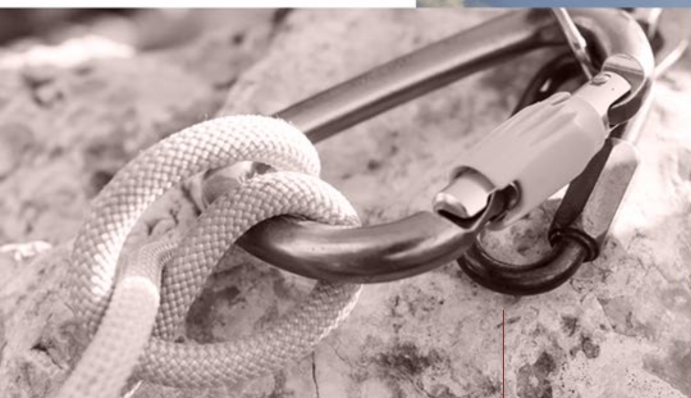
CITĒ GESTION
PRIVATE BANK

Newsletter: A sentiment of «déjà vu» March 2023



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3. Equity
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Key Take-Aways

- In February, the narrative of higher Fed rates for longer had a negative impact across all asset classes, with the exception of the US dollar, reminding investors a sentiment of «déjà vu» from 2022.
- Most recent data, not only in the US, suggest a reacceleration of the economy. Focusing on the US, the recent series of data showing healthy growth and persistent price pressures culminated with the Fed's preferred measure of inflation the US core PCE - printing 4.7%, much higher than the forecast of 4.3%, and a reverse in its recent moderating trend.
- Spreads on both investment grade and HY first widened going into February but moved sideways in the second half of the month. While spreads remain historically elevated, they are far from pricing a recession. And in USD, cash has now become a serious competitor to investment grade bonds, offering comparable yields without duration risk.
- But the time might have come, to consider taking a bit more duration again, at least in USD. While the hiking cycle is not over yet, it is clear that at some point, the US Treasury curve will steepen again. We recommend to buy into some of the recent high-quality issues with maturities slightly longer maturities.
- In equity, we continue to remain cautious on growth stocks which should be more affected by the slowdown in earnings growth, especially as their respective valuations remain high.
- We expect weaker corporate results in the 2nd half of the year and in the current market environment, we recommend to overweight defensive market sectors (healthcare, consumer staples, utilities & communication services) but to underweight weighted cyclical sectors. Quality remains key.
- In Europe, the outlook has improved as the energy crisis did not materialize and China reopened. The low point hit by the markets in September 2022 is probably behind and Europe is now outperforming on the American markets for a few months now
- On the FX side, The same forces that positively impacted the US dollar throughout 2022 were back in play in February. The dollar strengthened, driven in particular by strong US economic data, which included a resilient job market. All of this data suggests that the Federal Reserve will have to continue raising interest rates to curb inflation.

Review

It may take longer than expected

The equity and bond markets declined in February after the strong gains seen in January, except for Europe, which continued its strong run. Good economic data and rate hikes by the Fed, the European Central Bank and the Bank of England caused investors to rethink their theory of a rapid decline in interest rates.

This was reflected in bond yields which all rose, with the US 10Y approaching 4% and the Bund reaching levels not seen for 10 years.

The S&P500 weakened by -2.45%, the Dow Jones by -3.94% and the Russell 200 by 1.69%, with only the Nasdaq Composite doing better, ending the month at -1%.

The EuroStoxx50 ended the month at +1.94%, the CAC 40 at +2.63 and the Dax + 1.57%. Only the SMI finished in the red, at -1.66%.

The MCSI Emerging Markets index fell by -6.48%, driven by China (CSI 300 -2.08%), South Korea (-0.50% in LC and -6.93% in HC) and especially by Brazil (-7.49%).

As for the US sectors, only technology ended in the green, with a shy gain of 0.45%.

On the bond side, the rise in sovereign rates pushed the global indices down sharply, with the Bloomberg Global Aggregate Index rising by -3.32%, the EMBI index by -2.20% and the BBG Global High Yield by -1.89%. In Europe, the BBG Euro Aggregate Index continued to suffer from rising rates, with a loss of 2.09%.

The DXY index recovered what it had lost the previous month, i.e. 2.72%.

As mentioned above, the US 10 year yield ended the month up 41bps, the Bund up 37bps and the UK Gilt up 49bps.

The Bloomberg Commodity Index continued its decline from August 2022, ending the month at 106.159.

The VIX remained fairly stable at 20.70 vs 19.40 for January.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,970	-0.29	-0.64	-2.45	3.68	3.68	16
Nasdaq	11,456	-0.10	-0.30	-1.00	9.61	9.61	21
Russell 2000	1,897	0.06	0.51	-1.69	7.89	7.89	17
Euro Stoxx 50	4,238	-0.23	-0.28	1.94	12.07	12.07	12
Stoxx 600 EUR	461	-0.32	-0.51	1.89	8.78	8.78	12
FTSE 100	7,876	-0.74	-1.02	1.76	6.18	6.18	10
SMI	11,098	-1.08	-1.63	-1.66	3.44	3.44	15
NIKKEI 225	27,446	0.08	-0.04	0.49	5.25	5.25	15
CSI 300 China	4,069	0.63	-1.78	-2.08	5.14	5.14	12
MSCI EM Index	964	-0.33	-3.11	-6.48	0.91	0.91	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,970	-0.29	-0.64	-2.45	3.68	3.68	16
UTILITIES	329	-1.72	-3.24	-5.90	-7.78	-7.78	16
ENERGY	638	-1.43	-0.65	-7.12	-4.51	-4.51	11
TELECOM	174	0.25	-1.47	-4.66	9.16	9.16	13
CONS STAPLES	752	-0.74	-1.97	-2.40	-3.27	-3.27	18
REAL ESTATE	240	-0.02	-1.70	-5.99	3.32	3.32	16
CONS DISCRET	1,130	-0.02	0.01	-2.16	12.54	12.54	20
MATERIALS	515	0.49	2.35	-3.30	5.38	5.38	16
HEALTH CARE	1,480	-0.73	-2.34	-4.61	-6.39	-6.39	15
INFO TECH	2,380	-0.19	0.03	0.45	9.81	9.81	20
FINANCIALS	593	0.17	0.18	-2.30	4.41	4.41	11
INDUSTRIALS	852	-0.23	0.28	-0.89	2.80	2.80	17

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	104.869	0.19	0.67	2.72	1.30	1.30
EUR-USD	1.0576	-0.31	-0.68	-2.64	-1.21	-1.21
USD-JPY	136.17	-0.01	0.86	4.67	3.85	3.85
USD-CHF	0.9422	0.68	1.55	2.84	1.91	1.91
EUR-CHF	0.9965	0.37	0.88	0.14	0.71	0.71
GBP-USD	1.2022	-0.35	-0.74	-2.42	-0.50	-0.50
EUR-GBP	0.8798	0.04	0.05	-0.21	-0.63	-0.63
JP EM FX Index	50.22	0.12	-0.40	-1.98	0.64	0.64

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.92	1	-3	41	5	5
Germany	2.65	7	12	37	8	8
UK	3.83	2	21	49	15	15
SWITZERLAND	1.47	-1	-3	18	-15	-15
Japan	0.51	-0	-0	1	8	8
US IG Spread	139	1	1	10	-4	-4
US High Yield spread	470	-2	-23	7	-39	-39
EUR High Yield spread	412	1	-1	-21	-89	-89

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	106.2	0.18	-0.83	-5.05	-5.89	-5.89
Gold Spot $/OZ	1826.9	0.54	-0.45	-5.26	0.16	0.16
Crude Oil WTI	77.1	1.81	1.17	-2.31	-4.00	-4.00

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	20.7	-0.25	-2.17	1.30	-4.48	-0.97

Source : Bloomberg 02/28/2023

Macro & Rates

An unpleasant sentiment of «déjà vu»

In February, the narrative of higher Fed rates for longer had a negative impact across all asset classes, with the exception of the US dollar, reminding investors a sentiment of «déjà vu» from 2022.

Most recent data, not only in the US, suggest a reacceleration of the economy. Focusing on the US, the recent series of data showing healthy growth and persistent price pressures culminated with the Fed's preferred measure of inflation the US core PCE - printing 4.7%, much higher than the forecast of 4.3%, and a reverse in its recent moderating trend. Even the housing market seems to have digested the aggressive tightening from 2022 with House Prices rising 0.7% in January.

The disinflation process observed from nearly 2 quarters gave hope to investors for a pivot in June this year with investors having expected at the end of January aggressive rate cuts from the Fed as soon September. At the extreme, investors were anticipating the peak in Fed fund rates at 4.75% for June and a reverse to 4.1% by December, below the level we started in January this year.

In a couple of sessions early in February, the macro picture moved drastically from hard landing, to soft landing to reach maybe the point of no landing at all. This has naturally triggered a recalibration of policy expectations to a significant degree.

The US employment report from January outsized strength in labor markets. 517,000 jobs last month, far more than the 188,000 expected by economists. The unemployment rate fell to 3.4%, the lowest since 1969. Consumer is not in rest as well: Retail Sales crushed expectations with headlines figure rising 3% vs 2% expected meanwhile the Empire survey also bested expectations, rising all the way to -5.87 from the prior -32.9.

The rise in yields since the release of the US employment on February 3rd to today has been obvious, and it is clear that the market has recalibrated its expectations for Fed policy over the next few months. Investors now anticipate a terminal Fed fund rates at 5.5% and more importantly for much longer with the net easing over the course of 2023 having disappeared.

Over the last month, the spread between the first Fed fund future (march 2023) and the one in one year (March 2024) moved by 135bps, the biggest move ever! This translates quite well the violence of the recent policy recalibration.

The risk of an "overshoot" from the Fed is elevated and we now consider the risk of a higher anticipated or realized Fed fund rates at 5.75%, even 6%. If realized, the probability of a recession in one year should increase materially from current level.

For now, Credit and Equities do not fully discount recession, given that the S&P500's peak-to-trough drawdown is now only 17% (compared to 25-30% recession norm) and that the credit curve (spread between High Yield and High Grade) is only about 339 bp slope vs recession norm of at least 600bp.

However, we consider that we are close to point where we would be confident to add/own quality duration. The pass-through from 2Y rates to 10Y rates diminishes significantly during the late-cycle phase as recession fears grow. Diminishing pass-through is why the curve inverts, and why the money market can price a higher terminal rate (5.75%) while 10s don't go much above 4%. Target 4.25%.

If a scenario of recession materializes, there are for sure further adjustments to be made to the market rate structure, the foreign exchange market and more broadly to the price of anything that uses discount rates to derive net present values.

Fixed Income
Back zo zero

An extraordinary start into the year was followed by a quick reversal: fixed income YTD performances have fallen, and in the case of govies they are now negative. High-yield held up better thanks to a «spread buffer» and no pricing of recession risk, at least for now.

The turning point coincides with the Fed's rate decision at the beginning of February. However, it was not so much the expected 25bps hike that upset the market. A flurry of macro data in the US weighed on (USD) fixed income: non-farm payrolls 517k vs 189k, still high YoY and MoY US CPI and PPI and stronger than expected retail sales, to name just a few.

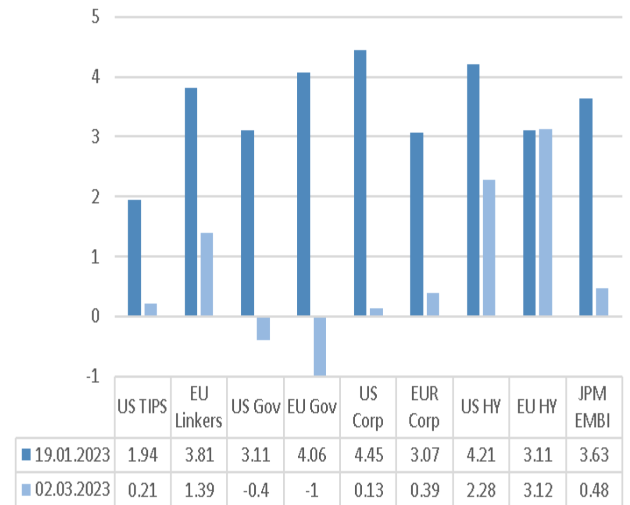
The impact was a flattening of the Treasury curve. Especially the «belly» of the curve as well as the longer end rose. The 3-7 year segment saw yields rise by 80bps+. This was the main driver of the negative performance in USD indices. The shorter end remained relatively well-anchored and holding short paper as we advocated earlier helped avoid worse portfolio performances.

Spreads on both investment grade and HY first widened going into February but moved sideways in the second half of the month. While spreads remain historically elevated, they are far from pricing a recession. And in USD, cash has now become a serious competitor to investment grade bonds, offering comparable yields without duration risk.

But the time might have come, to consider taking a bit more duration again, at least in USD. While the hiking cycle is not over yet, it is clear that at some point, the US Treasury curve will steepen again. We recommend to buy into some of the recent high-quality issues with maturities slightly longer maturities (see examples in the table).

In EUR, the hiking-cycle is probably less advanced. But a recent wave of new EUR issues mainly from financial issuers offers interesting investment opportunities, too.

Fixed income performances 19.01.23 & 02.03.23



Source : Bloomberg

US Treasury curve 02.02.23 and 02.03.2023

Source : Bloomberg

US Corporate Bond Opportunities

ISIN	COUPON	ISSUER	MATURITY	IND. PRICE	IND. YIELD	RATING
US742718FY05	4.1	Procter & Gamble	26.01.2026	98.35	4.72	AA-
US458140CD04	4.875	Intel	10.02.2026	98.84	5.34	A
US459200KW06	4.5	Ibm Corp	06.02.2026	98.08	5.22	A3
US713448FQ60	4.55	Pepsico Inc	13.02.2026	99.43	4.76	A+
US031162DN74	5.507	Amgen Inc	02.03.2026	99.93	5.53	BBB+
US24422EWR60	4.75	John Deere Cap	20.01.2028	99.57	4.85	A
US04636NAF06	4.875	Astrazeneca	03.03.2028	99.3	5.04	A
USU74078CT83	4.25	Nestle Holdings	01.10.2029	97.18	4.75	AA-

Equity

Technical and fundamental analyzes benefits to Low quality rally

Markets are technically well oriented in the US and in Europe but fundamental values make us remain cautious.

The main US stock indices closed down in February. The S&P 500 tested its 200MA before going up again. The Nasdaq evolved similarly and remains above its 200 MA. Technically, the markets are well oriented but the latest economic figures make us think that the rate hike is by far not over and that it could impact the equity markets.

The ISM manufacturing index rose in February for the first time since May 2022 (although it remains in contraction at 47.7), while the services PMI index fell slightly, but less than the expectations of the consensus, and still indicates a moderate expansion (55.1)

The US economy behaved quite unexpectedly since the start of the year with rising job creation and low unemployment. The S&P 500 shows a 12-month PER just below 18.

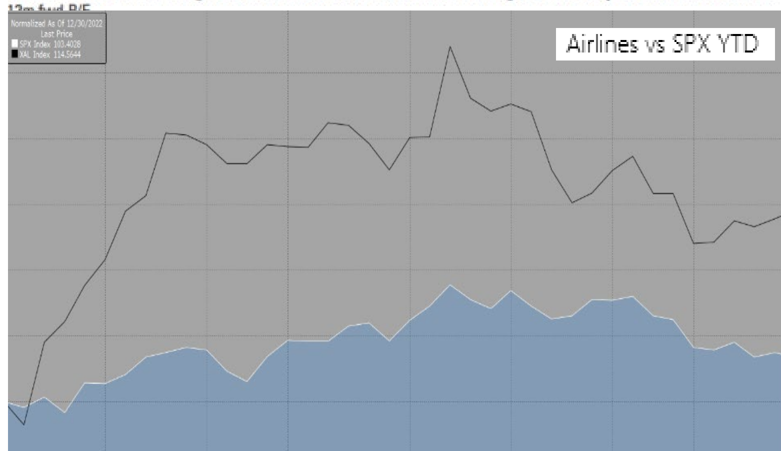
We continue to remain cautious on growth stocks which should be more affected by the slowdown in earnings growth, especially as their respective valuations remain high.

We expect weaker corporate results in the 2nd half of the year and in the current market environment, we recommend to overweight defensive market sectors (healthcare, consumer staples, utilities & communication services) but to underweight weighted cyclical sectors. Quality remains key.

In Europe, the outlook has improved as the energy crisis did not materialize and China reopened. The low point hit by the markets in September 2022 is probably behind and Europe is now outperforming on the American markets for a few months now.

Big Test
S&P 500 fights to stay above key uptrend line from October low

Exhibit 2: The US is trading at a round 18x forward consensus earnings while Europe trades at around 13x 12m fwd P/E



Source : Bloomberg

Thema : Airlines are back !

Airline stocks are back in investor portfolios. The sector is strongly outperforming S&P 500 year to date. Investors should remain cautious on stock selection. Indeed, some companies have diluted their capital more than others to stay afloat during the covid crisis. In Europe, Lufthansa has benefited in recent months from the anticipation of the reopening of the Chinese market and from record freight volumes, despite numerous flight cancellations last year. The 2022 results were rightly welcomed by the market. In the US, plane ticket prices are high, which allows players to maintain their margins in the face of higher costs than in 2019, in particular due to inflation. Reservations for the summer of 2023 are looking good according to the announcements of the various companies. Current prices do not yet reflect these figures. "Your Next Holiday Flight Will Cost a Fortune" titled the Washing Post in an article published on March 8th. All is said...

Forex And Commodities
USD Still King But For How Long ?

The same forces that positively impacted the US dollar throughout 2022 were back in play in February. The dollar strengthened, driven in particular by strong US economic data, which included a resilient job market. All of this data suggests that the Federal Reserve will have to continue raising interest rates to curb inflation.

Based on these factors, we could expect the US dollar to continue its bullish trend in the short term. However, unlike in 2022, we are starting to see fewer supportive macro forces in favor of the USD that could end its momentum by the end of H1 2023. Firstly, a slower path of Fed tightening is on the way and should continue to decrease in the upcoming months. Meanwhile, other G10 central banks continue to tighten their rates with no immediate pivot at the horizon. The narrowing of the rate differential between US and its peers could be enough to justify further USD weakness in 2023. Secondly, in the Euro area, inflation remains high and sticky, which is pushing up rate hike expectations for the European Central Bank (ECB). Additionally, China's reopening could have a negative impact on the dollar. As observed in early March, the dollar was negatively impacted by China's manufacturing activity expanding at its fastest pace since April 2012. This sent forex investors back toward riskier assets and away from the safe haven dollar.

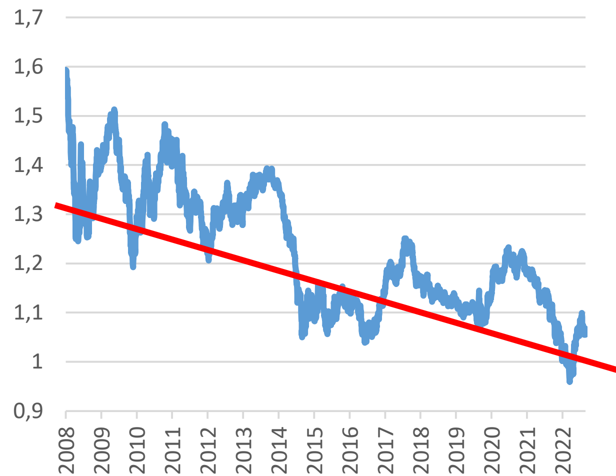
Therefore, we could expect that the gains in EUR/USD could regain more ground in the next 6-9 months. In the short term, the bearish trend should continue to move lower towards the support of the uptrend channel started in 2008 at level 0.94, while the recovery on the EUR/USD could be limited by the 200-day moving averages at 1.0725. In the long term, we could expect the recovery phase to reach the 1% standard deviation resistance line at 1.13. The EUR/USD could finish the year around the 1.15 level.

The USD/CHF pair has been oscillating within a range of 0.90-0.96. The Swiss Franc could benefit from the relatively low inflation in Switzerland and its status as a safe haven currency, which makes the CHF real rate more attractive compared to its European counterparts. For the short term, it is likely that the USD/CHF will continue to trade within this range. However, if the pair breaks above the 200-SMA at 0.9564, this could be a medium-term bullish signal. Moreover, a break above the YTD median at 0.9604 could lead to a further rally close to parity.

We urge more caution on relatively lower yielding currencies such as GBP, NOK, SEK, or RMB. These currencies will remain vulnerable given their lower carry and are likely to depreciate, as the support of their respective central banks weakens. For forex investors, the rate advantage of these currencies is too small considering the associated risk. On the contrary, high carry EMs such as the MXN and BRL could continue to withstand US yield repricing.

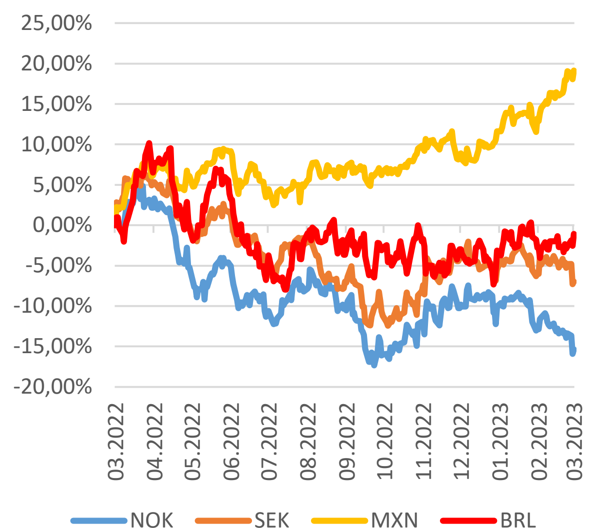
Finally, regarding gold and precious metals, investors are waiting for any signs of additional weakness in the US economy, which could support these assets. Gold is very sensitive to rising US interest rates and could regain momentum once the situation normalizes. In the meantime, if the psychological support at 1800 is breached, gold could continue its bearish trend till the next support at 1775. On the other side, a break above resistance at 1869 (50-day SMA) could open the door to new momentum.

The bottom support of the EUR/USD limited by the bearish trend started in 2008



Source : Bloomberg

The impact of low carry currencies vs High Carry relative to the USD



Source : Bloomberg

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