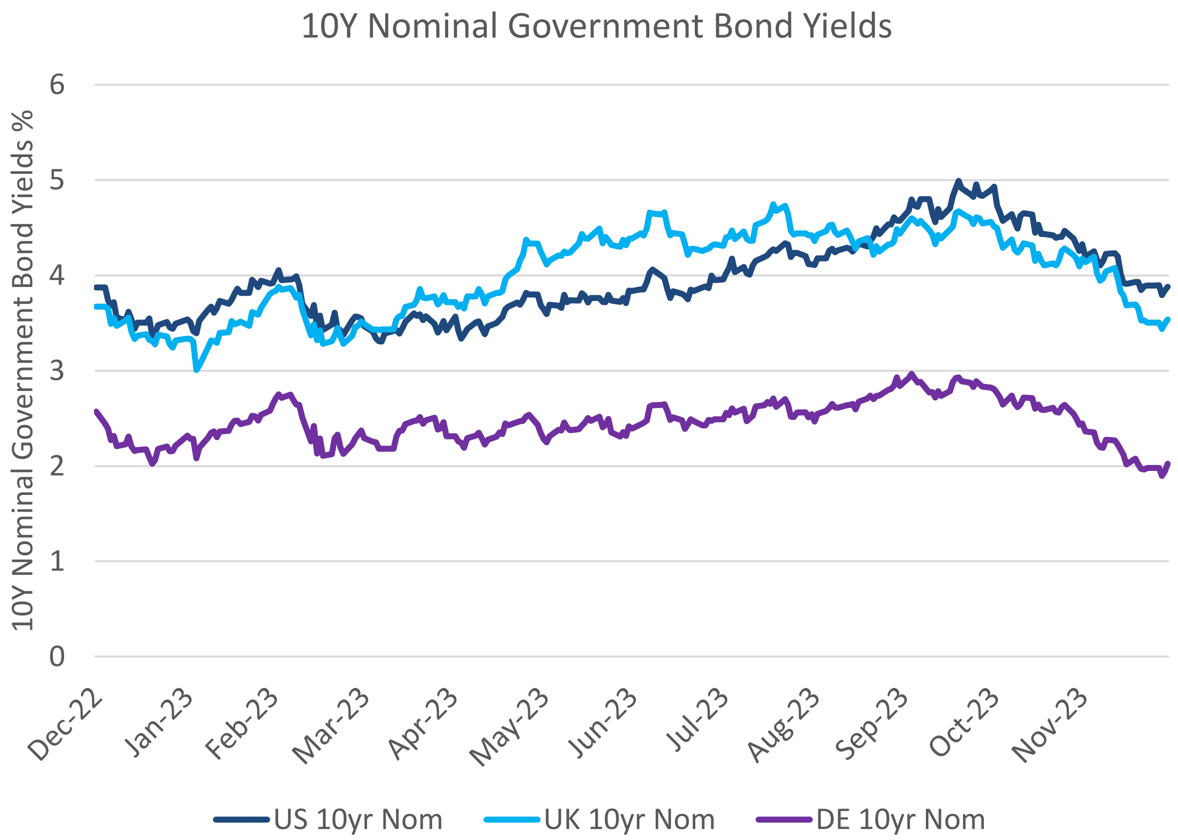
2023 rates markets were characterized by softening inflation with flat to lower rates





Source: SECOR, Bloomberg. Data as of December 31, 2023.

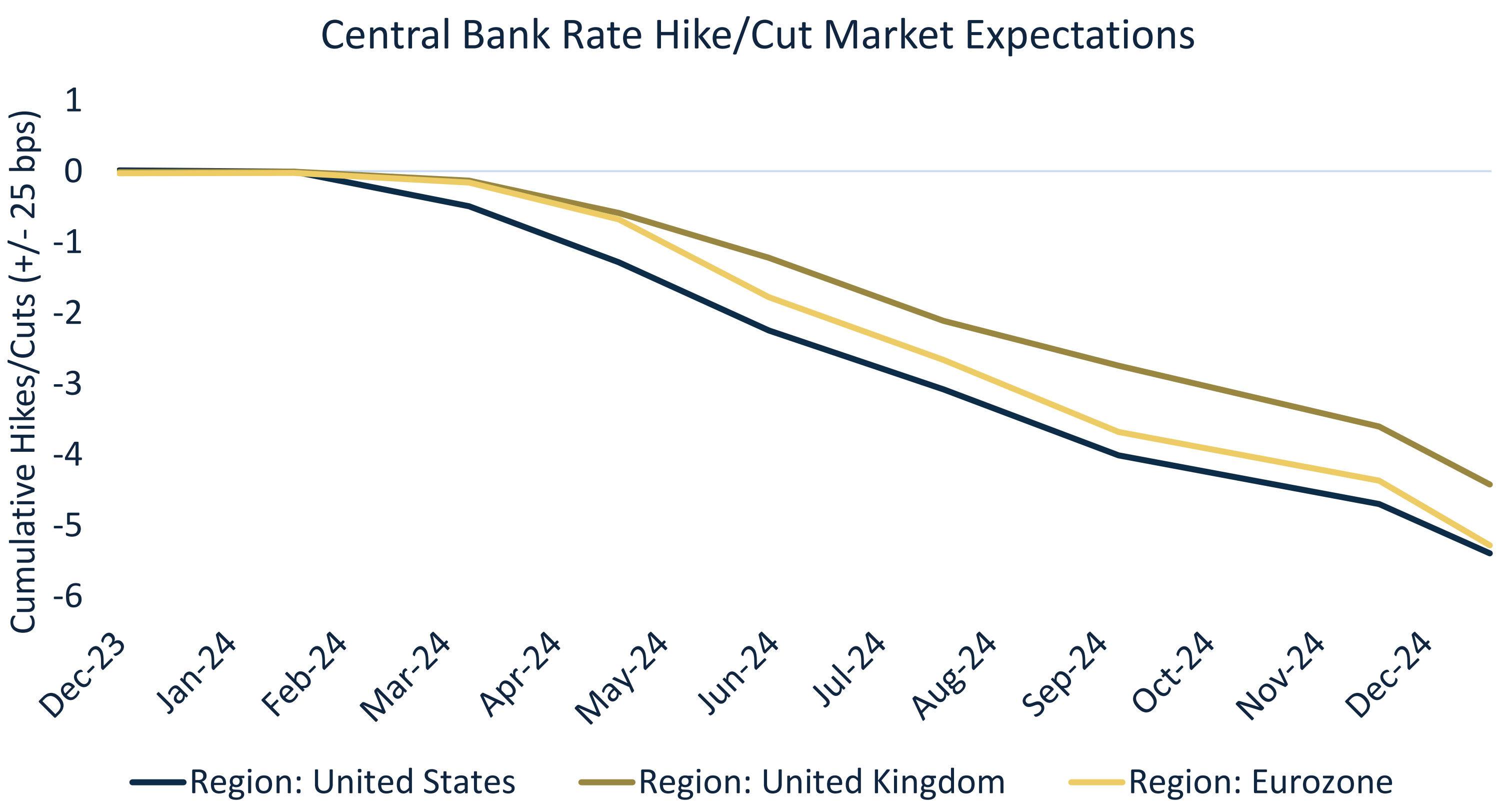
2024 Overview

- Strong progress on Western inflation in recent months
- Central banks projecting shift towards easing
- Growth outlook drives the extent of curve steepening
- Potential for lower rates volatility
- More downside to European traded inflation than the US
- Global QT and liquidity drain to pick up pace

- Trade Opportunities
  - *Curve trade – Growth outlook drives the extent of curve steepening*

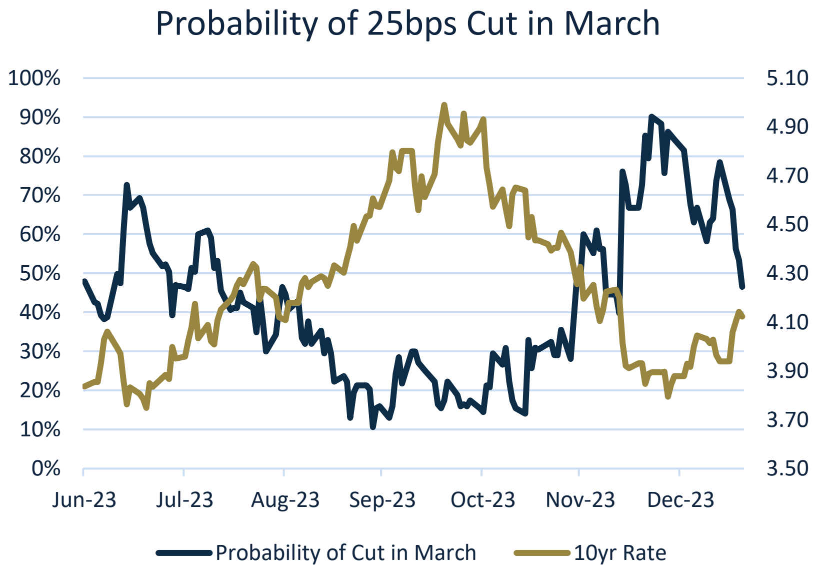
Market Implied Policy Rates

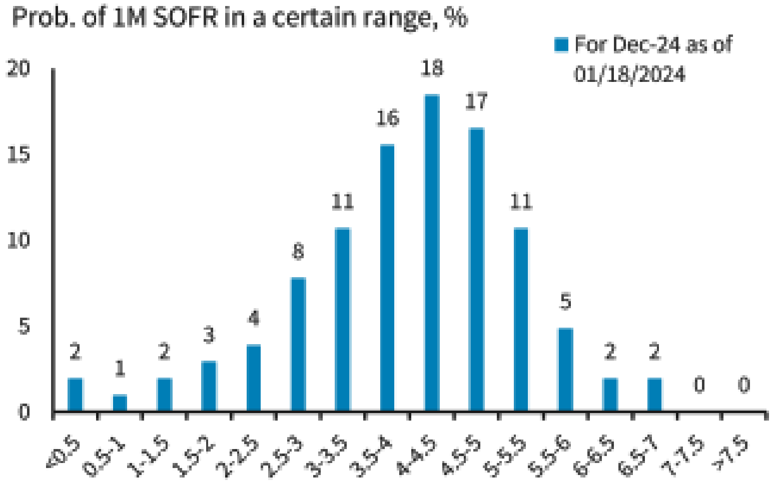
- Markets are currently pricing in aggressive cuts between 4 to 5 cuts over 2024



Source: Bloomberg

US Rates



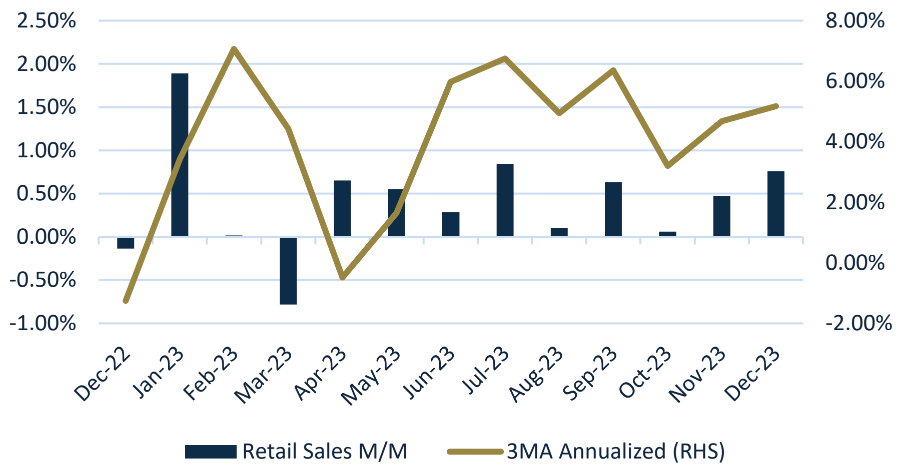


- Likelihood of cuts starting in March has backed off in recent weeks
- Markets are pricing in 140bps of cuts for the year, reflecting recession risk in the left tail

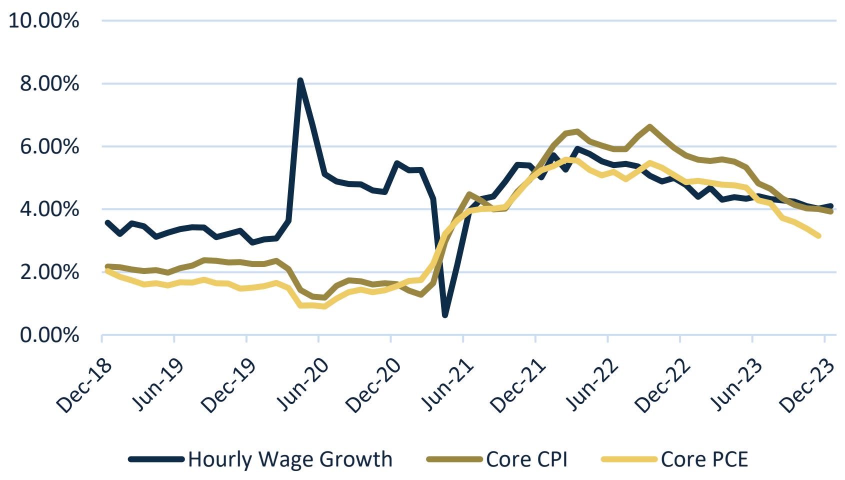
Source: Bloomberg, Barclays

US Inflation

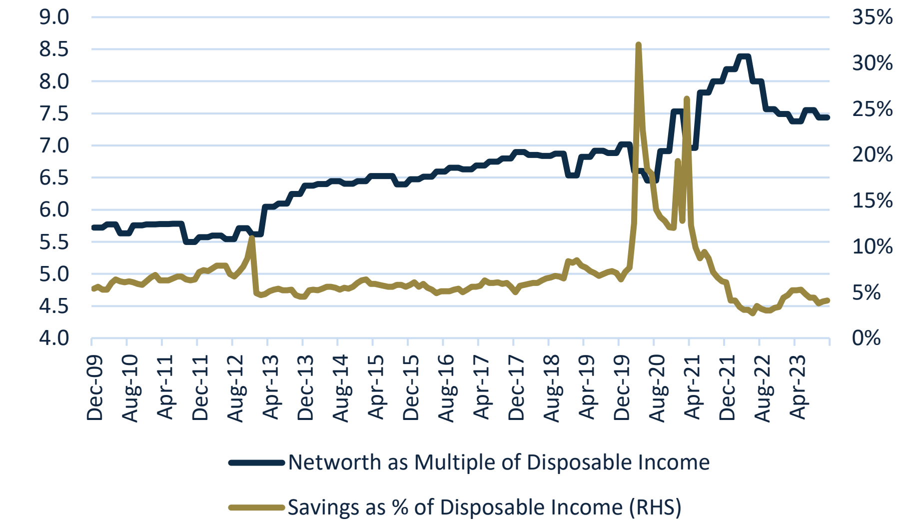
Retail Sales Control Group



Wage and Inflation



Savings

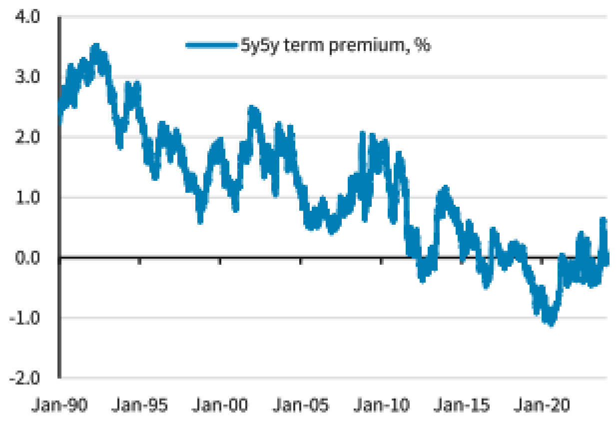


Inflation has made progress through 2023, but there is still work to be done before getting to the 2% target rate

Source: Bloomberg

US Term Premium

FIGURE 12. **5y5y term premium is well below historical levels**



There is room for term premium to increase, leading to de-inversion of the curve

FIGURE 13. **Stock-bond return correlation remains positive, pointing to low diversification benefits of USTs**

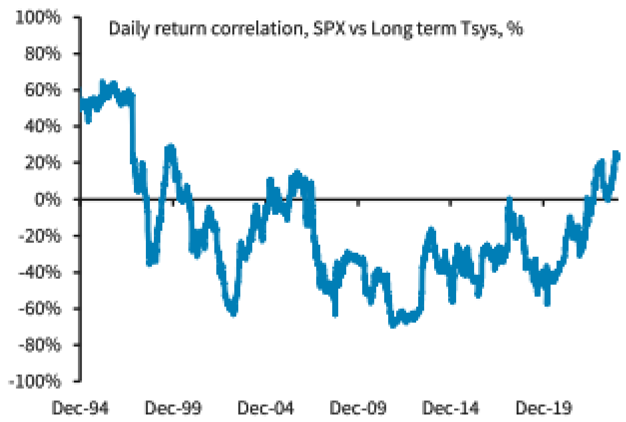
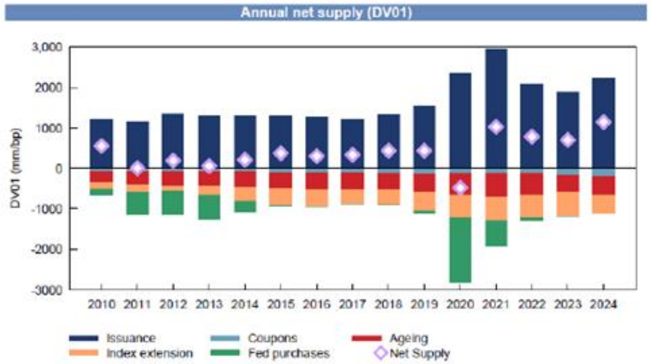


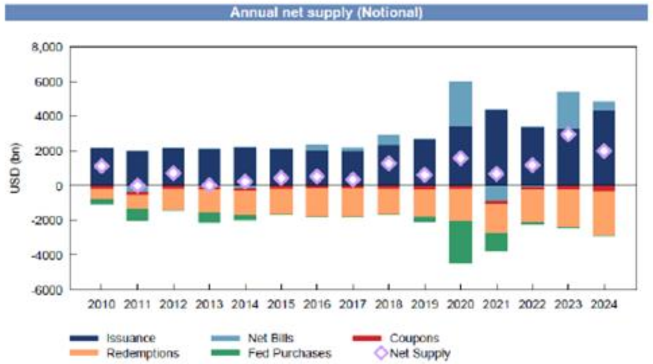
FIGURE 14. **Interest rate volatility remains high, arguing for high term premium**

Source: Barclays Research

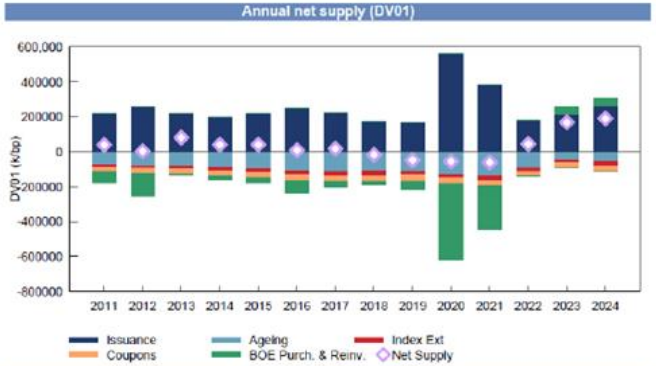
Swap Spreads

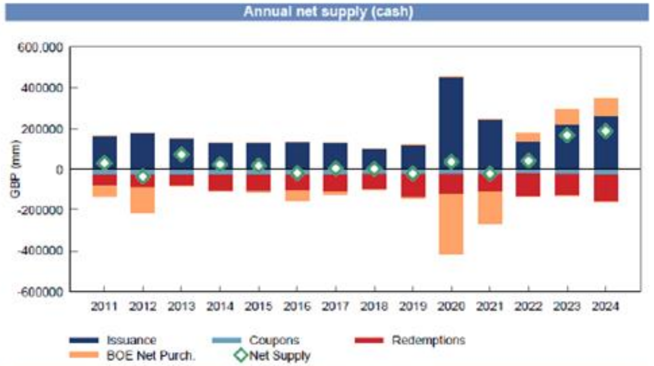
US



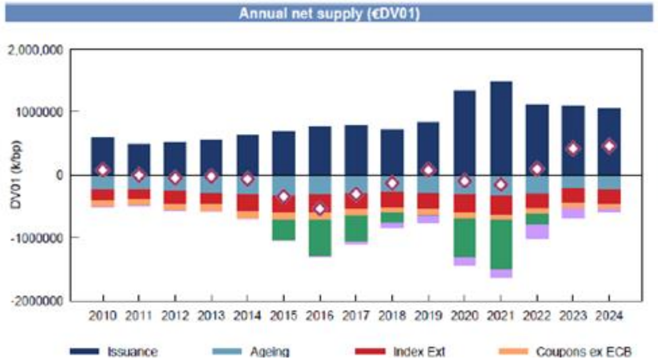


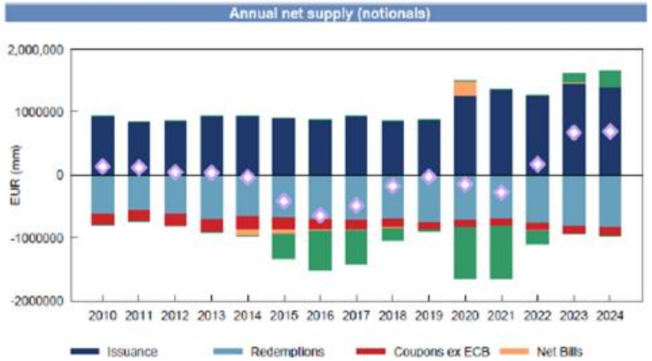
UK





Eurozone

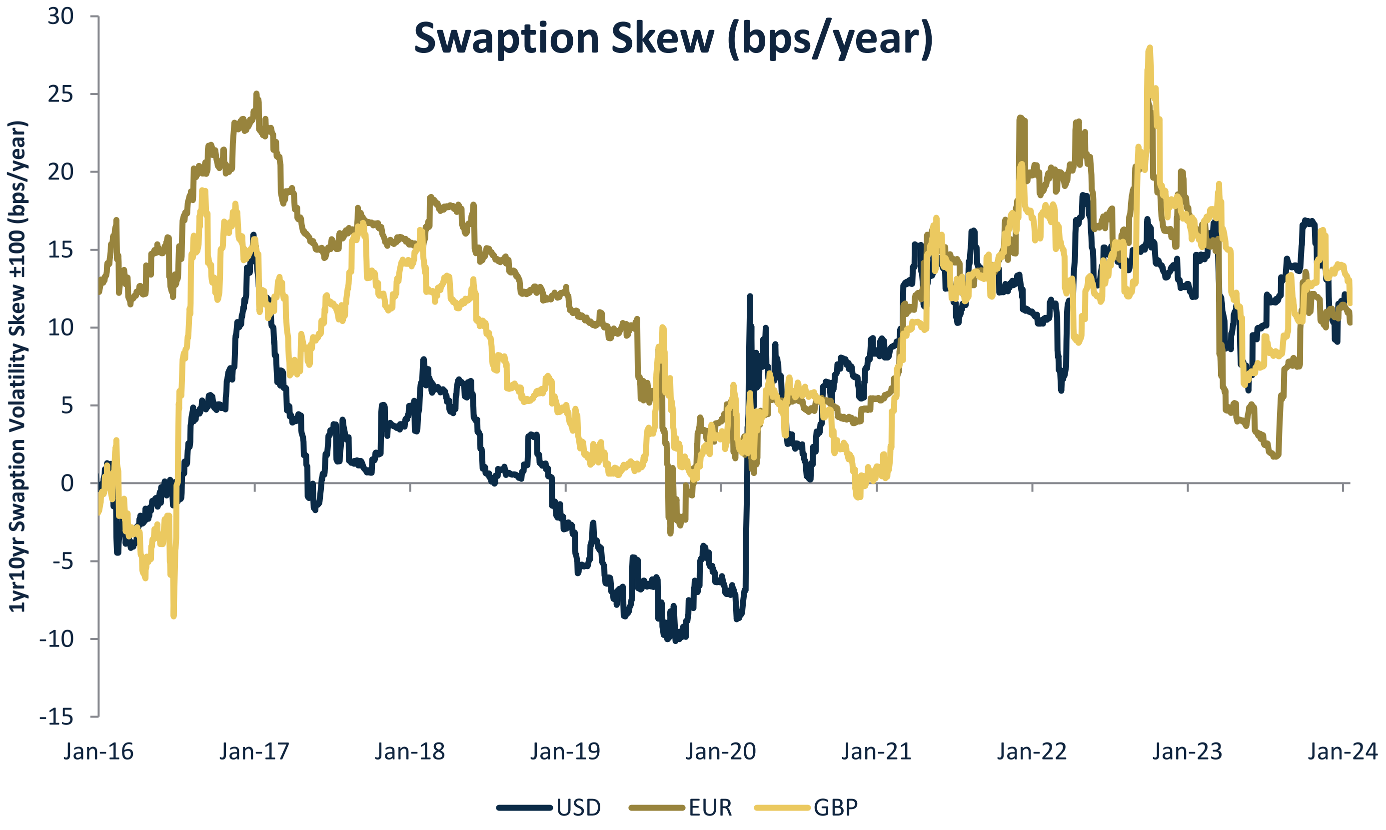


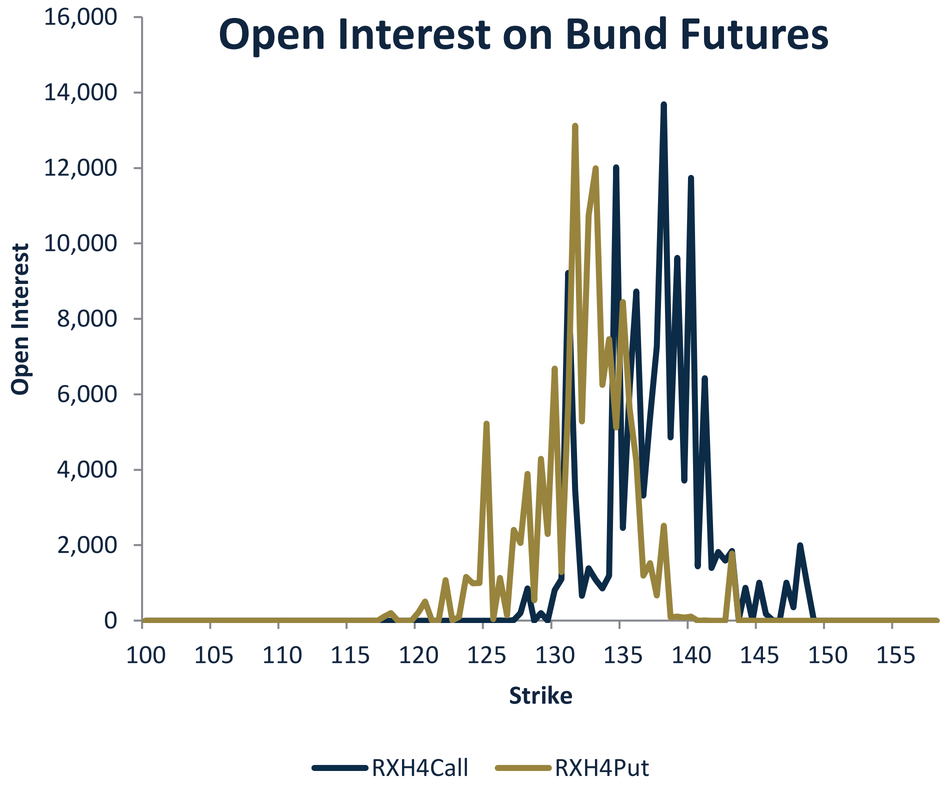


Source: GS

Markets are positioned slightly short to neutral duration

- 1Y-into-10Y Volatility Skew = +100 Payer Vol – 100 Receiver Vol
- Skew has come off the highs of 2023 in November and is now closer to 2021 levels
- Open interest on Bund Puts 0.97x Calls which is lowest ratio we've seen in years





Source: SECOR, Barclays Live, Bloomberg

Trade Bet Performance: USD 2s10s Curve Steepener

- Currently +8.14% return since beginning of 2023 when trade was recommended
  - Last meeting in October 2023, the return was +6.25%
- Trade benefitted in during “banking crisis”, long end real yield increase, and central bank pivot
- Spread currently at -47 bps vs -59 bps

Source: Citi Velocity, SECOR Analytics

Rates Summary Page

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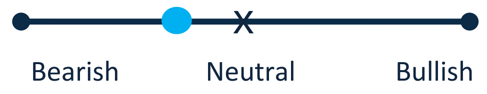
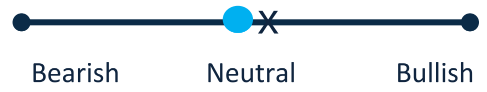
Factors	Comments	Historical Range
Valuations and Fundamentals	▪ Fiscal supply at highest dv01 levels in past 14 years should have negative impact on long end ▪ Inflation lingering may continue to pose as a risk ▪ There is a question around the aggressiveness of the rate cuts being priced	
Technicals	▪ Term premium remains below pre-covid levels even though volatility and neutral rate may be higher today ▪ Lesser opportunity in 2s10s and 5s30s steepening but may persist but less attractive than prior levels	
Macro Impact	▪ Inflation is trending down but still a lingering risk. Central banks may make policy mistake post pivot. Markets still watching economic data prints to determine policy path which should be supportive of volatility in the near term.	
Overall	▪ 9-to-12 month view vs Fwds is generally neutral to ever so slightly bearish	

● Current Quarter

X Last Quarter

Scenario-Based Outlook: Neutral Duration

- Key take aways
  - Rates should eventually stabilize over the next 1 to 2 years as inflation normalizes and monetary policy pivots
  - There are risks around data prints as the central banks are more data driven
  - Overall, we are neutral vs the forward rates

As of 19 Jan 2024	30yr EUR Swap	30yr GBP Swap	30yr USD Swap
Spot Rates	2.47%	3.80%	3.65%
Probabilities			
Tail risks: Recession shock, geo-political environment deteriorates	10%	10%	10%
Lingering inflation and earnings/growth below expectations	30%	30%	30%
Market Base Case: Soft Landing	45%	45%	45%
Positive earnings + falling inflation and improved productivity	15%	15%	15%
Probability Weighted Rate	2.45%	3.78%	3.62%
Implied 1yr Forward Rate	2.39%	3.73%	3.56%
Difference vs Forward	0.05%	0.05%	0.06%

Source: SECOR, FTSE

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Equity investments involve a high degree of risk. Equity securities may decline in value due to factors affecting securities markets generally, and equity securities generally have greater price volatility than debt securities/investments. Equity securities of certain jurisdictions may experience more rapid and extreme changes in value and may be affected by uncertainties such as international political developments, currency fluctuations and other developments in the laws and regulations of countries in which an investment may be made. There can be no assurance that return objectives will be realised and investors could lose up to the full amount of their invested capital. Fees and expenses may offset the trading profits.

Debt investments (such as, but not limited to, investment grade, high yield, emerging market debt, asset backed securities and insurance linked securities) involves special considerations and certain risks, including risk of default and price volatility, and such securities are regarded as being predominantly speculative as to the issuer's ability to make payments of principal and interest.

LDI and equity overlay strategies may invest and trade in many different market strategies and instruments (including securities, non-securities and derivatives) and may employ different investment, hedging, leverage and arbitrage methodologies, so the risks of those would be material to understanding the risks and benefits of the portfolio. Counterparty and ISDA arrangements may pose potential risk. Furthermore, derivative strategies may be exposed to the risk of market disruptions, volatility, and governmental interventions.

Illiquid investments (such as, but not limited to, private credit, private equity and infrastructure):

General/Loss of capital. Investment involves a high degree of risk. There can be no assurance that return objectives will be realised and investors could lose up to the full amount of their invested capital. Fees and expenses may offset the trading profits.

Limited liquidity. Investments in private markets may result in restricted liquidity since withdrawal rights are limited and interests are not freely transferable or redeemable. There is unlikely to be a secondary market for private market investments interests.

Volatility. Investment techniques used may include the use of leverage and derivative instruments such as futures, options and short sales, which could amplify the possibilities for both profits and losses and may increase volatility.

Hedge Fund investing is speculative and involves significant risk including the risk of losing some or all of the invested capital. Hedge fund strategies may participate in the buying and selling of equity and debt securities, private investments funds, non-readily realisable investments, illiquid investments suspension of trading, concentrated investments, developed and emerging market investments. Hedge fund strategies may be exposed to risks stemming from usage of leverage, derivatives, futures, options, over-the-counter derivative transactions. Counterparty and ISDA arrangements may pose potential risk. Furthermore, hedge fund strategies may be exposed to the risk of market disruptions, volatility and governmental interventions.

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Forward looking return, volatility, and correlation assumptions have been derived by SECOR, and are based on a combination of: a) the historic performance of each asset class based on what we consider to be appropriate indices or suitable proxies, and over a period that we consider to be appropriate in light of prevailing market conditions (typically 10 years); and b) our judgement in relation to how historic performance, and its various components, may differ in the future. This may include, for example, ad-hoc adjustments to reflect our view that markets are over or under valued.

The resulting assumptions are assumed to be appropriate for asset and liability projections over the medium to long term i.e. 10 to 20 years or longer, and are net of all ongoing management costs and fees.

Expected returns for an asset class are generally built up from and include an allowance for our projected return on cash, inflation, spreads, risk premiums, liquidity premiums, potential losses, valuation adjustments, alpha for active management, management fees, other ongoing costs, and any other factors that we may consider are appropriate for the asset class and/or prevailing market conditions. Expected returns generally <u>do not</u> allow for SECOR advisor or fiduciary management fees, or any transition or rebalancing costs between asset classes or an existing portfolio.

A material risk factor is that the projected returns modelled are underpinned by historic market returns combined with SECOR's assumptions on future market returns, meaning that the projected net returns used for modelling portfolios may not be realised within expected timeframes.

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