CITĒ GESTION

# Newsletter : Conflict, Inflation, Rate Hikes | April 2022


1. Macro and Rates
2. Fixed Income
3. Equity
4. FX and Commodities

## Key Take-Aways

- Overall, in March markets recovered part of the losses from the first two months of the year, with the S&P500 up by 3.7% and the Stoxx600 up by 1.1%. However, this still marks a considerable negative first quarter for markets - the S&P500 lost 4.6% and Stoxx600 5.9%.

- The Russia-Ukraine war is still far from an end, despite the ongoing peace talks and improvement in negotiations, as Russia re-concentrates its troops in eastern Ukraine. This should continue to contribute to higher inflation as well as greater uncertainty.

- Commodity prices continued to increase amid the war, with the global index up 8.61% in March and the WTI increasing 4.76%, ending the quarter above $100. The increase in oil happened despite the announcement that the US is going to release up to 180 M. barrels over several months from its strategic reserves.

- Inflation has continued to accelerate, leading central banks to become more hawkish. In March, the Fed delivered its first rate hike since 2018. Going forward expectations are higher – it is now forecasted that rates will be 1pp higher within the next three months which compares with estimates at the beginning of the year for a 1pp increase throughout 2022.

- The significant repricing of higher rate expectations is making 2022 a challenging year for fixed income, with US Treasuries experiencing its worst drawdown in recent history.

- A positive aspect of higher interest rates has driven shorter duration bonds in CHF and EUR into positive territory. With short-term Treasuries from 1 to 3-years seeming quite attractive.

- During the month, the US yield curve has inverted, with 2-year Treasury yields temporarily trading at higher levels than the 10-year Treasury yield. Historically, yield curve inversions have been strong leading indicators of recessions.

- This increasing interest rate environment has led value stocks to outperform growth stocks by almost 10% this quarter, the second highest outperformance in more than 20 years.

- Emerging equities, had another negative month, following the largest outbreak of Omicron cases in China since 2020. It weighed on the Chinese markets with authorities sticking to their Zero-Covid policy, imposing lockdowns in Shanghai.

# Review: March 2022

After a very volatile and negative February, March was the opposite, at least for the US market, which returned to pre-war levels. US economic data continues to show a robust labor market, with the economy continuing to expand. On the flipside, inflation is very high, 7.9% YoY. In Europe, economic data showed a market that remains in expansion, as well as inflation that continues to rise with 5.9% YoY.

The S&P500 closed the month up 3.71%, reducing its YTD decline to 4.60%, the Nasdaq and Russell 2000 also closed in the green with a 3.48% and 1.24% rise respectively. Bringing the YTD performance down to -8.94% for the NDX and -7.53% for the RTY. In Europe, the FTSE 100 continues to be the only major index to be positive, up 1.42% for March and 2.89% for the quarter. The EuroStoxx50 continues to suffer with a negative month, at -0.42%, ending the quarter at -8.86%. In the rest of the world, the Nikkei was up strongly at +5.68% (-2.58% on the quarter), the CSI300 plunged -7.83% (-14.53% YTD) while Brazil slowed its rise to 0.79% (+14.48% YTD). The Russian index (RTS $), meanwhile, recovered 19.78% in March, reducing its annual loss to -35.67%.

In terms of US sectors, defensives attracted investors, with Health Care at +3.77%, Consumer Staples at +3.60, Utilities at +3.08% and Real Estate at +2.45%, while at the other end of the spectrum, apart from Energy and Materials, all sectors were negative.

The dollar index appreciated by 1.66%, EUR/USD depreciated by -1.35%, USD/CHF -0.62%, GBP/USD -2.91% and JPY -5.83%. The Brazilian real rose sharply, +7.97% over the month.

The US 10-year yield closed the month at 2.34%, up 51bps. The bund yield rose by 41bps to end March at 0.55%. On the fixed income side, we are still witnessing one of the worst bear markets in decades, with the Bloomberg Global Aggregate Index at -3.05%, the JPMorgan EMBI at -1.12%, the Bloomberg Global High Yield Index at -0.86% and the Bloomberg Core Developed Government Index at -2.98%.

Commodities continued to rise, with the Bloomberg Commodity Index up +8.61% in March to close the quarter at +25.45%. The WTI rose by 4.76%, ending the quarter above $100. US equity volatility was down 9.59 points to end the quarter at 20.60.

| Equity % Change | Price | 1 day | 5 days | MTD | QTD | YTD | EST P/E |
|---|---|---|---|---|---|---|---|
| S&P 500 | 4,530 | -1.56 | 0.24 | 3.71 | -4.60 | -4.60 | 18 |
| Nasdaq | 14,221 | -1.53 | 0.21 | 3.48 | -8.94 | -8.94 | 24 |
| Russell 2000 | 2,070 | -1.00 | -0.21 | 1.24 | -7.53 | -7.53 | 18 |
| Euro Stoxx 50 | 3,903 | -1.43 | 1.01 | -0.42 | -8.86 | -8.86 | 12 |
| Stoxx 600 EUR | 456 | -0.91 | 0.74 | 1.13 | -5.87 | -5.87 | 13 |
| FTSE 100 | 7,516 | -0.80 | 0.68 | 1.42 | 2.89 | 2.89 | 11 |
| SMI | 12,162 | -0.63 | 0.44 | 2.82 | -4.27 | -4.27 | 16 |
| NIKKEI 225 | 27,821 | -0.73 | -0.28 | 5.68 | -2.58 | -2.58 | 14 |
| CSI 300 China | 4,223 | -0.74 | -0.67 | -7.83 | -14.53 | -14.53 | 11 |
| MSCI EM Index | 1,142 | -0.65 | 0.48 | -2.25 | -6.99 | -6.99 | 11 |

| Equity % Change | Price | 1 day | 5 days | MTD | QTD | YTD | EST P/E |
|---|---|---|---|---|---|---|---|
| S&P 500 | 4,530 | -1.56 | 0.24 | 3.71 | -4.60 | -4.60 | 18 |
| UTILITIES | 378 | 0.40 | 3.77 | 3.49 | 4.77 | 4.77 | 21 |
| ENERGY | 582 | 2.10 | -1.02 | 3.42 | 38.99 | 38.99 | 12 |
| TELECOM | 235 | -0.94 | -0.55 | -2.05 | -11.92 | -11.92 | 15 |
| CONS STAPLES | 791 | 0.43 | 1.91 | 4.05 | -1.01 | -1.01 | 21 |
| REAL ESTATE | 302 | -0.18 | 3.74 | 2.27 | -6.32 | -6.32 | 43 |
| CONS DISCRET | 1,463 | -1.11 | 0.59 | -3.21 | -9.03 | -9.03 | 22 |
| MATERIALS | 553 | 0.33 | -0.24 | 0.13 | -2.38 | -2.38 | 16 |
| HEALTH CARE | 1,595 | 0.24 | 0.87 | 4.03 | -2.58 | -2.58 | 17 |
| INFO TECH | 2,794 | -1.43 | 0.20 | -4.18 | -8.36 | -8.36 | 22 |
| FINANCIALS | 638 | 0.47 | -1.78 | -1.71 | -1.48 | -1.48 | 13 |
| INDUSTRIALS | 870 | -0.58 | -0.15 | -3.26 | -2.36 | -2.36 | 17 |

| Currency % Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| DXY | 98.312 | 0.53 | -0.48 | 1.66 | 2.76 | 2.76 |
| EUR-USD | 1.1067 | -0.82 | 0.64 | -1.35 | -2.66 | -2.66 |
| USD-JPY | 121.70 | 0.11 | 0.53 | -5.83 | -5.75 | -5.75 |
| USD-CHF | 0.9225 | 0.08 | 0.83 | -0.62 | -1.05 | -1.05 |
| EUR-CHF | 1.0212 | 0.89 | 0.18 | 0.72 | 1.57 | 1.57 |
| GBP-USD | 1.3138 | 0.03 | -0.37 | -2.10 | -2.91 | -2.91 |
| EUR-GBP | 0.8424 | 0.85 | -1.02 | -0.75 | -0.13 | -0.13 |
| JP EM FX Index | 53.49 | 0.04 | 2.50 | 3.23 | 1.77 | 1.77 |

| 10 yr Yield Bps Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| US | 2.34 | -1 | -3 | 51 | 83 | 83 |
| Germany | 0.55 | -10 | 2 | 41 | 73 | 73 |
| UK | 1.61 | -6 | -4 | 20 | 64 | 64 |
| SWITZERLAND | 0.60 | -10 | 10 | 35 | 74 | 74 |
| Japan | 0.22 | -1 | -1 | 3 | 15 | 15 |
| US IG Spread | 125 | 0 | -8 | -8 | 25 | 25 |
| US High Yield spread | 362 | -4 | -21 | -15 | 92 | 92 |
| EUR High Yield spread | 419 | 7 | -24 | -44 | 73 | 73 |

| Commodity % Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| BBG Commo Index | 124.4 | -1.62 | -3.67 | 8.61 | 25.45 | 25.45 |
| Gold Spot $/OZ | 1937.4 | 0.24 | -1.03 | 1.49 | 5.92 | 5.92 |
| Crude Oil WTI | 100.3 | -6.99 | -12.30 | 4.76 | 30.25 | 30.25 |

| Volatility | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| VIX | 20.6 | 1.23 | -1.11 | -9.59 | 19.40 | 3.34 |

Source: Bloomberg 03/31/2022

# Macro and Rates: The war is not over yet

*As the Russia-Ukraine war is entering its second month, on-going peace talks and improvement in negotiations are offering some hope for a potential ceasefire agreement. However, the end of the war is not close yet.*

Russia declared it would scale back its military activities around Kyiv and in the meantime, re-concentrated its troops in order to take over the eastern Donbas region. Those developments were positive enough for equity markets that regained pre-invasion level during the month.

*Inflation has broadly accelerated, forcing central bank officials to be more vocal.*

March inflation data came on the upside and Central banks are responding. A number of Fed officials, including Chair Jerome Powell indicated that a 50bps hike is in discussion for the next meeting in May and some ECB members forecasted the end of negative interest rates by the beginning of next year.

Following those comments, global yields rose substantially. Financial markets are now pricing in more than 85bps of rate hikes between now and the June FMOC meeting and more importantly, the expected Fed terminal rates stands at 2.95%, well above the expected neutral level of 2.5%. The US yield curve flattened sharply with now the 2 year versus the 10 year part of the curve inverted. Market attention focuses on this inversion phenomena as in the past, it has been a strong indicator of a coming recession.

Indeed, every recession, which occurred in the last 40 years, has happened after the 2Y/10Y curve has inverted. Recently, on the 29th and 31st of March, this phenomenon has reproduced. Following history we could expect a recession to happen within a 12 to 24 months' time span.

All yield curves between 2 and 10 years have inverted with the exception of the 3months/10 years part of the curve which is taking a steep route in positive territory. This phenomenon can be interpreted in two ways. The first could be a reflection of the FED being behind the curve. Something that should not last as future hikes are on target.

The second one is the rapidity with which the Fed changes its tone regarding monetary policy. The 12 month rolling 1 year into 1 year forward stands at 2.81% in March. The biggest and fastest increase ever that has for sure fueled a rapid inversion of the 2-10's part of the curve

*Having said that, we do not underestimate how much the war, which is far from over yet, will impact world's macroeconomic and geopolitical outlook.*

Global growth will likely be hit more than previously anticipated with now forecast at 3.5%. Global inflation will likely be revised higher and could reach 7%, although a peak in price pressures should be observed in the coming few months.

Again, the inflation/growth shock related to the war and the post-pandemic era won't be homogeneous. In the US, energy intensity, which measures the quantity of energy required per unit output or activity has fallen sharply since the 1970s. With a trade balance in petroleum products close to the equilibrium and other buffers built through the Covid pandemic including excess savings, should prevent from a massive slow-down. We believe the US economy to be well positioned to absorb the double shock from higher oil prices and tightening monetary policy.

Europe is definitely not in the same position. Russia accounts for 30% of EU oil imports and 45% of oil in 2021. The war raises the challenge for Europe to diversify its energy supplies and accelerate the shift to alternative energy sources. Due to this dependence, growth in Europe will likely be revised lower again, to possibly reach 3% in 2022. On top of that, the euro weakness will exacerbate current inflation pressures and the desire of the ECB to stick with its inflation mandate will weigh on the economic activity.

In China, the economy was on a strong momentum following its initial recovery from the pandemic in the fourth quarter. However, a renewed surge in Covid cases and fresh lock-down measures may hurt short-term growth prospects in the world's second largest economy.

# Fixed Income: A tough start into the year

*2022 has so far been a difficult year for fixed income. First, the Fed surprised with its u-turn away from «transitory» inflation to a hawkish mode, acknowledging that inflation is real. Later, the war in Ukraine further pushed prices of commodities up thereby increasing inflation expectations.*

These sharp changes in inflation expectations have had their toll on bond markets. With the changing language of central banks, markets have re-assessed rate-hike expectations for 2022. This led to sharp losses across the asset class.

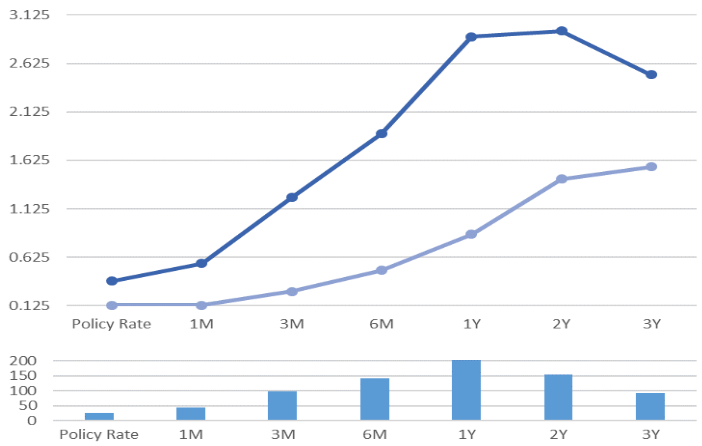
In the US, at the beginning of the year the policy rate was expected to reach about 1% around year-end. It was expected to reach 1.5% at the end of the cycle about two years later. Today, the Fed is expected to rise to 1% within the next three months. Rates are expected to reach 3% within one year. Interestingly, markets also expect the Fed to cut rates as early as end-of-2023/beginning of 2024.

In Europe the situation is similar and whereas at the beginning of the year the ECB was expected to hike rates up to 0.1% in the course of 36 months, the policy rate is now expected to reach 1.1% in 24 month.

*In March, the US yield curve has also inverted, with 2-year/3-year Treasuries temporarily trading at higher yields than the 10-year Treasury. Historically, yield curve inversions have been good leading indicators of recessions. The unknown is the lag of the recession vs. inversion and also the question whether «this time it's different» because of still huge amounts of liquidity in the system. Finally, the TIPS curve reflecting real yields is not inverted which can be interpreted as a sign that inflation expectations are lower the further in the future they are.*

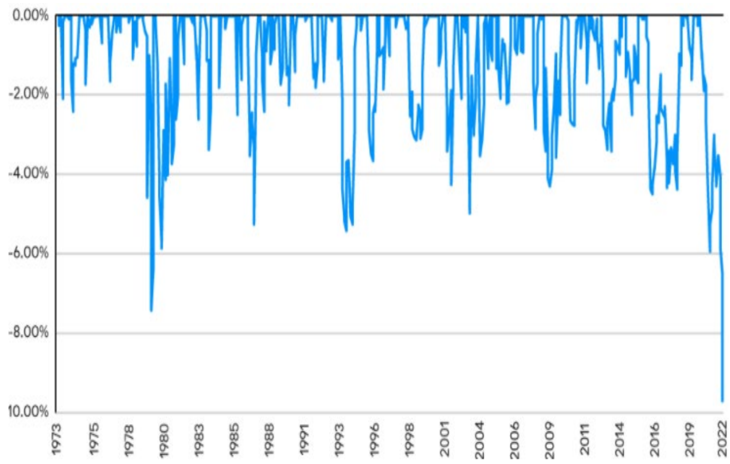
All else being equal, and assuming that bond markets are better in predicting the future than equity markets, we could assume that much of the bad news is now priced in bonds. Indeed, YTD most types of bonds are deeply negative which makes 2022 so far one of the worst years for bonds. And if Inflation doesn't continue to rise from current levels, we could be close to a floor. This opens opportunities in bonds, at least in the context of portfolio construction. Even shorter duration bonds in CHF and EUR have positive yields again. A 3-year US Treasury yielding 2.75% also looks quite attractive. Finally, EM bonds could be worth a look for those who expect a stabilization or even depreciation in the US dollar.

**Implied Fed policy curve as of 6.1.22 (light) vs. current (dark)**



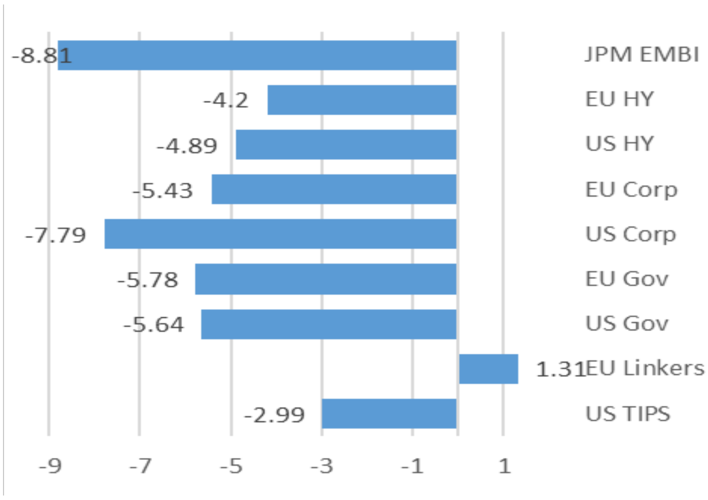

Source: Bloomberg

**US Treasuries experiencing the worst drawdown in recent history**




Source: Bloomberg, JPMorgan

**Total return of bond indices YTD**




Source: Bloomberg

# Equity: Global markets suffering its worst start of the year since Q1 2020.

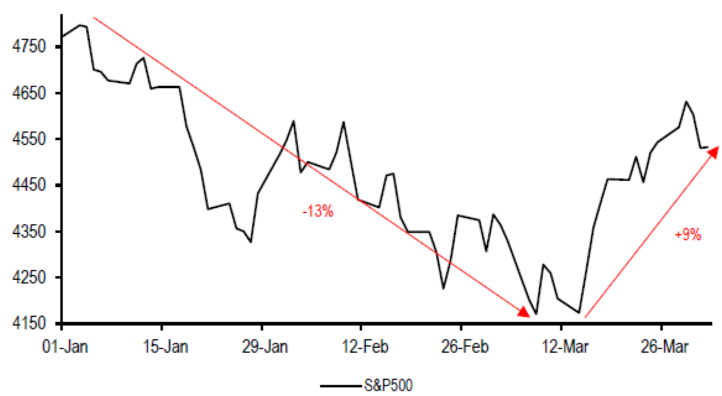
*In March developed market equities recovered some of their losses to end up the month with a positive return of approximately 3%. However, they are still down 5% YTD.* In what has been a volatile month and quarter for oil prices, the best performing sector was energy (up by 7.8% MTD and 31.0% YTD), which aided indices in avoiding greater losses YTD.

*While the month was positive for developed markets, that was not the case for Emerging equities, with the index losing a further 2% in March leaving them down nearly 7% YTD. A new outbreak of Omicron cases in China, the largest since early 2020, weighed on the Chinese markets as authorities stick to their Zero-Covid strategy, imposing a lockdown in Shanghai.* As Shanghai is home to the world's largest container-shipping port, fears regarding supply chain disruption naturally increased and pose further threats to continued elevated inflation. During the month Chinese ADR shares witnessed strong drawdowns with ADR stocks such as Alibaba and Baidu losing more than 25% but they did recover towards the end of the month ending March with losses of less than 15%. The rebound was supported by news that Chinese authorities may remove legal hurdles that would allow inspections by US regulators.

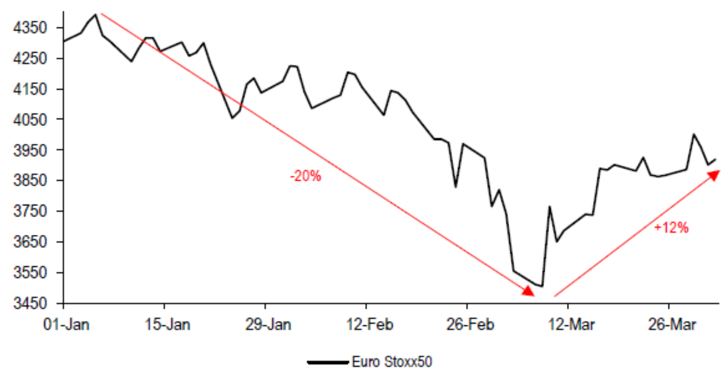
*Over the quarter, developed market value stocks were only down 0.5% while growth stocks fell nearly 10%. This was justified by increasing interest rates, with the 10-year Treasury yields reaching 2.4%, up from only 1.5% at the start of the year, after the Federal Reserve delivered its first rate hike since 2018, in a context of increasing inflation expectations fueled by the Russian invasion of Ukraine.* This value outperformance during the quarter was the highest since 2021 Q1, and the second highest in over 21 years, marking the extraordinary dispersion that we've witnessed in markets during these first three months of the year. As interest rates continue to increase we should expect further value outperformance against growth.

For those who consider that inflation will be more persistent for the medium-longer term it is important to have exposure to quality companies that have pricing power and the ability to pass increasing production costs to their clients. As observed once again this quarter we have further evidence that we have entered a new environment where value can indeed outperform growth (which has hardly been the case in the previous economic cycle post 2008 global financial crisis). As such it is important to keep portfolios diversified in terms of style exposure and maintain a balanced position between value and growth. Although Europe presents an attractive relative valuation to the US, currently the risks for European equities are higher, as the Russia-Ukraine conflict persists and was not of a rapid resolution as some predicted. Adding to this, we also have the French presidential elections in April with the far-right candidate Marine Le Pen gaining traction in most recent polls. *For these reasons Europe should continue to be the most volatile market among developed regions and more risk averse investors should remain cautious in their exposure to Europe.*

**S&P500**




**EuroStoxx50**




Source: Bloomberg, J.P Morgan

# Forex And Commodities: USD Remains Strong, Yen Weakened, New Oil Supply ?

*Uncertainty and fear of US inflation should leave the dollar strong*

Amid a month of consolidation that followed a climb to 99.42 (highest level in 9 months), the dollar index finished the month at 98.312. With hopes that the war may enter in a de-escalating phase, the dollar appreciation came to a halt. However, we could still expect the dollar to be supported by market uncertainty and hawkish Fed policy. With the current geopolitical situation, a strong but stable Dollar is likely to continue, and investors need USD to buy oil and gas. We could expect the Dollar Index to remain supported in the middle of its 97 – 99 range.

*High rate hike expectations for the Fed and ECB could be key for the EUR/USD pair.*

The EUR/ USD could face a more uncertainty bias, with EU inflation that keeps rate hike odds to increase for the ECB, it helped already to drag EUR/USD from a two years low at 1.08 to 1.1150 at the end of March. However, the 1.13 level showed a resistance for investors, who turned to become net short in EUR at this level. Trade signal for investors points out also that the European currency is already overbought at 1.12 level (see CCI indicator chart). While, EUR/USD should remain volatile in the short term, the most likely way to see a euro going above 1.13 could depend on further positive development in the Ukraine situation and lower commodity prices.

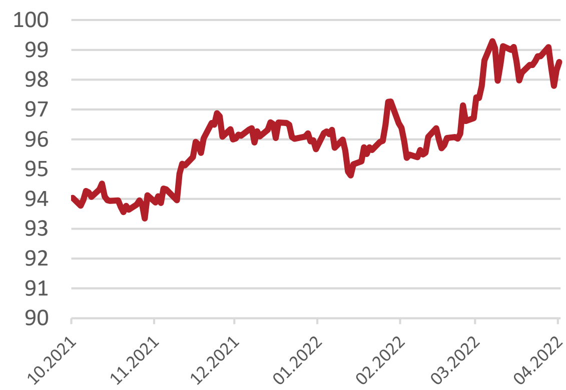
*Could the current low level of the Yen be sustainable ?*

Global investor keep a close look on the further direction in the USD/JPY pair. The higher commodities prices led to a rising gap between US and Japanese Government bonds, causing the dollar to gain +6.28% vs. the Yen in March. The Japanese preference for a weaker currency is motivated by its net energy importer position and is sustainable because inflation remains relatively quiet in Japan. However, this tacit acceptance from the US is only due to the fact that a strong dollar pushes down the cost of imported goods and tamps down inflation in the US. Hence, it is likely that this current level could be maintained in the short term (range 120-125).

*Is the US becoming a substitute for Russian Energy ?*

After reaching a peak at 120, the Brent crude oil futures reversed course to 100 at the end of March after the announcement that the United States is considering releasing up to 180 million barrels of oil over several months from strategic reserves. This new supply's aim is to make up for disrupted oil supply following the invasion of Ukraine. Despite providing a relief in the short-term price, this action would likely cap price around USD 100 per barrel but given the complexities of the industry's supply and demand, it is not likely to have much long-term effect on the downside pressure on Oil.

**US Dollar Index shows consolidation around 97-99 ?**




Source: Bloomberg

**EUR / USD is currently overbought based on CCI indicator (measures the difference between the current price and the historical average price)**


Source: Bloomberg

**USD / JPY reached a peak ?**


Source: Bloomberg


By choosing Cité Gestion, you will benefit from our unique business model which sets us apart from most traditional wealth managers. Learn more on our website : [www.cité-gestion.com](www.cité-gestion.com)

[And follow us on LinkedIn]() to stay connected to all market news and perspectives.

# Disclaimer and important information