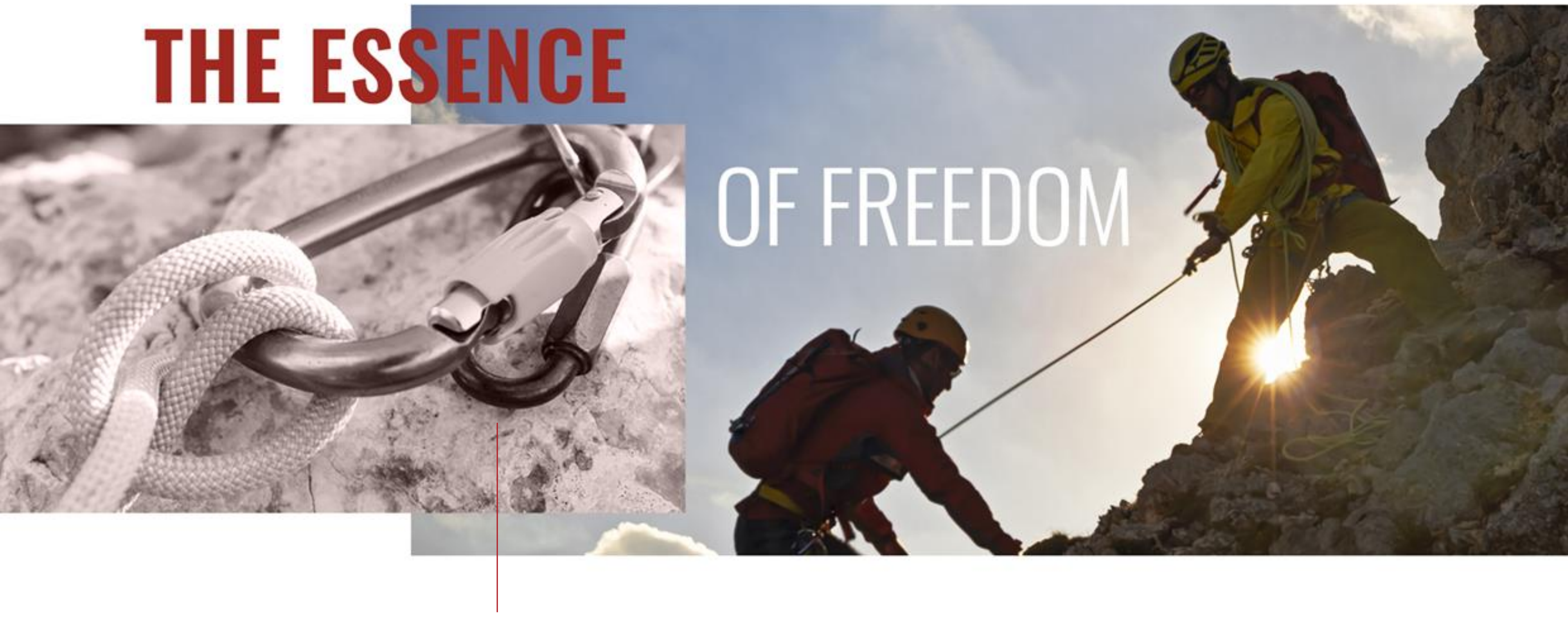
CITÉ GESTION
PRIVATE BANK

# Newsletter: Consensus Around a Soft Landing/ August 2023



1. Macro and Rates
2. Fixed Income
3. Equity
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## Key Take-Aways

- Inflation's gradual fall combined with resilience in both consumption and employment rose the probability of a soft landing.
- The FED followed by the ECB rose their rate by 25 bps.
- Fitch Ratings has downgraded the US rating from AAA to AA+ due to, among other reasons, an "expected fiscal deterioration over the next three years".
- The S&P500 TRI posted a 3.21% return in last month, its best ever July performance in 26 years with a YTD 20.65%.
- The Super Seven Stocks which are Microsoft, Meta, NVIDIA, Google, Amazon, Tesla and Apple, they all hit new highs during July. Their equally weighted performance is +5.16% versus the S&P500 total return +3.21%.
- The US economy grew by 0.6% in Q2 and the inflation fell faster than anticipated.
- A US Credit Downward , Geopolitical uncertainty and strong economic data helped to push back the DXY around 102.

# Review
# Investors Buying Goldilocks

- July was another strong month for equities with major indices rising sharply. US small caps as measured by the Russell 2000 index rose 6,11% over the period. The Nasdaq and the S&P 500 rose by more than 4,08% and 3,21% respectively. The Japanese equity market was flat after its June rebound. The FTSE 100 was up 2,35%. The CSI 300 China index was up 5,36%, a strong performance.

- No sectors were negative in July within the S&P 500. The best performance came from the energy, followed by telecoms up 7.40% and 6.94% respectively. Financials followed with a performance of 4.85% after the FED rate hike. Other sectors performed more or less in line with the index. If we look at the performance for the year all sectors are up with the exception of utilities -3.36% and healthcare, flat. As we previously wrote, Technology continues to advanced its leadership over the index..

- In forex markets, the dollar continued to give up most of its previous gains, and the dollar index fell by 1.03%. The EUR appreciated 0.81% vs. the greenback, touching the 1.10 level again, with a spike over 1.12 during the month. The yen further depreciated vs. the dollar, falling 1.40% but hit the 138 mark during the month. Although the EUR managed to depreciate 1,86% vs. the Swiss franc, the latter depreciated vs. a strengthening dollar by 1.66% after crossing the 1,31 mark during the month. EM currencies remained under pressure and depreciated by 0.37% on average.

- The Bund faced some volatility in July although it corrected at the end of the month and ended with a slightly higher yield. US rates ended the month higher. Only UK saw a correction of the 10 years rate in July. Japan was very volatile, ending the month at a level unseen in more than 5 years.

- Spreads of private investment grade and high yield issuers tightened by 10bps and 32bps, respectively.

- While the commodities segment as a whole rose by 5,78% in July, performances within this group were uneven: Gold added 7.73% fell by 2.21%. Meanwhile WTI added 15,80% after a strong June.

- Equity volatility was flat and the VIX index remains around 13,6%, well below long-term averages.

| Equity % Change | Price | 1 day | 5 days | MTD | QTD | YTD | EST P/E |
|---|---|---|---|---|---|---|---|
| S&P 500 | 4 589 | 0,15 | 0,51 | 3,21 | 20,64 | 20,64 | 19 |
| Nasdaq | 14 346 | 0,21 | 1,56 | 4,08 | 37,72 | 37,72 | 29 |
| Russell 2000 | 2 003 | 1,09 | 1,16 | 6,11 | 14,67 | 14,67 | 20 |
| Euro Stoxx 50 | 4 471 | 0,11 | 2,88 | 1,77 | 21,29 | 21,29 | 12 |
| Stoxx 600 EUR | 471 | 0,12 | 1,28 | 2,17 | 13,92 | 13,92 | 12 |
| FTSE 100 | 7 699 | 0,07 | 0,33 | 2,35 | 5,53 | 5,53 | 11 |
| SMI | 11 309 | -0,08 | 1,12 | 0,26 | 8,56 | 8,56 | 17 |
| NIKKEI 225 | 33 172 | 1,26 | 1,55 | -0,04 | 28,60 | 28,60 | 18 |
| CSI 300 China | 4 015 | 0,55 | 2,80 | 5,36 | 5,83 | 5,83 | 11 |
| MSCI EM Index | 1 047 | 0,36 | 1,47 | 6,28 | 11,66 | 11,66 | 11 |

| Equity % Change | Price | 1 day | 5 days | MTD | QTD | YTD | EST P/E |
|---|---|---|---|---|---|---|---|
| S&P 500 | 4 589 | 0,15 | 0,51 | 3,21 | 20,64 | 20,64 | 19 |
| UTILITIES | 341 | 0,06 | -1,90 | 2,47 | -3,36 | -3,36 | 16 |
| ENERGY | 669 | 2,03 | 1,61 | 7,40 | 1,43 | 1,43 | 12 |
| TELECOM | 231 | -0,03 | 3,14 | 6,94 | 45,70 | 45,70 | 16 |
| CONS STAPLES | 794 | -0,46 | -0,28 | 2,14 | 3,45 | 3,45 | 19 |
| REAL ESTATE | 239 | 0,72 | -1,67 | 1,25 | 5,02 | 5,02 | 17 |
| CONS DISCRET | 1 363 | 0,56 | 1,53 | 2,44 | 36,22 | 36,22 | 24 |
| MATERIALS | 539 | 0,52 | 0,56 | 3,41 | 11,41 | 11,41 | 18 |
| HEALTH CARE | 1 562 | -0,79 | -1,22 | 1,02 | -0,48 | -0,48 | 17 |
| INFO TECH | 3 167 | 0,13 | 1,28 | 2,68 | 46,60 | 46,60 | 25 |
| FINANCIALS | 588 | 0,45 | -0,69 | 4,85 | 4,30 | 4,30 | 14 |
| INDUSTRIALS | 934 | 0,23 | 0,03 | 2,90 | 13,38 | 13,38 | 18 |

| Currency % Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| DXY | 101,855 | 0,23 | 0,96 | -1,03 | -1,61 | -1,61 |
| EUR-USD | 1,0997 | -0,17 | -0,80 | 0,81 | 2,73 | 2,73 |
| USD-JPY | 142,29 | 0,80 | 1,46 | -1,40 | 8,52 | 8,52 |
| USD-CHF | 0,8719 | 0,24 | 1,29 | -2,65 | -5,69 | -5,69 |
| EUR-CHF | 0,9588 | 0,04 | 0,47 | -1,86 | -3,11 | -3,11 |
| GBP-USD | 1,2835 | -0,12 | -0,82 | 1,04 | 6,22 | 6,22 |
| EUR-GBP | 0,8568 | -0,07 | 0,02 | -0,29 | -3,22 | -3,22 |
| JP EM FX Index | 48,90 | -0,39 | -0,86 | -0,37 | -2,01 | -2,01 |

| 10 yr Yield Bps Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| US | 3,96 | 1 | 9 | 12 | 8 | 8 |
| Germany | 2,49 | 0 | 1 | 10 | -8 | -8 |
| UK | 4,31 | -2 | 3 | -8 | 64 | 64 |
| SWITZERLAND | 1,01 | 0 | 2 | 5 | -61 | -61 |
| Japan | 0,61 | 4 | 16 | 21 | 19 | 19 |
| US IG Spread | 123 | -2 | -6 | -10 | -20 | -20 |
| US High Yield spread | 434 | -8 | -16 | -32 | -75 | -75 |
| EUR High Yield spread | 433 | -0 | -5 | -7 | -68 | -68 |

| Commodity % Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| BBG Commo Index | 107,3 | 0,10 | -0,18 | 5,78 | -4,85 | -4,85 |
| Gold Spot $/OZ | 1965,1 | 0,29 | -0,35 | 2,38 | 7,73 | 7,73 |
| Crude Oil WTI | 81,8 | 1,72 | 3,83 | 15,80 | 1,92 | 1,92 |

| Volatility | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| VIX | 13,6 | 0,30 | 0,44 | 0,04 | -37,10 | -8,04 |

Source: Bloomberg 07/31/2023

# Macro & Rates

# Consensus around a soft landing

*Economic data continued to support a Goldilocks scenario in which inflation is slowing down gradually meanwhile consumption remains resilient: a perfect cocktail for a soft landing.*

Uncertainties have eased in the US, mainly coming from the inflation report showing gradual fall in the Consumer Price Index. The disinflationary trend in place combined with resilience both in consumption and employment prompted a strong response from risk assets and rose the probability of a soft landing scenario to the detriment of a recession one.

The second quarter GDP report, that came out at the end of the month confirmed the current narrative. It was clearly a good GDP, printing an above-expectation 2.4% growth rate, fueled partially by stronger-than-expected consumption growth of 1.6%. At the same time, the price indices came in below expectations, with the headline metric showing a particular shortfall, printing 2.2% versus 3.0% expected. The core PCE price index was also below expectations. Capex also picked up during the quarter

Meanwhile, employment continued to defy gravity. Initial jobless claims printed lower than expected at 221k, while continuing claims dropped to 1.69 million, the lowest level since January.

All the US macro data in July painted a Goldilocks scenario: better than expected growth with lower-than-expected inflation, amidst ongoing strength in the labor market… We could easily understand that equity markets were celebrating the data.

*In this context, Central bankers did not surprise the market and raised their benchmark borrowing costs, leaving the door open for more.*

As largely expected, the Fed delivered another 25bps rate hike bringing the benchmark rate to 5.5%. This was the 11th move of the cycle, setting Fed funds to a 22 years high. Fed Chair J. Powell delivered a somewhat hawkish message, underlining the idea that additional policy firming might be appropriate. In other words, the Fed by now and more than ever will become data-dependent. The market is not buying this scenario and is currently predicting that there will be no further increases for the rest of the year.

The European Central Bank followed the Fed by raising the benchmark rate by 25bps to 3.75%, a level not seen since 2008 with the perspective of another 25bps move by the end of the year. Nothing surprising here.

The only central bank that managed to surprise the market was the Bank of Japan (BoJ). Indeed, On July 28th, the BoJ changed its monetary policy by changing its Yield Curve Control (YCC). Previously capped at 0,5%,, the bank decided to move the cap on the 10 year Japan government bond to 1%, keeping its benchmark rate into negative territory at -0,1%. What could have been a "shock" ended in a nearly unchanged day for both the yen and rates as a leak the day before ruined the surprise action of the central bank.

*Governments may start to feel fiscal pressure. The recent Fitch downgrade of the US sovereign credit rating could be the first of a series.*

Coincidence is this downgrade came the day after the Treasury upped its marketable borrowing estimate for the current quarter to more than USD 1 trillion. History (currently we have only one example with the 2011 S&P downgrade) suggested that this sort of move has a more deleterious impact on equities than Treasuries. The fact that July saw another decent rally in equites (with notably short stops) provides a rather unhealthy landscape for the arrival of bad news. The budget deficit clearly looks wider than it "ought" to be. Perhaps this downgrade will be the catalyst for the long-awaited risk-asset correction.

# Fixed Income

## Bear steepening

On 1st of August, Fitch downgraded the US rating from AAA to AA+. Although it had put the US on «negative watch» earlier and warned in May of a rating downgrade, the move has unnerved markets. The US Treasury curve has steepened with longer yield rising sharply (see chart at the bottom). As of writing, the US 10-year yield is 4.1% and the 30-year yield 4.3%.

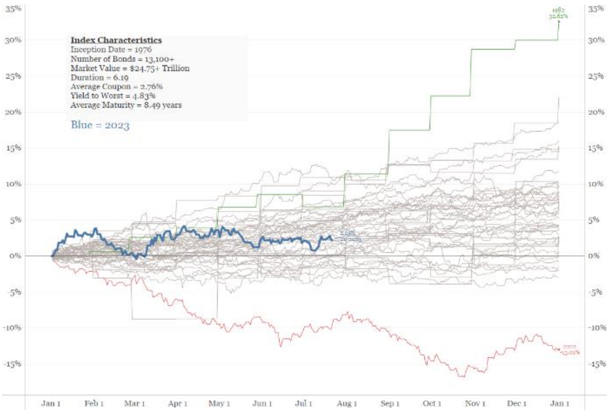
*Among the reasons for the downgrade Fitch mentions an «expected fiscal deterioration over the next three years». The US deficit is expected to rise to 6.3% in 2023 from 3.7% in 2022, and reach 6.9% in 2025. The rise in deficits is due to weaker revenues, new spending initiatives and a higher interest burden. The debt to GDP ratio of 122% is also far above the AAA's median of 39.3%. Most interestingly, however, is Fitch's concern over an «erosion of governance»: «the repeated debt-limt political standoffs and last-minute resolutions have eroded confidence in fiscal management», according to the rating agency.*

Even before that news, bonds had a weak month: while equities continued to rise, bonds remained broadly flat, in some cases (US Treasuries, US corporate bonds) even posting small losses. After posting their worst year since 1976, bonds were expected to deliver a solid performance in 2023 – but so far equities have been by far the better bet.

*Corporate and high-yield bond spreads continued to tighten in July in-line with risk-on sentiment in equity markets. Meanwhile core bond yields have suffered on the back of hawkish central banks. Both the Fed and the ECB hiked by 25bps in July and more are priced by the market.*

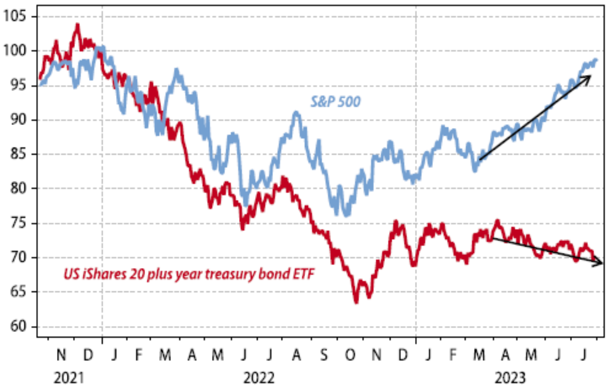
We continue to see fixed income, and especially high-quality and shorter-duration bonds as increasingly attractive. Short 1-3 year US Treasuries, for example, now offer one of the highest risk-adjusted real yields of around 3.3%. This is higher than the 1.5% or real risk-adjusted yield of longer Treasuries and more than the average ROIC of corporate America (0.8%) and the US equities earnings yield (0%).

### YTD Total Return for the Bloomberg AS Aggregate Index (red: 2022, blue: 2023)



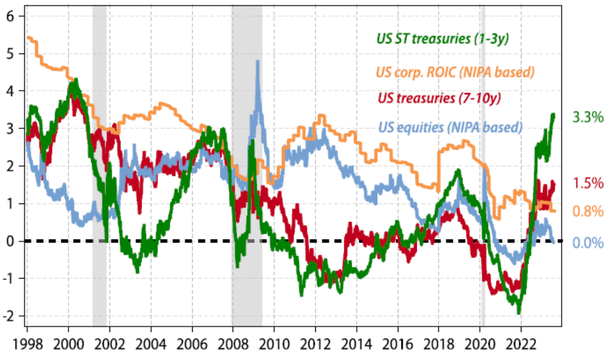
Source: Bianco Research LLC

### S&P 500 vs TLT US (long-dated bond ETF)



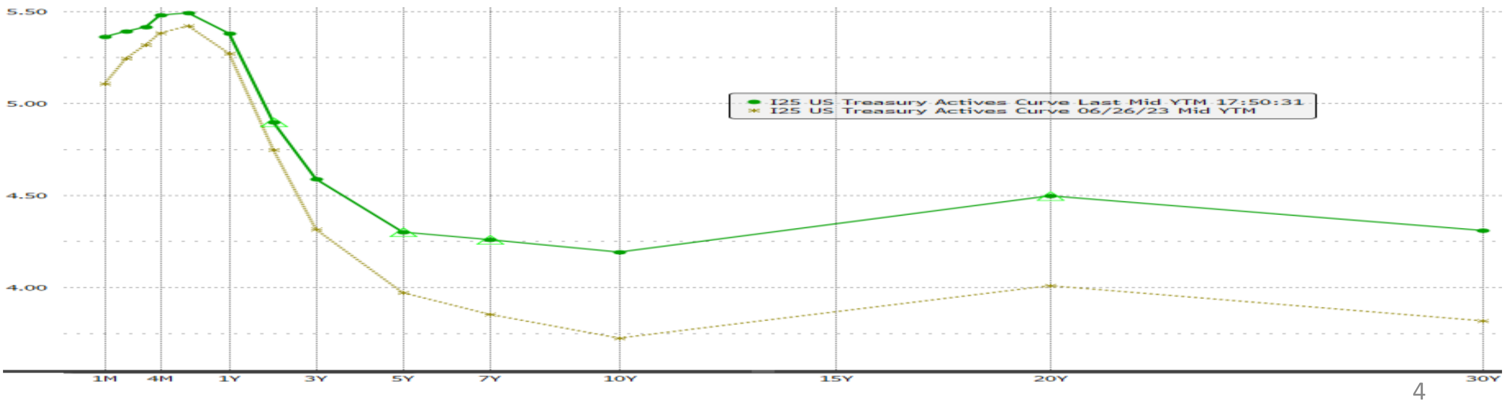
Source: Gavekal

### Risk-adjusted real yields



Source: Gavekal

### US Treasury yield curve on 26 June and 3 August



# Equity

## July… another good month!

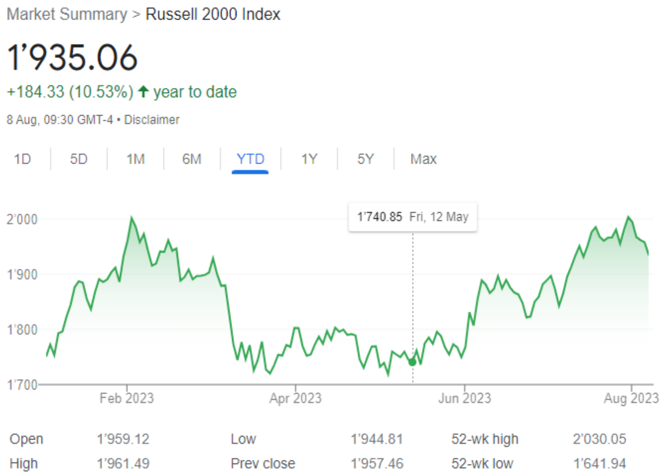
*The S&P 500 TRI Index posted a 3.21% return in July, its best ever July performance in 26 years. The index is now up 20.65% year-to-date. US equities managed their way through the wave of the earning season. All? Not really. A few stocks continue to drive the performance of the index.*

### US Equities

July 2023 was marked by a boost from stronger-than-expected growth data, better-than-expected corporate earnings, and a decline in inflation rates.

Despite concerns over the future rate trajectory of the Federal Reserve, US equities continued to achieve significant gains. The US Economy grew by 0.6% in Q2 and inflation fell faster than anticipated.

The robust earnings of US companies in recent months and the resilience of Super seven stocks in the face of these uncertainties contributed to a strong performance in July. During this period, all sectors experienced growth, with a notable resurgence in sectors that had previously lagged behind the technology sector this year. Particularly, Oil & Gas Equipment and Regional Banks emerged as the top gainers in July, with increases of 20.9% and 19.4%, respectively. On the flip side, the weakest performing sector was Consumer Discretionary, which posted a modest increase of 2.45%.



Market Summary > Russell 2000 Index

1’935.06

+184.33 (10.53%) ↑ year to date

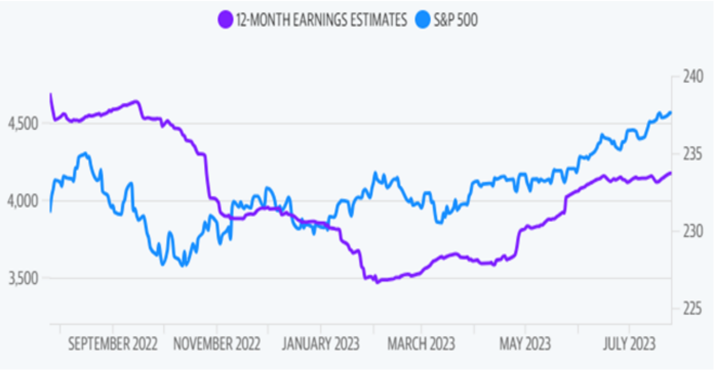
8 Aug, 09:30 GMT-4 • Disclaimer

| | | | | | |
|---|---|---|---|---|---|
| Open | 1’959.12 | Low | 1’944.81 | 52-wk high | 2’030.05 |
| High | 1’961.49 | Prev close | 1’957.46 | 52-wk low | 1’641.94 |

### Super seven stocks versus S&P 500

With the exception of Microsoft (-1.36%), the six other companies continued to achieve a positive performance in July: Meta (+11.02%), Nvidia (+10.47%), Google (+10.04%), Amazon (+2.55%), Tesla (+2.16%), Apple (+1.28%). All the Super seven have hit new highs for the year. The equally weighted performance of the Super seven is +5.16% significantly over performing the S&P 500 index in July.

### Earnings



The S&P 500 trades at 20.62 times its earnings, a significant valuation that can be supported if earning estimates resume the uptrend seen in Q2 this year, interest hike stops and no recession points out. As we can see on the below graph, the 12-month earning estimates went up alongside the S&P 500 since March.

### US Small caps

The Russel 2000 is up 6.11% in July marking a fresh new high for the year and catching up with the S&P 500. Small caps are now up 12.16% year to date – they were most affected in February when the index gave up all gains achieved in just a month

# Forex And Commodities

## Carry Trade Still Prevailing ?

*In July, uncertainty surrounded the direction of the US dollar. A negative momentum pushed the US dollar index (DXY) below the key psychological support of 100. This downward pressure may have been triggered by speculative selling from Hedge Funds.*

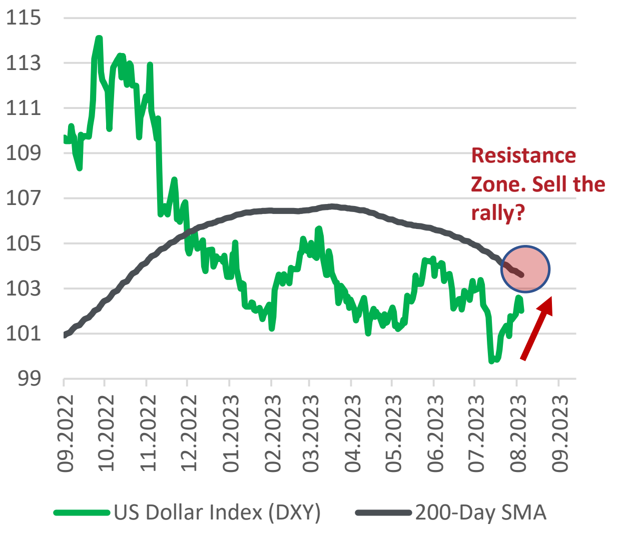
However, an immediate rebound was observed, pushing the DXY back to around 102 at the start of August. While this rebound could indicate a reversal in speculators' positions (new buying pressure in an oversold territory), a simpler explanation could be the US economy that remains robust. The USD likely rose in response to strong economic data, prompting forex investors to anticipate further rate hikes by the Fed, making the USD's carry even more appealing. Additionally, factors such as the US Credit downward and geopolitical uncertainty continue to favor the USD with a flight to safety. Short-term expectations suggest the dollar index will likely remain in the 101-103 range. However, from a technical analysis perspective, USD gains are expected to be limited. A bearish outlook persists as long as the index remains below the 200-day SMA. If that level is reached, it could trigger a selling opportunity and a potential longer-term move toward 97-98 and beyond.

*Turning to the Euro, following its recent rally to levels around 1.12-1.13 against the USD, the market entered a short-term profit-taking phase, causing the EUR to dip below the psychological level of 1.10.* Despite the European Central Bank's (ECB) recent 25 bps rate hike, questions linger about their remaining options. If the ECB fails to inspire confidence with at least another 25 bps increase in September, the EUR/USD could become vulnerable again, primarily due to rate differentials. In the short term, the 100-day moving average may provide support (currently at 1.092), but a break below could lead to further declines, targeting the next support level at 1.075 (200-day SMA).

Contrasting the EUR, the Bank of England's recent 25 bps rate hike, with potential for a larger 50 bps move, sets it apart as a likely stronger performer compared to its peers. This could sustain GBP's mid-term momentum against the USD. A breach above 1.28 could open the path for GBP to approach its first resistance at 1.33.

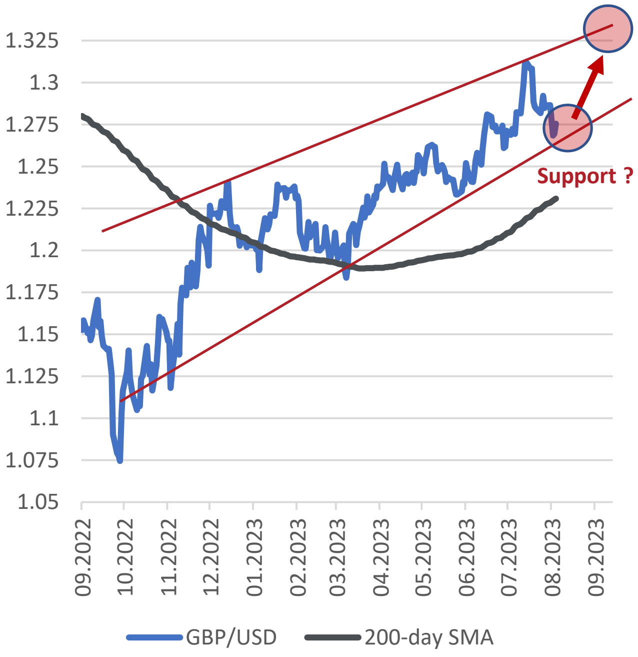
*In the case of the Japanese Yen, it remains weak against the USD and other G10 currencies. A substantial shift in the Bank of Japan's ultra-dovish monetary policy is needed to boost the Yen, though the timing is uncertain.* Many economists expect the BoJ to adjust yield caps on government bonds. Longer-term consensus is still anticipating the Yen to reach 120-130 by year-end. However, without more hawkish actions from the Boj, the Yen is likely to continue to range between 135-145 against the USD. The only significant changes could emerge in the mid-term due to a broader trend of USD weakening.

### An Upcoming Break For The USD ?



Source : Bloomberg

### Will The British Pound Remain In A Bullish Channel ?



Source : Bloomberg

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