CITĒ GESTION

Newsletter : Good News is Bad News | October 2022

Key Take-Aways

- September marked as one of the worst months for financial assets since 2020, with markets being volatile, as the VIX Index surpassed 30 points and reaching 35 points.

- In an environment where inflation remains at extremely elevated levels, with US inflation running above 8% and in Europe above 10%, central banks maintained their hawkish stance. In both Europe and the US, central banks raised rates by 75 bps. Jerome Powell reaffirmed the Fed's commitment to combat inflation.

- As central banks maintained their rate hike path, the macro forecast has been revised down. In the US the GDP growth revised sharply lower this year and next, with higher inflation expectations and more importantly, the FOMC now sees unemployment rising to 4.4% next year.

- The positive correlation between fixed income and equity remains. Bonds were once again severely hit by the hawkish tone of central banks. In this environment, the US 10 year yield broke the 4% level on the 28th of September and led the US Corporate bond index to end the month down 18% YTD.

- The withdrawal of liquidity has been significant for equity markets. The S&P 500 is now back to November 2020 levels and has lost $10 trillions in market value year-to-date.

- Stress in the market became even more evident with concerns regarding Credit Suisse as they're trying to find a new turnaround strategy. In the meantime, their market capitalization fell sharply and Credit default swaps (CDS) have reached their highest level since the banking crisis in 2008. But for the moment, we are far from a Lehman scenario as we can read in the media with the elements currently available.

- The US Dollar, once again demonstrated its safe haven status, appreciating to a 35 year high. The movement was also supported by the net carry global investors receive by holding the US dollar instead of another currency.

- After trading below USD 80 pb, the crude oil is bouncing again as an Iran deal looks unlikely in the short term and after the OPEC+ 2 mln cut in quotas to get back in control of prices.

Review : A Painful September

September was a difficult month for investors in both equities and fixed income, especially those with a longer duration, after another 75bps hike by the Fed, fixing its funds rate to 3.25%. The move was similar in Europe, which raised rates by 75bps to reach 1.25%, in Switzerland by 75bps (0.50%) and in the UK, which raised rates to 2.25% (50bps). Only Japan left rates unchanged at -0.10%.

Inflation continues to rise, leaving little hope that monetary tightening will stop or decrease in 2023.
The negative sentiment that dominated the month of September was exacerbated when the UK announced its unfunded mini-budget plan, which further erodes its twin deficits. It only took a few days for the UK 10-years yield to rise from 3.5% to 4.5% and for sterling to lose over 9 cents. The situation could have been worse if the BoE had not intervened to support the interest rate market.

The major equity indices tumbled, posting losses of between -5.23% for the FTSE 100 and -10.44% for the Nasdaq. The S&P500 finished just below -10% at -9.22%. Europe outperformed the US, losing "only" -5.54%. The Ibovespa finished slightly positive at 0.47%.
On the fixed income side, the BBG Global Aggregate index closed the month at -5.14%, the BBG Euro Aggregate at -3.69%, the EMBI at -6.07% and the Global High Yield at -3.63%.

In the US, IT and real estate sectors were unsurprisingly down 12.01% and 13.15% respectively, both suffering from rate hikes and the doubling of mortgage rates in the US over the last year for the latter.

The DXY index rose by 3.14% to stand at 112.117.

The US 10-years yield ended the month up 64bps, the bund up 57bps and the UK Gilt up 129bps.

The Bloomberg Commodity Index contracted, for the second month of the year, by 8.35%, reducing its annual gain to 12.42%.

The VIX rose by 5.75 points to close the month above 30.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,586	-1.50	-13.26	-9.22	-4.89	-23.88	15
Nasdaq	10,576	-1.51	-14.86	-10.44	-3.91	-31.99	20
Russell 2000	1,665	-0.60	-13.80	-9.57	-2.18	-25.11	17
Euro Stoxx 50	3,318	1.19	-9.41	-5.54	-3.65	-20.40	10
Stoxx 600 EUR	388	1.30	-10.06	-6.43	-4.24	-18.05	10
FTSE 100	6,894	0.18	-7.53	-5.23	-2.80	-3.78	8
SMI	10,268	1.39	-6.64	-5.29	-4.28	-17.98	14
NIKKEI 225	25,937	-1.83	-7.67	-6.99	-0.94	-8.19	14
CSI 300 China	3,805	-0.58	-6.67	-6.67	-14.29	-21.40	11
MSCI EM Index	876	0.29	-10.87	-11.71	-11.46	-26.99	10

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,586	-1.50	-13.26	-9.22	-4.89	-23.88	15
UTILITIES	333	-1.97	-13.79	-11.34	-5.99	-6.51	18
ENERGY	553	-0.90	-12.26	-9.45	2.16	34.49	8
TELECOM	162	-1.66	-15.13	-12.15	-12.71	-39.04	13
CONS STAPLES	696	-1.79	-11.37	-7.99	-6.62	-11.83	18
REAL ESTATE	226	1.03	-16.30	-13.15	-11.03	-28.93	30
CONS DISCRET	1,122	-1.83	-12.80	-8.06	4.36	-29.89	20
MATERIALS	428	-0.29	-13.31	-9.35	-7.13	-23.75	13
HEALTH CARE	1,411	-1.40	-6.17	-2.60	-5.18	-13.08	15
INFO TECH	2,080	-1.94	-17.16	-12.01	-6.21	-31.44	18
FINANCIALS	504	-1.09	-11.02	-7.76	-3.10	-21.25	11
INDUSTRIALS	701	-1.30	-14.64	-10.48	-4.72	-20.72	15

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	112.117	-0.12	3.17	3.14	7.10	17.19
EUR-USD	0.9802	-0.13	-1.66	-2.51	-6.51	-13.79
USD-JPY	144.74	0.19	5.56	4.16	6.65	25.77
USD-CHF	0.9870	1.17	2.11	0.97	3.34	8.12
EUR-CHF	0.9674	1.05	0.40	-1.58	-3.37	-6.76
GBP-USD	1.1170	0.48	-5.33	-3.89	-8.28	-17.45
EUR-GBP	0.8775	-0.60	3.86	1.44	1.93	4.30
JP EM FX Index	48.44	-0.58	-3.51	-3.24	-6.21	-7.86

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.83	4	72	64	232	232
Germany	2.11	-7	74	57	229	229
UK	4.09	-5	140	129	312	312
SWITZERLAND	1.23	-8	40	40	137	137
Japan	0.24	-1	2	2	17	17
US IG Spread	177	-6	28	23	77	77
US High Yield spread	585	-8	95	63	315	315
EUR High Yield spread	659	5	91	84	312	312

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	111.5	-0.96	-10.63	-8.35	-4.75	12.42
Gold Spot $/OZ	1660.6	0.00	-5.17	-2.95	-8.12	-9.22
Crude Oil WTI	79.5	-2.14	-16.89	-11.23	-24.84	3.25

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	31.6	-0.22	8.80	5.75	10.14	14.40

Source: Bloomberg 09/30/2022

Macro & Rates: Global Rate Normalisation

The era of Central Bank philanthropy is officially over. Just during the third week of September, central banks in the developed markets delivered a cumulative 350bps hike. Add the Emerging markets, the total rate hikes reached 1137.5 bps.

Of course, the Fed meeting on September 21st was the most awaited. And once again, the US Central Bank led by J. Powell reaffirmed the "whatever it takes" message, indicating that the times of large and abundant liquidity are over for some times. In details, the meeting had a clear hawkish taste with dots median moving to 4.625% as the peak Fed fund rates in 2023, far higher than anyone had expected. The Dots also showed that the Fed members agree to keep rates above 4% for the majority of 2024. The macro forecast has been naturally revised down: GDP growth revised sharply lower this year and next, with higher inflation expectations and more importantly, the FOMC now sees unemployment rising to 4.4% next year and rates going up, illustrating the near-term pain that they are willing to live with.

But for now, exluding the crash observed in stock and fixed income indices, the monetary policy normalisation has not provided any material results. Employment, particularly in the US, remains healthy and economic activity is not slowing fast enough to bring inflation down.

At this stage, preliminary data for European inflation (above 10% year-on-year in September) and US Core PCE (one of the Fed's prefered measure of inflation) do not suggest a pivot is in the pipe soon. Instead, Central Banks, led by the Fed, are on track to deliver, even accelarate their hiking cycles, «whatever it costs».

In some countries, monetary tightening is starting to create tensions with governments. In the UK, Chancellor Kwasi Kwarteng announced a GBP 45bn unfunded fiscal stimulus and likely more to come.

Following the news, the bond and FX market revolted as the Bank of England is clearly not in a mood for Quantitative Easing during a severe and brutal hiking cycle. The UK 10 year Gilt yield rose 100bps to 4.5%, a level not seen since 2008, while the pound hit an all-time low versus the US Dollar. While those market moves have a taste of «emerging market style», it also sounds an alarm for the UK. Markets now anticipate even more aggressive interest rate hike with 150bps priced-in for the November meeting meanwhile the IMF openly criticized the UK tax plans, urging the government to review its fiscal policy.

In Japan, it is another story. While the Bank of Japan continues to maintain interest rates at zero, its yield curve control and keep on printing money, the Japan Ministry of Finance decided to intervene on markets to support the yen, the developed currency that has the most depreciated this year. Not only the cost of such policy is elevated and but effects so far have been invisibles. History, (the UK and Sterling or more recently the Swiss national bank and the Swiss franc) shows the inefficiency of such interventions.

The odds of a recession in one year have risen considerably. US interest rates are expected to peak between 4 and 5%. A hard landing cannot be excluded if they approach or exceed 5%. The good news in a sense is that this brutal rate normalisation is close to be fully front-loaded and some macro indicators suggest we may not be too far from the end of this cycle.

The shape of the yield curve is one of them. A year ago, the spread 10Y-2Y of the US curve was trading around +100bps. It is now in negative territory at its historical low of -67bps. Inverted yield curves, going as far back as the early 60s, in the past always coincided with a peak in Fed fund rates, followed by policy easing.

In the near term, a rebound is likely. Indeed, a -24% YTD in the S&P 500 Index seems to make an attractive entry point in the short term. Nevertheless, for a sustainable bull market, one should wait for a Fed pivot, that is either a stop or a pause in the rate hike. While we are not there yet, we have never been so close.

Fixed Income: A Pause in the Rise of Yields – for now

In September, core rates continued to rise with the US 10-year Treasury yield hitting 4.015% on 28.9.22. The German 10-year Bund yield rose to 2.35%. Bonds thus posted another negative monthly return in September across all segments. As of 29 September, US corporate bonds and the Bloomberg Global Aggregate index were down about 18% and 20% YTD, respectively. In the last days of September, a set of slightly weaker than expected macro data in the US put an end to the sharp rise in yields and the trend reversed. Since, the yield curves in both the US and Europe have fallen by up to 40bps, the movement being the strongest in the 4-year part of the German curve and in the 7-year part of the US curve. The US curve remains inverted in the 2-year to 10-year part.

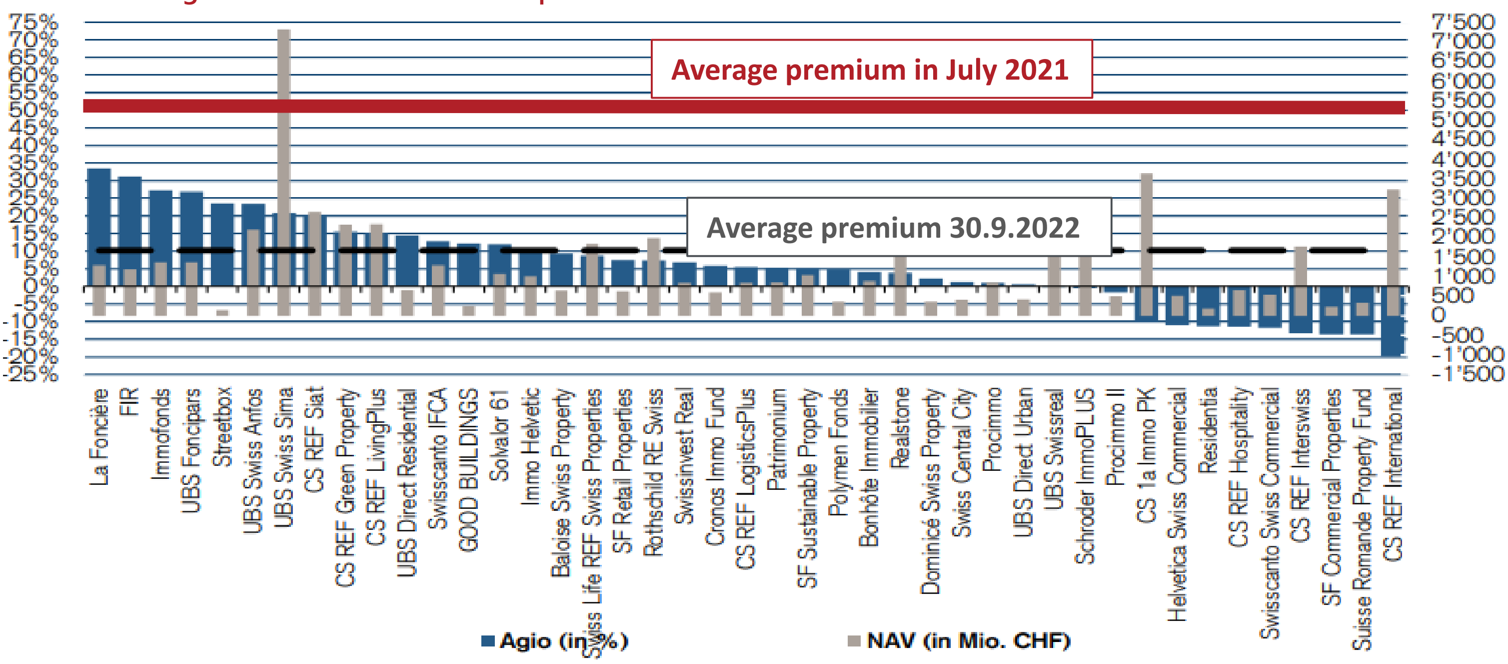
The expected terminal Fed Funds rate has also fallen. While it was expected to reach 4.65% in March 2023 on 23rd of September, it is now expected to reach a high of 4.4% and decrease more rapidly thereafter. However, Fed chairman Powell hinted that we should see real rates across the entire yield curve… with US YoY Core PCE currently standing at 4.9%, we still have some way to go… for rates or for inflation.

This year and September especially have been difficult for bonds. The ICE BofA MOVE index, an index measuring implied volatility of Treasury options, rose to 159, a level not seen since 2008 (apart from a brief spike during the pandemic). Another concern has been the decrease in the liquidity of the Treasury market as measured the Bloomberg US Government Liquidity index which rose to2.93, a level not seen since 2010 (apart March 2020).

Real estate, an interest-rate sensitive asset class, has suffered, too. The SWIIT Index, composed of all exchange listed real estate funds in Switzerland has fallen by 17.5% YTD. Rising short-term rates in CHF like the Saron have put upward-pressure on mortgage rates and thereby led to a re-rating of these funds. While they used to trade at premiums around 45% last year, the average premium now is around 10%. So far, vacancies remain at record lows.

In a sign of turmoil in the market, large funds like the UBS Direct Urban and Credit Suisse Green Property have delayed planned capital increases. However, average yields have again risen to around 3% which compares well to a 2-year Swiss government bond yield at 0.5%, currently. The tax-free nature of the distribution and exemption from wealth-tax of some of these funds are another advantage. And Swiss investors often reallocate portfolios to benefit from these features before year-end, leading to a seasonality which could offer an opportunity for investors looking at this asset class at current levels.

Swiss exchange listed real estate funds – premiums and discounts as of 30.9.2022



Source: Credit Suisse AG

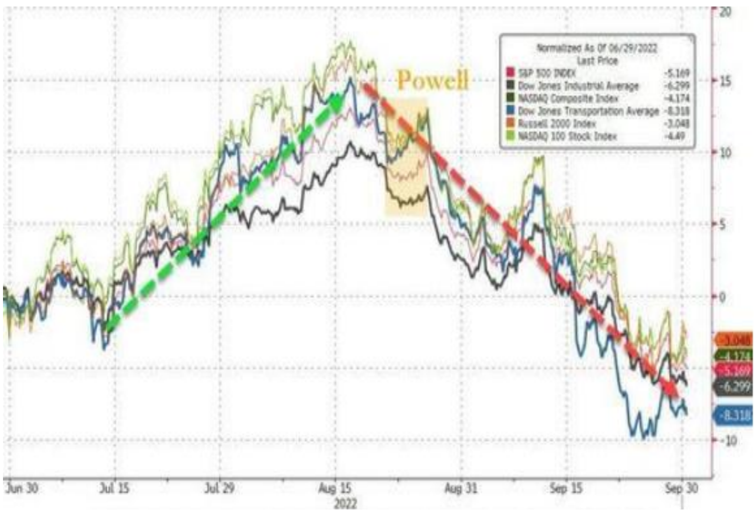
Equity: We're at year lows after the worst month for US equities since 2020.

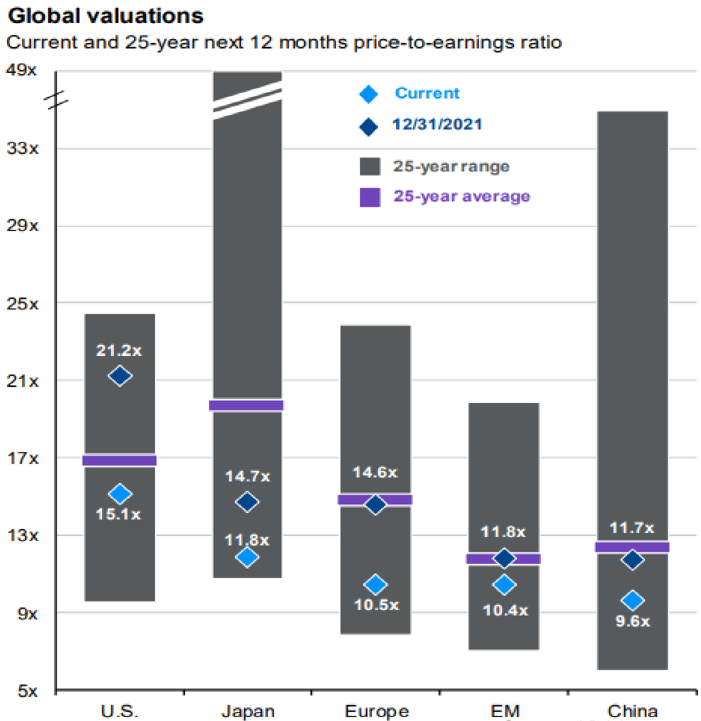
September did not escape the tradition of being the worst month of the year.

With the restrictive strategy of the major central banks, financial assets continued to suffer in September which was, as usual, one of the worst months of the year. It was the biggest monthly decline since Covid-19 in march 2020. The S&P 500 lost 370 points, or more than 9% in September. We are now back to November 2020 levels and the S&P 500 has lost $10 trillions in market value year-to-date.

Jackson Hole will have been the high point of the market and since Powell's speech in August, the market has been struggling to catch its breath. Volatility and violent ups and downs remain pervasive and are making investors nervous. The VIX volatility Index broke through the 30-points mark for the fist time since June and even approached 35 on September 28. With the uncertainty in the markets, there has not been an IPO over 50 millions in the US technology sector in 240 days - a first for the last 20 years according to the Financial Times. Closing the 3rd quarter, we see that the Nasdaq, over the first three quarter of the year 2022, had by far its worst performance since 2008

Strong start for Q3 but it ended in steep decline





Source: J.P Morgan

Credit Suisse is another source of stress for the market.

Credit Suisse (CS) market capitalization has fallen sharply and is now much lower than Deutsche Bank. The head of CS has asked investors for less than 100 days to find a new turnaround strategy. Credit default swaps (CDS), which investors buy to insure against defaults, have reached their highest level since the banking crisis in 2008. But for the moment, we are talking more about a restructuring of their activity and we are far from a Lehman scenario as we can read in the media with the elements currently available.

Europe outperformed US over the last month .

On the good news side, lets highlight the positive seasonality of October and that we could be not far from the FED pivot which could take place in the in the first quarter of 2023. Despite the geopolitical problems and the energy crisis, Europe has outperformed the US markets in the recent weeks. If we look at the normalized P/E of the S&P 500, we also see that US equities are not that cheap.

Favoring European and Japanese equity over US equities because of their cheaper currencies and relatively cheap equity valuations could be a good idea.

Forex And Commodities: The US Dollar at a 35 year high

While reasons why the US Dollar has gotten so strong recently are not entirely clear, we can nevertheless point out a couple of different drivers.

First of all, the US Dollar is THE safe haven currency and tends to appreciates when risky assets are falling. Another driver is naturally the net carry global investors receive by holding the US dollar instead of another currency. The Fed so far is leading the rate normalization and has been more aggressive in raising rates than any other developed central banks. Given the current geopolitics and macro environment, it seems that those two drivers mentioned above are still in action to keep the US Dollar' strength in place, until we observe either a resolution in the Russia/Ukraine war or a Fed pivot.

The Japan Ministry of Finance decided to intervene on markets to support the yen. History shows that FX interventions are not efficient and costly.

Nevertheless, for an event risk perspective, we find the yen attractive. Indeed, given the current undervalued level of the Japanese currency, pressure on the Bank of Japan to abandon its yield curve control. Such decision would trigger a rapid and massive appreciation of the yen.

Another currency pair is showing some interest. EUR/SEK is currently trading close to historical high. And this, despite far better fundamentals.

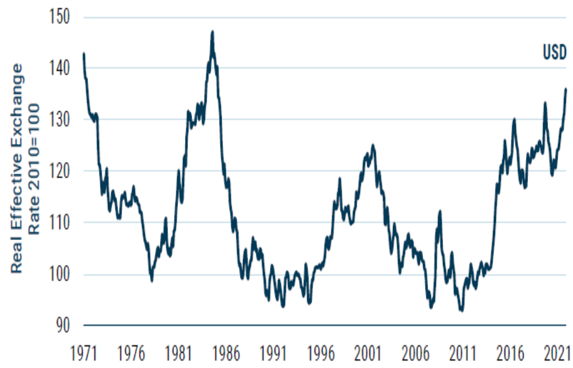
Indeed, Sweden is running a -0.2% budget deficit versus -5.1% for Europe meanwhile Swedish Debt to GDP stands at 36.7% against 95.6% for the Euro area. More extravagant, the deviation between the two currencies in terms of PPP (purchasing power parity) has reached an ultimate high, close to 30%. Given fundamentals, the current levels and the positive carry, the Swedish Krona seems appealing versus the euro.

The crude oil is bouncing again after having traded below USD 80 pb. Technically oil touched and held the bottom of the upward channel we have been in since Nov 2020.

Several reasons could support oil prices for another move up into year end. Iran deal looks unlikely in the short term. The US economy remains resilient for now and the perspective that China China will start relaxing zero Covid after Party Congress on 16 Oct and reopens is for sure bringing support for oil.

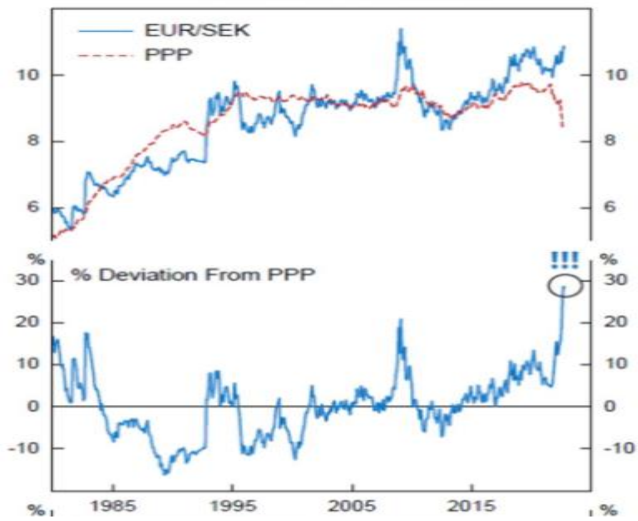
On top of that, OPEC is going to protect the downside. The 2mln cut in quotas is a strong evidence that OPEC+ wants to get back in control of prices.

USD Real Effective Exchange Rate



Data from August 1971 to June 2022 | Source: Bank of International Settlements

EUR/SEK Is Overshooting



Oil prices found a bottom

Source: Bloomberg

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