GALLOWAY CAPITAL

GALLOWAY EMERGING MARKETS BOND FUND – December 2024

The Federal Reserve executed its third consecutive rate cut in December, lowering the benchmark rate by 25 bps to a range of 4.25%-4.50%. Since the beginning of the easing cycle in September, rates have fallen by a total of 100 bps. The statement suggested a slower pace of cuts in 2025 than previously anticipated, as the Summary of Economic Projections reflected stronger economic growth. This was driven by upward revisions to growth and inflation forecasts, with core inflation adjusted from 2.2% to 2.5%, and a downward revision in the unemployment rate. Notably, the target rate is now estimated to be reached by 2027. In 2024, according to EPFR, global bond funds saw a record inflow of over **$600 billion**, driven by expectations of monetary easing due to slowing economic growth and inflation. The 10-year U.S. Treasury yield started the year at 3.88% and ended at **4.57%**, increasing by around **69 bps**. Despite these broader market challenges, our fund had a positive performance of **11.38%*** during 2024.

The Brazilian Central Bank (BCB) recently raised the Selic rate by 1 percentage point to 12.25%, signaling a more hawkish stance due to rising inflationary pressures and fiscal challenges. The decision, unanimously supported by the BCB board, including newly appointed directors, reflects concerns over persistent inflation, particularly in services, a stronger-than-expected economy, and external uncertainties. The BCB revised its inflation projections upward, expecting 4.9% in 2024 and 4.5% in 2025, well above the 3% target. Fiscal risks, particularly from recent government spending announcements, have contributed to market volatility, impacting inflation and exchange rate expectations. In response, the BCB committed to tightening monetary policy, with further rate hikes likely, bringing the Selic to 14.25% by March 2025. Given the increased challenges for highly leveraged companies, we have made the decision to reduce our exposure to Brazil by selling specific high-leverage positions, which are more susceptible to the impacts of the upcoming interest rate hikes.

In Turkey, the central bank reduced the policy rate by 250bps to 47.5%. While this was above the median estimate of 175bps, the move was not entirely unexpected, as some forecasters had anticipated it. Although there may be a partial political dimension to the decision, the CBRT clarified that it will not necessarily maintain the same pace of rate cuts. Instead, it emphasized a cautious, data-driven approach, stating that decisions will be made "prudently on a meeting-by-meeting basis with a focus on the inflation outlook." The size of the cut reflects the ongoing decline in inflation, which has dropped to 47.1% from over 75% in the first half of the year. The central bank has set an ambitious target to reduce inflation further to 21% by the end of 2025. This more positive outlook follows a significant shift in economic leadership after Erdogan's reelection in May 2023, which ushered in orthodox monetary policies, including a hike in rates to 50%.

The fund currently has a yield to worst of **8.50%**, duration of **4.36** years and an average credit rating of **BB-**.

Kind regards,