CITĒ GESTION
PRIVATE BANK

Newsletter: Politics driving the market for now / July 2024

Key Take-Aways

- Politics is joining the party bringing more volatility. In June, elections in Mexico, India and South Africa triggered significant moves in the financial markets. In Europe, elections show the far right is solicited in France, Germany and Italy, triggering notably snap elections in France.
- Politics will for sure be a vector this year for financial markets. Recent elections are a kind of rehearsal before THE election of the year: the US presidential election in November.
- In June, all major central banks decided on their interest rates. While the Fed and the BoE kept rates unchanged, the ECB (expected) and the SNB (unexpected) cut their policy rates by 25bps.
- June was therefore a good month for USD, EUR and CHF denominated bonds as the yield curves shifted downwards and prices rose.
- June saw mixed stock market performances with gains in the S&P 500, Nasdaq and Emerging Markets equities, despite European indices and China lagging.
- French equities suffered this month from the political uncertainty, and investors will probably remain cautious in the months to come.
- The US Dollar continues to be broadly supported in this environment
- The EUR/CHF has also been significantly impacted, falling from near parity to 0.95 within a month. The Swiss franc has benefited from its safe-haven status amidst the French political turmoil. However, a rebound in EUR/CHF occurred following the unexpected Swiss National Bank (SNB) decision to cut interest rates by 25 basis points for the second time.

Review
June's overview

In June, there was a certain disparity in the markets. The US markets had an excellent month, with a performance of 6.03% for the Nasdaq and 3.59% for the S&P 500, but with a large cap bias (Russell 2000: -0.93%). European markets experienced more difficulties, notably the Euro Stoxx 50, which posted a negative performance of 1.72%, pushing its QTD performance into the red (-1.58%). The Nikkei 225 rose by 2.52% last month, putting the YTD at 19.30%. One of the best-performing markets since the beginning of the year, if we disregard the sharp devaluation of the exchange rate for foreign investors. Lastly, the MSCI EM rose by 3.96% last month, indicating a strong rebound in emerging markets, given that China, which weighs heavily on this index, fell by 2.52% in June.

The breakdown of the S&P 500 performance by sector: the information technology, consumer discretionary and communication services sectors advanced by 9.32%, 4.89% and 4.80% respectively, reflecting strong demand for artificial intelligence and technology in general. By contrast, the utilities, materials and energy sectors fell by 5.51%, 3.03% and 1.29% respectively. These three sectors lagged behind because the current high interest rate environment is putting increasing pressure on capital-intensive sectors.

Bonds have risen across the board. A fall in yields has had a positive effect on EUR-denominated corporate bonds. The BBG EuroAgg Corp. index has gained 0.59% in recent days, bringing the year-to-date performance to 0.54%. European Govies have come back but suffered from the French elections in mid-June. US indices had a good month on the back of softer US inflation data. Bond performance, in general, came mainly from corporates and high yield, with YTD performances of 0.3% and 3.18% respectively.

The US dollar index strengthened slightly last month (1.14%). Overall, the EUR depreciated against the USD (-1.24%), CHF (-1.64%) and GBP (-0.50%). The CHF strengthened against the USD and EUR. The JPY continues to depreciate vs. the USD as the carry trade between the two currencies continues.

WTI crude oil rebounded strongly (5.91%). Gold, which is up 12.79% YTD, remained flat over the month. YTD, the Bloomberg Commodity Index performance is mainly driven by gold (15% of index) and crude oil (15% of index).

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5'460	-0.40	3.08	3.59	4.28	15.29	20
Nasdaq	17'733	-0.70	4.88	6.03	8.47	18.57	26
Russell 2000	2'048	0.51	-0.88	-0.93	-3.28	1.73	18
Euro Stoxx 50	4'894	-0.18	-2.60	-1.72	-1.58	11.15	13
Stoxx 600 EUR	511	-0.23	-1.46	-1.13	1.56	9.52	13
FTSE 100	8'164	-0.19	-1.51	-1.04	3.73	7.85	11
SMI	11'994	-0.09	0.54	-0.04	4.00	11.04	17
NIKKEI 225	39'583	0.61	2.52	2.94	-1.86	19.30	20
CSI 300 China	3'462	0.30	-3.05	-2.52	-1.01	2.06	11
MSCI EM Index	1'086	0.42	0.75	3.96	5.03	7.60	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5'460	-0.40	3.08	3.59	4.28	15.29	20
UTILITIES	346	-1.08	-3.92	-5.51	4.66	9.44	15
ENERGY	698	0.42	0.72	-1.29	-2.42	10.93	11
TELECOM	310	-1.63	4.18	4.80	9.38	26.68	18
CONS STAPLES	820	-0.43	-0.07	-0.18	1.35	8.98	19
REAL ESTATE	241	0.72	3.87	2.01	-1.91	-2.45	18
CONS DISCRET	1'492	-1.36	4.62	4.89	0.65	5.66	23
MATERIALS	557	0.01	-2.89	-3.03	-4.50	4.05	18
HEALTH CARE	1'700	-0.05	1.32	1.91	-0.96	7.81	18
INFO TECH	4'341	-0.43	7.73	9.32	13.81	28.24	27
FINANCIALS	684	0.41	-0.81	-0.89	-2.03	10.16	15
INDUSTRIALS	1'032	0.10	-1.74	-0.94	-2.90	7.75	19

Fixed Income - % Change	Price	5 days	MTD	QTD	YTD
BBG Global Agg Treasuries TR Index UNH $	192	-0.34	-0.14	-2.02	-4.85
BBG Global Aggregate TR Index Value $	456	0.07	0.14	-1.10	-3.16
BBG Global Aggregate Corporate TR $	285	0.75	0.69	0.20	0.30
BBG Global High Yield $	1'570	0.50	0.40	1.04	3.18
BBG US Treasury TR Unhedged $	2'257	1.02	1.01	0.09	-0.86
BBG US Corporate TR Unhedged $	3'205	0.73	0.64	-0.09	-0.49
BBG EuroAgg Government TR Index UNH €	234	-0.08	0.23	-1.25	-1.85
BBG EuroAgg Corporate TR Index UNH €	248	0.59	0.66	0.08	0.54

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	105.866	-0.04	1.09	1.14	1.32	4.47
EUR-USD	1.0713	0.08	-1.24	-1.24	-0.71	-2.95
USD-JPY	160.88	0.07	2.48	2.27	6.30	14.07
USD-CHF	0.8988	0.01	-1.74	-0.39	-0.29	6.82
EUR-CHF	0.9628	0.09	-2.97	-1.64	-1.05	3.65
GBP-USD	1.2645	0.05	-0.72	-0.76	0.17	-0.68
EUR-GBP	0.8473	0.05	-0.50	-0.50	-0.89	-2.27
JP EM FX Index	45.93	0.40	-2.52	-1.58	-1.27	-4.60

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	101.0	-0.33	-3.84	-1.94	1.51	2.38
Gold Spot $/OZ	2'326.8	-0.04	-0.30	-0.02	4.34	12.79
Crude Oil WTI	81.5	-0.24	3.56	5.91	-1.96	13.80

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	12.4	0.20	0.51	-0.48	-4.38	-0.01

Source: Bloomberg 30/06/2024

Macro & Rates

Politics driving the market for now.

Last month, we underlined the idea that global growth was about to be more balanced with the US decelerating and a regain in economic activity for the rest of the world notably Europe, China and Japan. Economic indicators in June showed that the opposite is the case.

June flash PMIs released raised some questions on the global picture, with disappointments in Europe and Japan, and positive surprises in the US. China showed better than expected retail sales but some deceleration in industrial production. In the US, this is the exact opposite: US PMIs were clearly solid with every aggregate beating expectations, pushing the Services and the composite to their highest level since April 2022. Some signs that US exceptionalism is not dead yet. This was confirmed by the job report meanwhile US inflation delivered the kind of downside surprise the Fed had been waiting for, both headline and Core inflation coming in -0.1% lower than expected.

Overall, global data looks consistent with some moderation in activity in the second part of the year, which may finally deliver the widely expected “soft landing” scenario, which is largely discounted by many asset classes, among them equities.

Central Banks were active in June. While the Federal Reserve and the European Central Bank continue to be surprised by the volatility in economic data, the Swiss National Bank continues to surprise financial markets.

The ECB delivered what was a well telegraphed and committed 25bps cut but delivered a hawkish message by repeating the “higher for longer” narrative. The Fed left rates unchanged but the dot plot was on the hawkish side as the median moved from 3 to 1 cut for 2024. However, the downside surprise in Inflation a few hours before the meeting made the dot plot move quasi-obsolete.

The two major central banks are facing a difficult task: provide monetary policy guidance during a volatile economic data environment in order not to surprise financial markets.

The SNB delivered another 25bps of easing delivering another dovish surprise for the second time in two quarters. In some ways, the SNB is the anti-Fed: they meet only quarterly, they talk up a lot and frequently intervene on FX and own a huge portfolio of foreign equity. And more than any other central bank, the SNB is more than happy to surprise the market. This cut was priced-in at 70%, enough to push EUR/CHF up by 1% after the nearly 5% CHF appreciation since the end of May.

Politics is joining the party bringing more volatility. In June, elections in Mexico, India and South Africa triggered significant moves in the financial markets. In Europe, elections show the far right is solicited in France, Germany and Italy, triggering notably snap elections in France.

Despite the recent downgrade of France and the 40bps widening between France’s and Germany’s 10-year govies, there is little doubt that the final outcome of the French elections on 7 July will provide further tensions in financial markets. For now, reactions have been limited to the domestic markets, mainly the CAC 40 Index and French government bonds. However, further tensions post-election could spread over international markets. French banks are prominent players in the US repo and other interest-rate markets, and any sudden withdrawal from activity there could potentially spark a liquidity event.

Politics will for sure be a vector this year for financial markets. Recent elections are a kind of rehearsal before THE election of the year: the US presidential election in November.

Fixed Income

The SNB as a precursor?

In June, all major central banks decided on their monetary policy. On 6 June, the ECB began the monetary easing cycle by lowering its main refinancing rate for the first time since 2016, bringing the rate to 4.25%. The cut was largely expected, but given the CPI Core YoY uptick to 2.9% from 2.7% published on 31.5.24, the move looked somewhat awkward. But the ECB had extensively guided on this move and decided to stick to its commitment. Then, on 12 June the Fed kept interest rates unchanged as expected: inflation remained stubbornly sticky at an elevated level in the US. Two days later, the BoJ also kept rates unchanged. Finally, the big surprise came on 20 June, not from the BoE which kept rates unchanged at 5.25%, but from the SNB: for the second time this year, the Swiss national bank surprised markets with an unexpected cut of 25bps, bringing the policy rate down to 1.25% from 1.75% at its recent peak.

The updated Fed Dot Plot shows a year-end rate around 5.1%. The market is pretty much aligned with the Fed (which was not always the case this year!) and prices currently about 1.8 more cuts in 2024. A cut in December has now a probability of more than 90%, while even the November and September FOMC meetings have 80% and 66% probabilities of cuts, respectively.

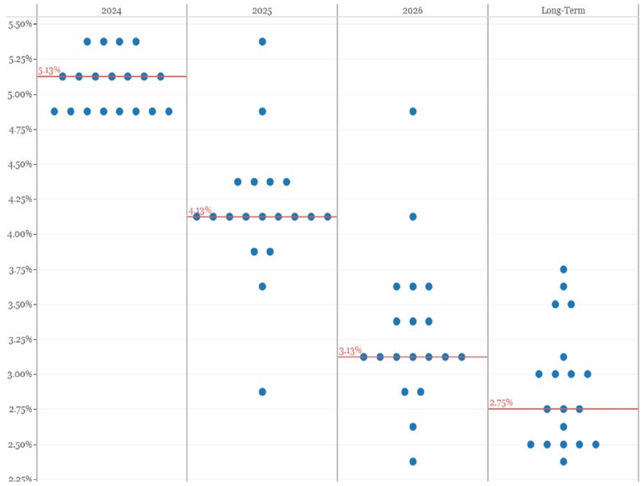
For the other two major banks already in the easing cycle, more cuts are expected, too: for the ECB, the market is currently pricing 1.5 more cuts and for the SNB one more. The BoE is expected to cut for the first time in August and then one more time before year -end.

June was another good month for bonds: the Bloomberg Global Aggregate TR Index in USD added 14bps, and the Bloomberg US Treasury TR index rose by 1.01%. European govies and corporates in both EUR and USD posted gains between 20bps and 60bps. The US yield curve fell into stronger inversion again as the 5Y-10Y part saw yields fall by up to 35bps as compared to their recent high in April.

In Germany, the short end of the curve began to move lower: shortest maturities fell by 45bps since 25 April, clearly more than just the first cut by the ECB and probably in anticipation of more to come. The inversion of the curve has diminished in this first move towards a “steepening”. The picture is similar in Switzerland, where the short end of the curve has fallen more than longer maturities.

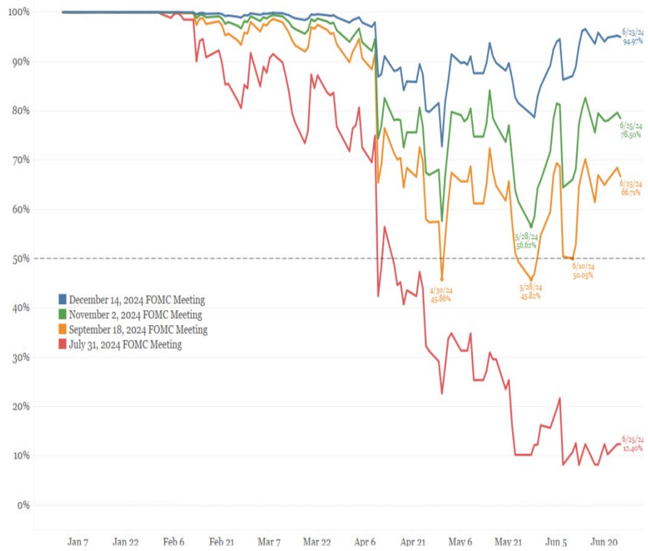
Is the SNB a precursor for things to come? If yes, other central banks could surprise with more cuts than expected by the market before year end. This is not our base-case scenario, but the monetary easing cycle has begun, at least in Europe. While the very long end of the curve remains risky in the US due to the fiscal situation, we believe that its time to have some duration in portfolios and a positioning in the 5Y-10Y segment in all major currencies apart from the yen.

12.6.2024 Fed Dot Plot



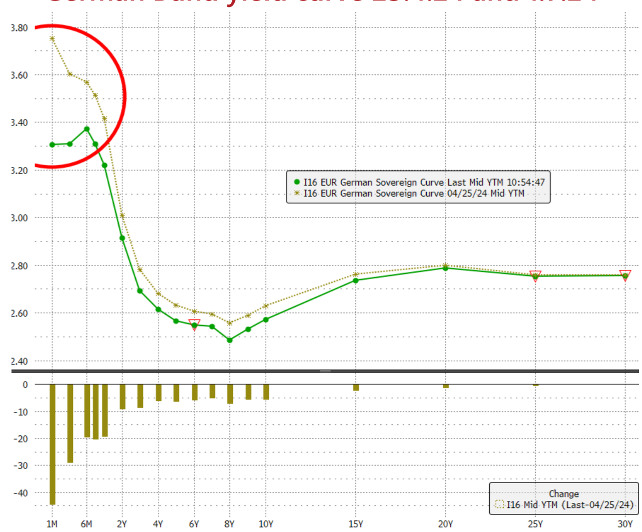
Source: Bianco Research LLC

When will the Fed cut rates?



Source: Bianco Research LLC

German Bund yield curve 25.4.24 and 1.7.24



Source: Bloomberg

Equity

US equities up, while European equities struggle

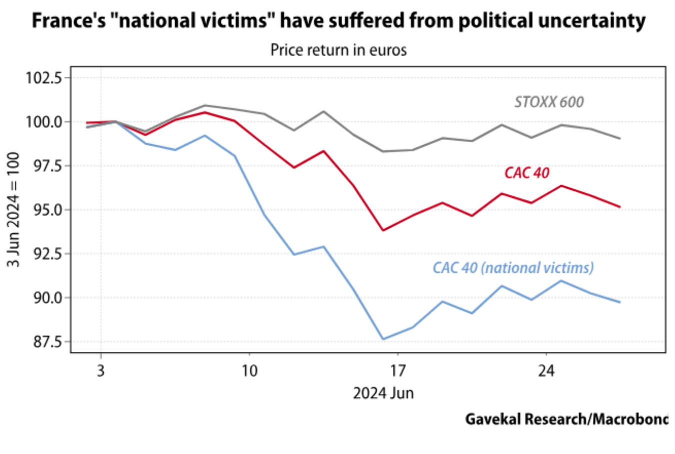
June saw mixed stock market performances with gains in the S&P 500, Nasdaq and Emerging Markets equities, despite European indices and China lagging. Upcoming elections and hedge funds selling tech could signal an increase in volatility.

A contrasted month

June presented a mixed performance for stock markets. Despite the S&P 500 breaking a three-week streak of gains on Friday, it still achieved a 3.59% increase for the month, resulting in a year-to-date (YTD) performance of 15.29%. Although the Nasdaq Composite fell by 0.7% on Friday, it still posted a strong June performance of 6.03%, bringing its YTD performance to 18.57%. Both indices are still near their respective all-time highs. Statistically, every time the S&P 500 ended the first semester with a double-digit positive performance, it ended the year with a positive performance, which tells us that there are good reasons to remain optimistic at the moment. On another note, Emerging Markets equities also had a notable month with a 3.96% increase, despite Chinese stocks having a poor month overall (CSI 300 China down 2.52%). European indices were disappointing, with the Euro Stoxx 50, Stoxx 600 EUR, FTSE 100~~,~~ and SMI all in the red. The uncertain political landscape (French and UK elections) explains the poor performance of the Old continent's stock markets.

Tech dump

Additionally, something very interesting happened during the month of June. That is, despite mega cap technology companies driving the stock market rally, hedge funds reversed their previous buying trend and started selling these stocks. According to Goldman Sachs analysts, hedge funds "aggressively" sold stocks in the technology, media~~,~~ and telecom sectors, with this month's net selling set to be the highest since 2017. If this trend continues, it is not impossible to see a significant price correction in stocks like Nvidia in the coming months, and that could also have an impact on volatility, which continues to be low as of today (12.4 VIX).



French equity sell-off amid Parliamentary elections

President Macron's decision to dissolve Parliament on the night of the June European election, following disappointing results for his government, triggered a sell-off in the French equity market. Investors feared uncertainties as polls indicated voters were split among three blocs, with Macron's party being the smallest and unlikely to lead a future majority, raising the prospect of "cohabitation". Under the French constitution, the President wields more power than the Prime Minister when holding a parliamentary majority but is significantly weaker under "cohabitation" with limited power. This announcement caused a reaction among investors, leading to a 6.3% drop in the CAC 40 index in the week following the announcement, compared to a 2.4% decline in the broader STOXX 600 index. The main "victims"- financials, utilities, and telecom stocks - fell by as much as 10%. These companies, operating in regulated sectors, often struggle during economic downturns due to increased borrowing costs and concerns over potential profit taxes. LVMH was also affected. It is likely that no absolute majority will emerge from the ballots, which may prevent any extreme faction from governing. However, the outcome on the evening of 7 July after the second round remains uncertain. Le Pen and Bardella's Rassemblement National is not eager to govern until the 2027 Presidential elections, as two years in power could jeopardise Marine Le Pen's hopes to replace Macron. A lack of majority would likely block significant reforms but would not halt the country's progress, as France has already undertaken several reforms on pensions and unemployment. The underperformance of French equities compared to European equities is expected to diminish after the second round. French banks, construction companies, and luxury firms should recover after the sell-off. Whether the market will return to its peak remains uncertain. Conversely, an RN-led government could bring further uncertainties. In any case, France does not appear to be a market to overweight in the equity allocation for the coming months.

Forex And Commodities

France Election: More Downside For the EUR?

In July, forex investors should closely monitor the French parliamentary elections, with the EUR taking centre stage for potential Forex moves.

The euro has experienced a significant decline following the late June European elections, which saw far-right parties rise to prominence. The EUR/USD pair dropped from 1.09 to 1.07, breaking all prior support levels. Currently, the pair is trading below new resistance levels, notably the 1.08 mark (the 200-day SMA), which must be surpassed to regain upward momentum. Market sentiment suggests that the political risk from France is now better digested and already priced into the EUR, reducing the likelihood of another sell-off in July like that in late June. Consequently, the premium to own bearish positions on the EUR is decreasing as the French election approaches.

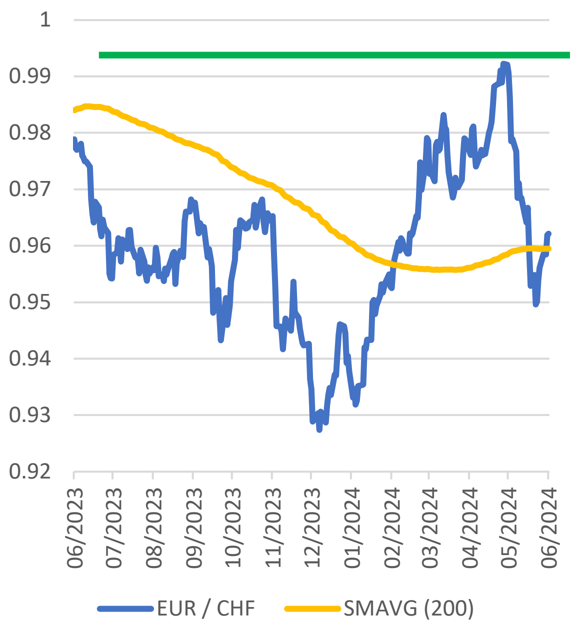
The EUR/CHF has also been significantly impacted, falling from near parity to 0.95 within a month. The Swiss franc has benefited from its safe-haven status amidst the French political turmoil. However, a rebound in EUR/CHF occurred following the unexpected Swiss National Bank (SNB) decision to cut interest rates by 25 basis points for the second time. This led to an immediate rally in EUR/CHF above 0.95, testing the 200-day SMA at around 0.96, though it has yet to break this resistance. The Swiss franc is now contending with opposing forces: its safe-haven appeal supports it, while the significant yield differential between the Swiss franc and the euro, now over 200 basis points, has driven EUR/CHF higher. Although short-term demand for the Swiss franc due to safe-haven status persists, the currency may remain under pressure from a dovish SNB stance over the longer term. The SNB has indicated readiness for further rate cuts if inflation stays controlled. We project EUR/CHF to remain around its nearest resistance at 0.96 in the short term, with a focus on the French election, before potentially moving towards parity.

For USD/CHF, the dynamics are similar to EUR/CHF but less pronounced. The dovish SNB stance is expected to keep CHF under pressure until the Federal Reserve initiates rate cuts. Geopolitical tensions might inflate both USD and CHF, affecting the pair to a lesser degree. Therefore, we expect USD/CHF to remain above 0.90 in the short term, with a potential decline when the Fed starts cutting rates.

Regarding the GBP, no rate cut was enacted in the last Bank of England (BoE) meeting. The BoE held rates steady, though some policymakers indicated the decision was "finely balanced“, heightening expectations for a potential rate cut in early August, despite market pricing suggesting a cut not before November. This outlook has driven GBP/USD down to a five-week low below 1.27. Should the BoE act dovishly before the Fed, increased pressure on the pound is anticipated. The next support level to watch is 1.263; breaching this could see GBP/USD drop to the psychological level of 1.25.

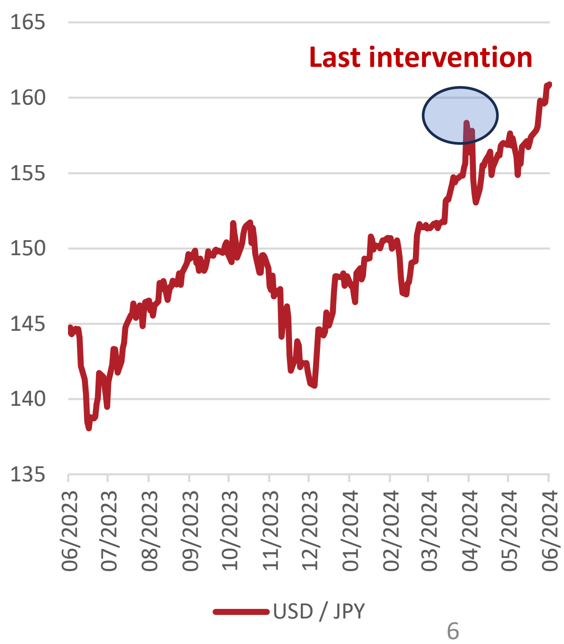
Lastly, the Japanese yen continues its depreciation. The Bank of Japan (BoJ) has further devalued the yen by deciding not to soften its bond purchase. Coupled with softer-than-expected core CPI data, this has propelled USD/JPY again at 160. This level is to be monitored as being a point where Japanese policymakers previously intervened to halt yen devaluation.

EUR/CHF more downside before parity?



Source: Bloomberg

USD/JPY on free ride till the next intervention?



Source: Bloomberg

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