Newsletter: Calm before the storm?

May 2023

Key Take-Aways

- Stock markets continued their rebound. The S&P 500 is up by 9.16% and the Euro Stoxx 50 index is returning 16.36% year-to-date. European equities outperformed their US equities, especially if measured in USD which depreciated vs the euro.
- A new episode in the banking crisis with the rescue of First Republic by JP Morgan. It highlights once again the outflow of cash from custodians in the US regional banks.
- The debt ceiling in the US is adding a new layer of stress in the market with the current projection for the US treasury to be short of liquidity in early June. In the T-bills market : maturities before June trade at significantly lower yields than longer ones.
- Small caps are still underperforming. Until April 28, the S&P500 index was up by 7.65% of which 6.44% came from the FAANG + MNT.
- A strong British Pound year to date mainly due to the fact that the BoE needs to bring up interests rates. The EUR/USD appreciated to 1.10 and a target at 1.15 for the end of the year seems now plausible.
- Gold is consolidating above USD 2,000 and is now, pushed by speculators, ready for a free run towards a record high at USD 2,075.

Review
Dispersion in equities and bonds

Equities continued their rebound which began in September of last year. The S&P 500 index is up 9.16% and the Euro Stoxx 50 index added 16.36% since the beginning of the year. In April, these indices returned 1.56% and 1.79%, respectively.

Equities were marked by two phenomena: firstly, small cap indices such as the Russell 2000 (-1.8%) underperformed large-cap indices such as the S&P 500 index (+1.56%). Secondly, European equities are still ahead of US equities both YTD and in April. Emerging Markets are once again lagging the overall market, with the MSCI EM index up only 2.85% YTD and down 1.12% in April.

When looking at sector performances in the S&P 500 index a mixed picture appears: on one hand IT (up 22.37% YTD) is among the strongest performers, but defensives such as telecoms also fared well (+25.05% YTD). In April, the best performance came from telecoms, consumer staples and energy. Consumer discretionary and materials posted negative returns.

In forex, the dollar continues its steady depreciation initiated in September of last year. The greenback lost another 1.66% vs. the euro and 2.26% vs. the Swiss franc. However, both the yen and the sterling depreciated against the dollar in April by 2.59% and 1.86%, respectively.

The Swiss franc once again appreciates on the back of “safe-haven flows” and is up 0.68% vs. the EUR. Emerging Market currencies showed some weakness in April.

Outperforming European equities coupled with an appreciation of the euro vs. the dollar led to a marked outperformance of European equities vs. US equities when measured in USD: the MSCI Eurozone index returned 45% in USD since September of last year while the MSCI USA index added merely 10.75%. YTD the performance of European equities measured in USD is more than double the performance of US equities.

Core rates traded sideway in April but both the 10-year US Treasury and the 10-year German Bund are up YTD, with their yield falling by 45bps and 26bps, respectively.

While “risk-free” govies saw their yields fall YTD, corporate spreads have not widened substantially over the same period as could be expected: US high-yield spreads rose by 4bps and EUR high-yield widened by 6bps in April.

Within commodities, gold was shining again in April. The yellow metal rose another 1.05%, bringing the YTD performance to 9.10%. Commodities as an asset class are down both in April and YTD, mainly driven by falling energy prices.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 169	0.84	2.42	1.56	9.16	9.16	17
Nasdaq	12 227	0.70	3.63	0.07	17.13	17.13	24
Russell 2000	1 769	1.02	1.33	-1.80	0.88	0.88	18
Euro Stoxx 50	4 359	0.15	-0.16	1.79	16.36	16.36	12
Stoxx 600 EUR	467	0.65	0.08	2.61	11.42	11.42	13
FTSE 100	7 871	0.50	-0.18	3.41	7.08	7.08	11
SMI	11 437	0.66	-0.66	4.14	9.44	9.44	17
NIKKEI 225	28 856	1.40	0.83	2.91	11.67	11.67	16
CSI 300 China	4 029	1.02	1.70	-0.50	4.14	4.14	11
MSCI EM Index	977	0.60	1.30	-1.12	2.85	2.85	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 169	0.84	2.42	1.56	9.16	9.16	17
UTILITIES	350	-0.16	-1.34	1.87	-1.44	-1.44	17
ENERGY	655	1.54	0.69	3.30	-1.56	-1.56	11
TELECOM	198	0.54	5.44	3.78	25.05	25.05	15
CONS STAPLES	807	0.48	0.79	3.60	4.45	4.45	20
REAL ESTATE	237	1.17	2.77	0.97	2.86	2.86	17
CONS DISCRET	1 152	-0.04	2.34	-0.95	14.95	14.95	21
MATERIALS	507	1.14	1.30	-0.14	4.14	4.14	17
HEALTH CARE	1 555	0.82	-0.09	3.07	-1.37	-1.37	17
INFO TECH	2 650	1.07	5.06	0.45	22.37	22.37	23
FINANCIALS	551	1.23	1.88	3.18	-2.56	-2.56	13
INDUSTRIALS	846	0.92	1.01	-1.18	2.24	2.24	17

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	101.659	0.15	-0.20	-0.83	-1.80	-1.80
EUR-USD	1.1019	-0.08	0.42	1.66	2.93	2.93
USD-JPY	136.30	1.74	1.90	2.59	3.95	3.95
USD-CHF	0.8946	0.02	0.30	-2.26	-3.23	-3.23
EUR-CHF	0.9854	-0.10	0.68	-0.68	-0.42	-0.42
GBP-USD	1.2567	0.55	1.27	1.86	4.01	4.01
EUR-GBP	0.8768	-0.64	-0.85	-0.26	-0.97	-0.97
JP EM FX Index	50.65	0.17	0.73	-0.35	1.50	1.50

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.42	-10	2	-5	-45	-45
Germany	2.31	-15	-7	2	-26	-26
UK	3.72	-8	2	23	5	5
SWITZERLAND	1.05	-9	-2	-20	-57	-57
Japan	0.39	-7	-9	4	-3	-3
US IG Spread	145	1	-1	0	2	2
US High Yield spread	506	3	-6	4	-3	-3
EUR High Yield spread	475	6	5	6	-26	-26

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	104.3	0.94	-0.29	-1.13	-7.53	-7.53
Gold Spot $/OZ	1990.0	0.11	-0.37	1.05	9.10	9.10
Crude Oil WTI	76.8	2.70	-0.38	1.47	-4.34	-4.34

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	15.8	-1.25	-2.98	-2.92	-27.18	-5.89

Source: Bloomberg 04/30/2023

Macro & Rates
Further Bricks in the Wall of Worries

The banking crisis is adding another brick in the wall and is again making headlines, following evidence of more deposit flights from US regional banks and First Republic's rescue by JP Morgan. Liquidity leaving the smaller lenders is the consequence of the Fed's very tight policy that the banking system as a whole cannot sustain for long. A deeply inverted yield curve limits lenders' profitability and in the end their balance sheets, feeding the inevitable credit crunch.

It is a matter of time for banks and lenders to gradually adjust accordingly, shrinking credit, that in turn will negatively impact the economy, most likely triggering a vicious circle. At that point further weakened banks in the financial system will emerge. For instance, the banks overexposed to commercial real estate, a significant asset in the balance sheet of smaller lenders at risk of falling further in value, could come in the spotlight. And this brings us to the underappreciated odds of the risk of an economic contraction.

The Debt ceiling in the US is also building up the wall of worry. It is currently projected that the US Treasury would be running out of available funds to pay its debt as soon as early June, unless the debt ceiling is raised by Congress and the Treasury is then allowed to again issue bonds to finance it.

The debt ceiling debate is still ongoing and of course, there is little doubt that neither side wants a remake of 2011. Indeed, the debt ceiling crisis this year sparked the most volatile week for financial markets since the 2008 crisis, led to the downgrade by Standard & Poor of the credit rating of the United States government (the first time in the country's history) and increased borrowing costs by an estimated USD 19 billions.

While our core scenario is NOT a debt ceiling fracas that would bring down financial markets, we underline the risk that any delay would bring in terms of liquidity for financial markets. In summary, the intersection of the banking crisis and the debt ceiling is going to cause significant liquidity to leave markets. In a less liquid summer market, this liquidity drain will likely affect risk assets.

As widely expected, the Federal Reserve (Fed) and the European Central Bank (ECB) both increased their benchmark rate by 25bps to respectively 5% and 3.25%. Between the lines, The Fed signaled that future moves will based on a data dependent approach suggesting a pause for now, while the ECB' small rate increase suggests it might have entered the final stage of its tightening cycle.

While the fact that those two major central banks approach the end of their tightening cycle might be good news, both remain very concerned about inflation, and recent data gives them the right to be cautious.

In the US, the headline GDP price index and core PCE deflator both came in hot, printing 4% and 4.9% versus expectations of 3.7% and 4.7%, respectively. The US Employment Cost Index rose more than expected at 1.25% on the quarter. Wages climbed 1.2% on the quarter, underlining a pretty solid rise in labor costs

On top of that, the labor market continues to show some resilience. The recent US employment report was stronger than expected, suggesting more labor-market tightening with the unemployment rate matching its cyclical low of 3.4%. Monthly pay gains were 0.5%, well above expectations. Taken at face value, that suggests that the labor market is tight enough to spur more aggressive pay rises as firms compete for labor.

Clearly, the inflation theme is not dead yet. Central banks are facing a difficult environment to decide the future of monetary policy. A resilient economy with strong labor market, a highly anticipated markdown in earnings that has so far failed to materialize in this earning seasons (Q1 2023 earning are indicating that S&P500 companies will deliver a 3% beat on earnings versus consensus expectations), a sticky inflation and a global outlook that will likely deteriorate in the coming weeks on the back of the banking crisis and the debt ceiling debate: The wall of worries is building up.

Fixed Income
Stress in the T-bill market

Since the beginning of the year, all types of fixed income are in positive territory with performances ranging from approx. 2% to 5%. Meanwhile, volatility has increased significantly. The US 10-year Treasury yield traded in a range between 3.2% and 3.64% to end the month literally unchanged at 3.4%. Implied volatility, as measured by options on Treasuries, has risen to a level not seen since 2008.

This nervousness is on one hand due to the uncertainty regarding inflation and the future path of monetary policy. On the other hand, in the US the Treasury is expected to run out of cash as early as June. So far no agreement to lift the debt ceiling has been reached. This has led to a remarkable anomaly in the T-bills market: maturities before June trade at significantly lower yields than longer ones. Clearly, institutional investors regard short-dated bills as the best option to place cash, preferring them to bank deposits in light of the recent regional bank failures in the US.

While the flight to «risk free» T-bills seems strong for now, the longer-term outlook and appetite for this asset class seems at least questionable: a persistently high US deficit calling for $2trn of new issuance per year, fading appetite from foreigners to place their reserves in Treasuries and the fact, that the debt-servicing charge from the Treasury is rising sharply - to name just a few. And all this in an environment where the Fed is rising rates and trying to shrink its balance sheet...

Surprisingly, credit spreads have not widened a lot in April: US HY spreads remained around 5% and investment grade traded not wider than 1.5% on average. There seems to be no stress in corporates so far.

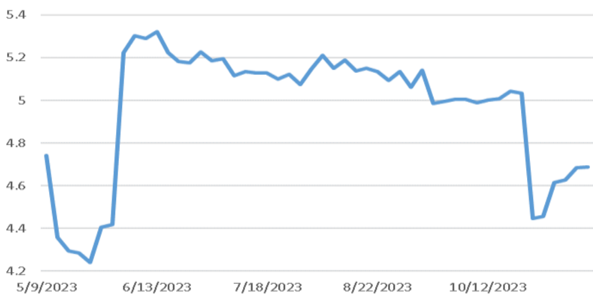
We do not recommend to have more than a neutral allocation to HY corporate debt in this uncertaine environment. Investors who seek security and do not expect the US to default on its debt, soon, can find interesting opportunities at the short end of the Treasuries curve.

In general, we favour good-quality US investment grade debt. Meta (A+) tapped the market with a jumbo multi-tranche issue, raising more than $8bn – an issues which according to some sources even weighed on Treasury yields on the day of issuance due to its size!

Implied volatility on 1m US Treasury options

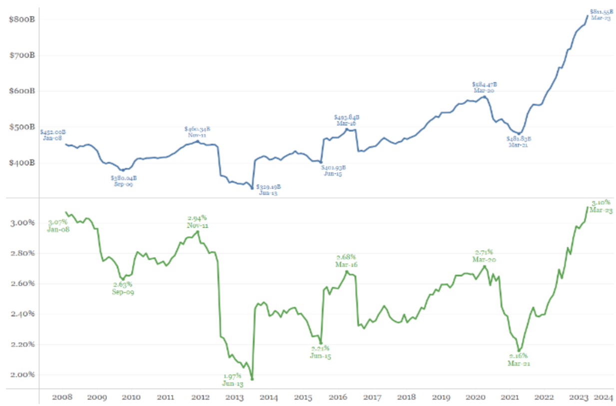
Source: Gavekal Research

US T-bills curve as of 5.5.2023



Source: Bloomberg

Sum of 12-months Treasury interest expenses (blue) and as yearly percentage of GDP (green) since 2008



Source: Bianco Research LLC

New Meta (Facebook) multi-tranche issue in USD (prices and yields are indicative)

ISIN	COUPON	ISSUER	MATURITY	IND. PRICE	IND. YIELD	RATING
US30303M8L96	4.6	META	15.05.2028	100.955	4.38	A+
US30303M8M79	4.8	META	15.05.2030	101.117	4.61	A+
US30303M8N52	4.95	META	15.05.2033	100.748	4.85	A+
US30303M8Q83	5.6	META	15.05.2053	100.502	5.56	A+
US30303M8R66	5.75	META	15.05.2063	100.64	5.7	A+

Equity
A rally built on… FAANGs

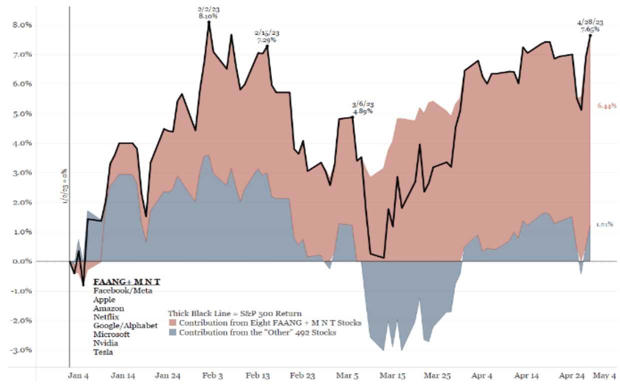
Year to date all major equity indices are comfortably positive, with European large-caps in the Euro Stoxx 50 up 16% and US tech stocks in the Nasdaq returning 17% as of 30.4.23. In April, small-caps continued to underperform, especially in the US, where the Russell 2000 index fell 1.8% while the S&P 500 index added 1.56%. Once again, the US equity rebound YTD was mainly fuelled by the «tech» and «communication services» sectors. Until April 28, the S&P 500 index was up 7.65% YTD, and 6.44% came from FAANG + Microsoft, Nvidia and Tesla. Only 1.21% came from the remaining constituents of this index.

Small caps have markedly underperformed the overall market in the US YTD. Indices like the Russell were more impacted by the heavy losses in US regional bank stocks than for example the S&P 500 which is dominated by a few tech stocks. The S&P 500 Reginal Banks Index is down 33% YTD after steep losses in March. In comparison, the Russell 2000 is virtually flat YTD while the Nasdaq is up double-digit (17.13%).

In spite of the increasing stress in US regional banks, volatility of US stocks as measured by the VIX index remains historically low: the index was trading at 14% at the end of April after briefly spiking to 30% (intraday) in March. The question thus is: are fundamentals sound enough to justify such a low volatility? Or is implied volatility «cheap» in light of increasing problems in the real economy (e.g. US regional banks stability)? The implications are at least twofold: firstly, selling volatility, for example via structured notes, is not a well remunerated activity right now. Secondly, for those who would like to hedge their portfolios via option-strategies, the timing seems quite good as buying protection is relatively cheap.

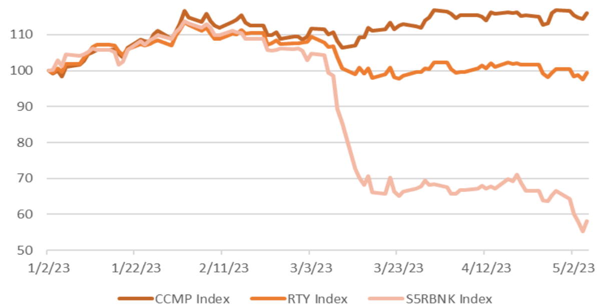
The current earning season will shed more light on the true health of corporate America. So far, large US banks such as JPMorgan, Wells Fargo and Bank of America all beat estimates. It seems that «too big to fail» banks benefit from the whobbles in regional banks.

FAANG+MNT Stocks' Impact on S&P500 YTD



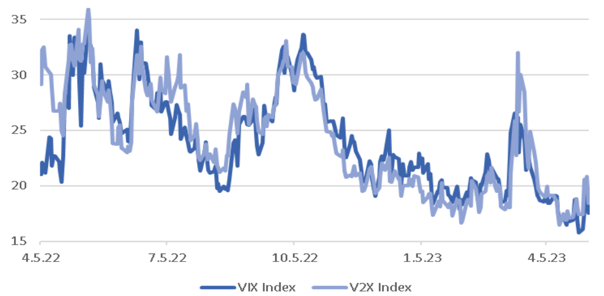
Source: Bianco Research

Nasdaq, RTY & S&P US Regional Banks YTD



Source: Bloomberg

VIX and V2X Index over 1 year



Source: Bloomberg

Earnings release calendar – a selection of US large caps

Company	Ticker	Date	Time	Period	Actual Source	Estimate	Guidance	Description
Walt Disney Co/The	DIS US	10.05.2023	Aft-mkt	Q2 23	Adjusted	0.942		Q2 2023 Earnings Release
Beyond Meat Inc	BYND US	10.05.2023	Aft-mkt	Q1 23	Adjusted	(1.011)		Q1 2023 Earnings Release
Home Depot Inc/The	HD US	16.05.2023	Bef-mkt	Q1 24	Adjusted	3.847		Q1 2024 Earnings Release
Target Corp	TGT US	17.05.2023	Bef-mkt	Q1 24	Adjusted	1.79	1.70	Q1 2024 Earnings Release
Cisco Systems Inc	CSCO US	17.05.2023	Aft-mkt	Q3 23	Adjusted	0.972	0.97	Q3 2023 Earnings Release
Walmart Inc	WMT US	18.05.2023	13:00	Q1 24	Adjusted	1.298	1.28	Q1 2024 Earnings Release
Applied Materials Inc	AMAT US	18.05.2023	Aft-mkt	Q2 23	Adjusted	1.838	1.84	Q2 2023 Earnings Release
Deere & Co	DE US	19.05.2023	Bef-mkt	Q2 23	Adjusted	8.516		Q2 2023 Earnings Release
Intuit Inc	INTU US	23.05.2023	Aft-mkt	Q3 23	Adjusted	8.446	8.46	Q3 2023 Earnings Release
NVIDIA Corp	NVDA US	24.05.2023	Aft-mkt	Q1 24	Adjusted	0.915		Q1 2024 Earnings Release
Costco Wholesale Corp	COST US	25.05.2023	22:15	Q3 23	Adjusted	3.32		Q3 2023 Earnings Release
Dollar General Corp	DG US	26.05.2023		Q1 24	Adjusted	2.409		Q1 2024 Earnings Release
Macy's Inc	M US	26.05.2023		Q1 24	Adjusted	0.468		Q1 2024 Earnings Release

Forex And Commodities
Will the Dollar Retreat As Forex Investors eye Macro Data ?

The beginning of May was a significant period for EUR/USD, with both central banks announcing a 25 basis point hike in interest rates, along with other substantial macro data factors. These data points played a critical role in determining the future policy of the Fed on interest rates. If a pause in rate hikes is confirmed, the USD is likely to continue weakening. Currently, the EUR/USD has reached its bullish target at 1.10 and is now attempting to consolidate above this level, with a resistance level at 1.11. Other bullish factors, such as the net Eurozone portfolio inflow that is growing, improving trade balance in the Eurozone, and the "catch-up" effect favor a higher EUR/USD with a plausible end-of-year target at 1.15.

However, some signals may suggest a short-term reversal of the EUR/USD. The primary risk for a bearish EUR is any geopolitical or economic event that could negatively impact the Eurozone. These events could include the spread of the US banking crisis inside the Eurozone or any unexpected event that could lead investors to seek the safe-haven dollar. The growth in China is also a key factor for the EUR. As this country is essential for exports from the Euro area, a continuing slowdown in China could negatively affect the EUR. The immediate bearish support level for EUR/USD is at 1.10.

Regarding the British Pound, it has been the best-performing currency against the USD among the G10 currencies on a year-to-date basis. *This positive trend is likely to continue in the near term, as the Bank of England needs to continue pushing rates higher beyond May to bring inflation under control.* A more hawkish BoE vs. a cautious Fed would support a breakout month for the pound. The GBP/USD is consolidating above 1.25 and should trend towards a new bullish resistance level at 1.27, with the negative support level remaining at 1.25. The strengthening of the sterling is also observable vs other currencies such as the Euro. The EUR/GBP is likely to remain under pressure (it has already crossed below its 200-day SMA) and could fall below its new support level at 0.869.

As for the Japanese Yen, it has plunged to its weakest level since December vs. the US Dollar and to its lowest level since September 2008 vs. the EUR after the Bank of Japan decided to maintain its ultra-low interest rates and unchanged yield curve control for the time being. Seeing a USD/JPY at 140 could be realistic if no interventions from the BoJ are taken in the short term. *In the longer term, the direction of the USD will determine the dynamic of the USD/JPY, with a depreciating USD that could potentially be leading to a level of 120 by the end of the year.*

Finally, for Gold, speculators are banking on the Fed finishing its rate increases, which is pushing the precious metal to consolidate above the USD 2,000 level. If the dollar continues to deteriorate and US rates pause, gold could have a free run towards a record high at USD 2,075 and beyond. Gold shall remain a popular investment for those seeking a safe haven during times of economic uncertainty.

Could EUR/USD escape from its ociliation at 1.10 level ?

Bloomberg

Will Gold momentum be able to break the USD 2,075 historical high record ?

Bloomberg

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