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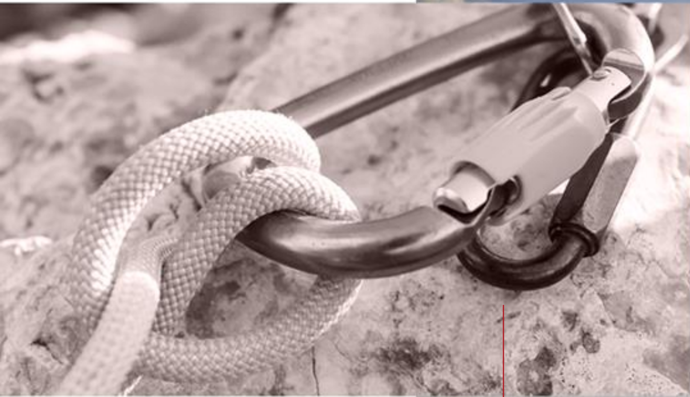
PRIVATE BANK

Newsletter: Is China back ? / May 2024



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2. Fixed Income
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Key Take-Aways

- In April, the markets finished in the red.
- The S&P 500 index posted a negative monthly performance (-4.08%).
- The US dollar index remains strong, helped by consistently high interest rates.
- CPI in the US rose at an annualized 4.6% and core CPI rose 4.5%.
- 10-year government bond yields have risen in all major currencies.
- China onshore equities have seen a recovery in valuations and downgrades in earnings estimates over the past three months.
- Bloomberg's commodity index rose by 2.20% last month, posting a YTD performance of 3.07%. In the commodities universe, WTI crude oil performed very well, as we saw earlier in the S&P500 energy sector.
- After reaching record highs due to geopolitical tensions, gold has witnessed a retracement in its value.

Review

April Overview

In April, the markets as a whole finished in the red. The only market (in the table) to finish with a positive performance was the Nikkei 225, with a return of 1.24% for the month, putting the YTD at 15.59%. The worst-performing indices were the Russell 2000, Nasdaq and S&P500, with returns of -2.09%, -2.03% and -1.57% respectively. The only index with a negative year-to-date performance was the Russell 2000 (-2.23%).

The S&P 500 index posted a negative monthly performance (-4.08%). This underperformance pushed the YTD performance down to 6.04%. The index's sector performances were widely disparate, particularly between the energy and telecoms sectors and the real estate sector, which had a complicated start to the year (-9.0%). The Information Technology sector remained solid despite the poor month of April. The YTD performance sits at 6.57% and the sector is up 65.89% in total return since 29.12.2022.

The US dollar index remains strong, helped by consistently high interest rates. The dollar strengthened against the euro and Swiss franc, respectively, EUR/USD -115 basis points and USD/CHF +200 basis points. The Japanese yen continues to devalue against the US dollar and other major currencies. The USD/JPY pair ended the month at 157.80, but reached 160 on April 29, forcing the BOJ to make an intervention. The Swiss franc lost some of its strength against the EUR and USD, which undoubtedly compensated for the CHF-based portfolios that suffered last year from the strength of the Swiss franc.

10-year government bond yields have generally risen. The market had anticipated several rate cuts for 2024, but the number of cuts has been revised downwards, partly because of sticky inflation which is tending to rise again. The chart shows that the US 10-year yield has risen 48bps this month and 80bps since the beginning of the year. The same applies to the UK, Germany and Japan, which have experienced the same phenomenon.

Bloomberg's commodity index rose by 2.20% last month, posting a YTD performance of 3.07%. In the commodities universe, WTI crude oil performed very well, as we saw earlier in the S&P500 energy sector. WTI is up 14.35% year-to-date. Gold has also had a very good start to the year, with a return of 10.82%.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5 036	-1.57	-0.70	-4.08	-4.08	6.04	18
Nasdaq	15 658	-2.03	-0.34	-4.38	-4.38	4.53	23
Russell 2000	1 974	-2.09	-1.07	-7.04	-7.04	-2.23	18
Euro Stoxx 50	4 921	-1.09	-0.99	-2.24	-2.24	10.42	13
Stoxx 600 EUR	505	-0.60	0.10	-0.80	-0.80	6.99	13
FTSE 100	8 144	-0.04	1.35	2.72	2.72	6.81	11
SMI	11 261	-0.45	-0.79	-2.72	-2.72	3.87	16
NIKKEI 225	38 406	1.24	-0.14	-4.86	-4.86	15.59	20
CSI 300 China	3 604	-0.47	2.43	2.01	2.01	5.18	11
MSCI EM Index	1 046	-0.51	1.13	0.43	0.43	2.89	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5 036	-1.57	-0.70	-4.08	-4.08	6.04	18
UTILITIES	339	-0.55	-0.00	1.65	1.65	6.29	15
ENERGY	715	-2.86	-2.68	-0.76	-0.76	12.82	11
TELECOM	278	-1.49	-3.05	-2.07	-2.07	13.42	17
CONS STAPLES	806	-0.42	-0.57	-0.89	-0.89	6.56	19
REAL ESTATE	227	-1.82	-1.21	-8.50	-8.50	-9.00	16
CONS DISCRET	1 421	-2.65	0.43	-4.33	-4.33	0.43	22
MATERIALS	558	-1.81	0.34	-4.59	-4.59	3.95	19
HEALTH CARE	1 634	-0.11	-0.41	-5.08	-5.08	3.32	17
INFO TECH	3 613	-2.16	0.16	-5.43	-5.43	6.57	28
FINANCIALS	671	-0.95	-1.80	-4.18	-4.18	7.75	14
INDUSTRIALS	1 028	-1.64	-0.51	-3.58	-3.58	7.00	19

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	106.22	0.61	0.34	1.66	1.66	4.82
EUR-USD	1.07	-0.51	-0.31	-1.15	-1.15	-3.38
USD-JPY	157.80	0.93	1.58	4.26	4.26	11.88
USD-CHF	0.92	0.99	0.47	2.00	2.00	9.27
EUR-CHF	0.98	0.47	0.16	0.78	0.78	5.58
GBP-USD	1.25	-0.57	0.22	-1.04	-1.04	-1.88
EUR-GBP	0.85	0.05	-0.54	-0.12	-0.12	-1.51
JP EM FX Index	46.16	-0.56	-0.12	-0.77	-0.77	-4.12

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	4.68	7	4	48	48	80
Germany	2.58	5	-0	29	29	56
UK	4.35	6	1	41	41	81
SWITZERLAND	0.77	4	-4	8	8	6
Japan	0.88	-1	-3	15	15	27
US IG Spread	96	1	-2	-2	-2	-9
US High Yield spread	344	1	-3	-2	-2	-27
EUR High Yield spread	342	-7	-2	-18	-18	-50

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	101.7	-1.65	-0.99	2.20	2.20	3.07
Gold Spot $/OZ	2 286.3	-2.12	-1.29	2.53	2.53	10.82
Crude Oil WTI	81.9	-0.85	-2.66	-1.49	-1.49	14.35

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	15.7	0.98	-0.32	2.64	20.29	3.20

Source: Bloomberg 04/30/2024

Macro & Rates
A Headache For The Fed

Warnings about high volatility in 2024 started to materialize in April. The main sources of this new environment are economic data (and their consequences on monetary policy anticipation) and geopolitics. In this context, nervousness in financial markets is palpable, with de-risking and technical analysis, much more than fundamentals, being the main drivers for financial markets for now.

Q1 US GDP was not hugely favorable; it was not far from a trauma. Growth was considerably lower than expected at 1.6% versus 2.5% expected, with slower-than-forecast consumption growth at 2.5% versus 3.0% expected. To make things worse, the quarterly core PCE price index came in at 3.7%, its highest reading since Q2 2023 and well above the 3.4% consensus. With less growth and more inflation, the US first quarter GDP report offered a fairly toxic mix for asset prices.

Messages delivered by the US ISM reports were not notably better and tend to confirm the broad-based weakness in economic activity. Both New Orders and Employment components fell, while the Price Paid component rose.

With this macro economic context, it was not surprising to see further adjustment in rate expectations, supported by several Fed members.

Earlier this year, the market anticipated an aggressive 7 rate cuts in 2024. In the first quarter, the resilience of the US economy forced a re-adjustment to 3 cuts, in line with the Fed's dot plots. Last month, the "less growth, high inflation" rhetoric pushed down rate cut expectations to 35 basis points, that is to say, less than two rate cuts. And for once, this was confirmed by Fed members among them Jerome Powell.

In recent comments, the Fed Chairman spotted the "resilience of economic growth" and mentioned the "stalled progress on inflation returning to target". More importantly, he commented that it will take longer than previously thought to obtain the required confidence that inflation is returning to target.

The president of the Fed of New-York, John Williams, seen as "neutral", also mentioned that further rate hikes, while noting the base case scenario, are possible if circumstances warrant.

Overall, the implication is that policy restriction will need to be maintained for longer, too. And this is exactly what the bond market has discounted in recent weeks.

Inflation and growth surprises do not sound like a consumer recession for now, but are nevertheless pointing to a bumpier phase in US markets. This leaves scope for outperformance in other markets, among them, Europe and China.

Growth in Europe is accelerating with inflation at least stable as shown in recent surveys. The perspective of easier policy in Europe as soon as June, alongside a better economy could provide an interesting window of opportunity for an improved performance of European equity markets, even in US dollar terms.

Interesting developments are also underway in China. Indeed, investors are warming up the idea that Chinese equity market is very undervalued and that more support measures may be on the way. China's macro outlook is now improving and as the global manufacturing cycle is now starting to expand again, China seems well positioned to be the main beneficiary.

Fixed Income

Higher for (much) longer

Since the beginning of the year, one thing is not heading in the direction expected by most: US inflation. While the Fed's Powell himself said in December that price growth in the US was rapidly approaching the 2% target and hence rate cuts would come soon, the situation has radically changed since then. There have been three inflation readings above expectations in the first three months of this year.

CPI in the US rose at an annualized 4.6% and core CPI rose 4.5%. Among the reasons are a higher oil price and the wealth-effect from rising asset markets. Moreover, rental inflation is rising strongly and services ex-rents have spiked upwards 8.7% annualized.

The big question now is whether this is a temporary change or a new trend. Looking at history, a scary comparison to the 1970s can be drawn: inflation first rose from 2.5% to 6% in 1970 and fell back to 2.8% in 1972. In a second wave, it rose to 12% in 1974, but again fell back to 4.9% in 1976. And finally it "exploded" in a third wave to 14.8% in 1980. It was then that Paul Volcker increased rates from 5% to 20% to finally win the batttle against inflation.

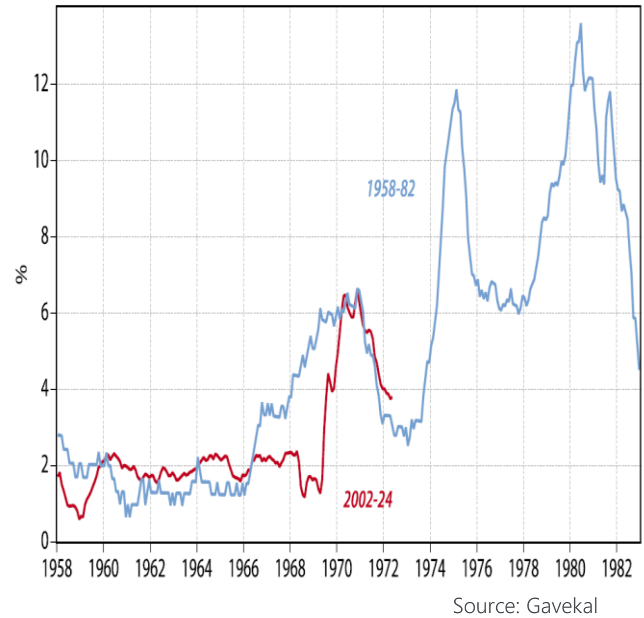
Are bond vigilantes finally gaining the upper hand? Has the Fed lost control of market yields? From a fiscal point of view, the situation in the US has indeed dramatically deteriorated: the government has been running a budget deficit around 7% for the last 6 years. The cost of servicing its debt is skyrocketing while federal spending is rising faster than tax receipts. US debt to GDP is approaching 130%...

There is still a good chance, however, that the recent evolution of inflation is based on a policy mistake: the overly optimistic Fed in the last quarter of 2023 was probably the main reason why market yields rallied in November and December. This by itself had a "stimulating" and inflationary impact on the real economy. The effect has been a slightly re-accelerating inflation. The recent sharp repricing in bond markets with the yield curve shifting upwards will probably have the opposite effect over the coming weeks and months.

Currently, the market is pricing 1.5 – 2 rate cuts until year-end by the Fed. In the eurozone, one cut in June is firmly priced. The SNB has already cut interest rates in March, but Mr. Jordan already warned markets that another inflation shock can not be ruled out.

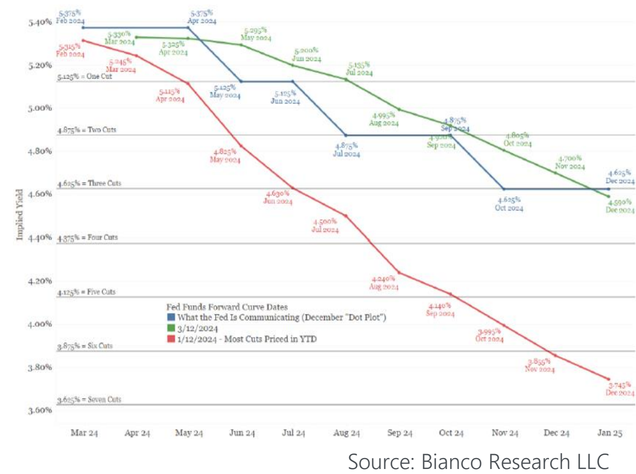
At Cité Gestion we have been gradually increasing our exposure to fixed income since May of last year. This has been helpful at the end of 2023 but is weighing on performance YTD. Given the attractive carry and cheaper valuations vs. for example, equity earnings yields, we stick to our positioning and do not think it is time to reduce fixed income. But it is clear that looking to the future, everything will depend on the data published. We recommend that quality in corporates and govies with intermediate duration is held.

3 waves of inflation: US core 58-82 and 02-24



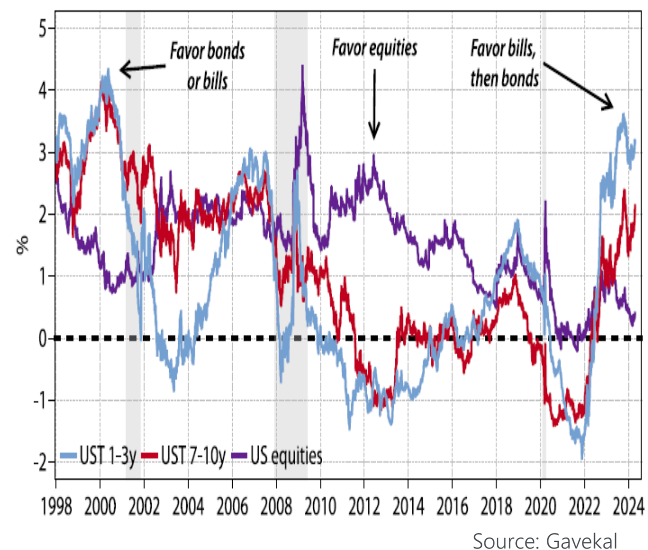
Source: Gavekal

Market pricing Jan. vs. Mar vs. Fed dot plot



Source: Bianco Research LLC

Real bond yields vs US equity earnings yield



Source: Gavekal

Equity

Buy in April... sell in May !

Stocks corrected in April, giving some room for upside post earning seasons in May. Investors are still hoping for a central banks rate cut to benefit corporate concerns.

Markets corrected ahead of earning season

During the month of April, US equity markets have been driven by the growing concerns surrounding rising inflation and the resulting hawkish sentiment from the Federal Reserve.

This uncertainty created a reverse in the momentum of the three previous months with the S&P 500 TR index finishing the month down 4.08%. In this context, the large-cap stocks demonstrated greater resilience during this downturn, while smaller caps bore the brunt of the downturn. As an example, the S&P500 Top 50 was down 3.72% vs. the S&P400 Mid Cap and S&P600 Small Cap Indices down 6.02% and 5.61% respectively. Mid-and Small-caps tend to be more economically-sensitive compared to large caps and the recent underperformance could be perceived as a sign of potential pessimism towards a favorable interest rate trajectory for the economy.

Another very good month and a very good quarter

Focus is on quality and guidance upgrade. As we type, 50% of healthcare companies have reported their Q1 results, with 80% surpassing earnings estimates. However, the devil is often in the detail. The US drove the positive results (nearly all companies have beaten on earnings across all sub-sectors, with biotech and pharma in the vanguard, not to mention the strong guidance upgrade at Lilly driven by its obesity franchise). Europe showed less enthusiasm, with only 60% coming above earnings expectations. On the latter, the beat was mainly a function of biotech and pharma companies, while medtechs were underwhelming.

In Switzerland, Novartis posted a solid beat and raise quarter. It delivered an 11% organic growth on the top line, mainly driven by its cardiovascular and immunology franchises. Combined with operating leverage and costs control, it resulted in a 29% EBIT increase. Built on this strong start, management raised its FY'24 guidance, both on sales and profits. Notably, the company proposed its new Chairman, Dr Caforio (former CEO and Chairman of Bristol Myers Squibb), for election in 2025, replacing Dr Reinhardt after his 12-year term.

In stark contrast with Novartis, Roche delivered another uninspiring quarter. Sales missed expectations (by 1%), both in Pharma and diagnostics. Unlike its direct competitor, Roche confirmed its annual guidance, calling for mid-single digit sales growth (vs high-single to low-double digit sales growth expected at Novartis).

Within smaller Swiss companies, Straumann disappointed investors. Despite FY'24 guidance reiteration and Q1 group organic sales growth coming in better than expected - thanks to strong demand in China, significant organic sales growth miss vs expectations in Europe and the US are spooking the market, with management blaming high interest rates for the latter.

While Lonza only deliver half year figures (on 25 July), management will give a qualitative update on 14 May. We like the stock, up 44% year-to-date. This was driven by solid execution (H2'23 came in above consensus), the upgrade of its mid-term sales guidance (now forecasting 12-15% annual growth in constant currency over 2024-2028), the BIOSECURE Act project in the US (precluding US biopharma companies from working with some Chinese companies, some of which are Lonza's competitors, accused of having links to China's military), the acquisition of a large-scale biologics site from Roche that will increase its manufacturing capabilities, and lastly the long awaited announcement of its new CEO (former CEO of Siegfried).

China's Guidelines for Capital Markets tend to coincide with market bottoms

China onshore equities have seen a recovery in valuations and downgrades in earnings estimates over the past three months.

Expectation of China "QE" has increased which has contributed to outbound investments into HK assets. Southbound investors have bought close to a net USD 20 bn of Hong Kong-listed equities throughout March and up to 23 April – as it stands the largest two-month purchase since 2021.

China's Politburo meeting on economic policy has recently been held in April. The most important takeaway from the meeting is that policymakers are shifting their attention to housing destocking, as they pledged to 'study measures'. It is likely that policymakers have been alarmed by the drop in housing sales and home prices in recent months, and finally sense the urgency to provide more measures to avoid a sustained downturn, which can be harmful for household wealth and confidence.

This change of attitude is important and with sufficient measures could help put a floor on housing. This may be one of the catalysts for the extension of the recovery in confidence and equity markets.

Forex And Commodities

Rates Differential As Key Vector Driving The Dollar ?

Over the past two years, it has become increasingly evident that interest rate differentials have played a pivotal role in dictating currency trends, with the United States leading the way. As May commenced, market participants were eagerly awaiting the Federal Reserve's policy decision regarding the maintenance of its interest rates at their current level. While the decision to keep rates steady was not surprising, the focal point shifted to how the Fed would assess key economic indicators such as inflation and employment. A hawkish stance from the Fed is unlikely to bolster the dollar significantly, but any dovish surprises could potentially weaken it. Currently, the prevailing rhetoric suggests that the attractiveness of carry trades continues to support the dollar's strength

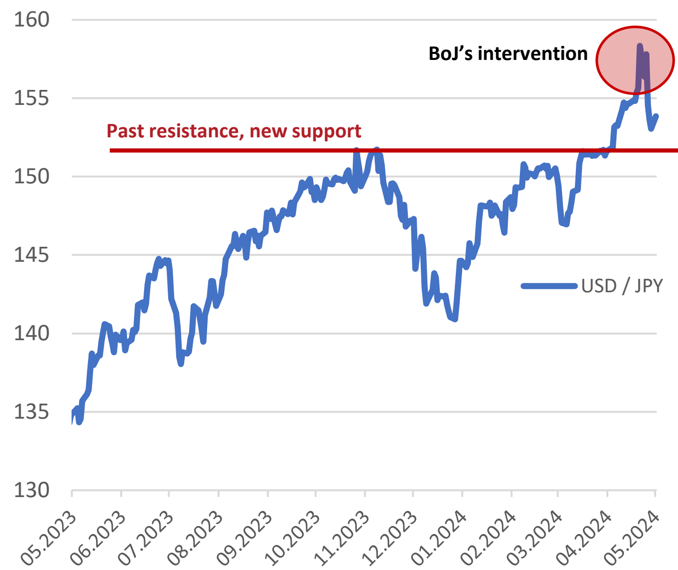
Consequently, the outlook for the EUR/USD pairing is facing headwinds, especially after breaking below the 200-day Simple Moving Average (SMA) in April. This breach has shifted the perspective to a more bearish stance, with no significant support levels anticipated until the 2023 low of 1.045. To witness a notable bullish reversal, the pair would need to surpass the 200-day SMA, currently situated at 1.08, before potentially targeting the psychological barrier of 1.10. In the short term, EUR/USD is expected to consolidate within the range of 1.05-1.08.

Since the beginning of May, the Japanese Yen has made significant moves, breaching a two-year resistance level against the USD at 152, then continuing with a sharp decline to a 34-year low at 160. The Bank of Japan's decision to keep interest rates unchanged also contributed to the Yen's decline, as did weak Japanese inflation and concerns about higher US rates. However, the abrupt reversal from 160 to 155 at the end of April suggests possible intervention by the Japanese government, although this has yet to be confirmed. Despite this rebound, the Yen's short-term potential for further appreciation appears limited, with pressure persisting until more negative US growth and inflation data emerges, coupled with a clearer hawkish stance from the BoJ. Any BoJ intervention would offer only temporary relief, and USD/JPY is likely to stay within the range of 153-157.

The recent momentum in EUR/CHF seems to have encountered a temporary hurdle, failing twice to breach the 0.985 resistance level, which also acted as a significant barrier back in June 2023. A break above this level could potentially propel the pair towards parity. Currently, the pair is retracing but remains above the 200-day SMA at 0.955. In the absence of any deterioration in geopolitical events and with a potential decrease in interest rates from the European Central Bank expected in July, the EUR/CHF is likely to continue oscillating within the range of 0.95-0.98.

As for gold, is it risky to enter the market now? After reaching record highs due to geopolitical tensions, gold has witnessed a retracement in its value. Concerns about prolonged high-interest rates and diminishing safe-haven demand have weighed on gold prices in early May. However, there remains the possibility of gold reclaiming lost ground, if bets on US rate cuts resurface and the USD weakens. Additionally, any escalation in geopolitical tensions could reignite interest in the precious metal.

Will Japan Let The Yen Decline ?



Source : Bloomberg

Momentum Break For The EUR / CHF ?

Source : Bloomberg

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