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PRIVATE BANK

Newsletter : No Fed Pivot Yet | November 2022

Key Take-Aways

- Financial markets strongly rebounded in October driven by optimism and rumours that the FED may announce a pause in the pace of interest rate hikes. Nonetheless, the Federal Reserve has continued with its rate hike path and we now expect higher rates for longer.

- In the US, inflation running above 8% and higher than expected together with a robust labour market (261k new nonfarm payrolls vs. 193k median expectation) continue to support the current path done by the FED.

- In the Eurozone the ECB also hiked rate by 75 bps to 2%, the highest level since 2009, as inflation is even higher than in the US at 10.7%, largely justified by higher energy prices.

- The US Treasury yield curve continues to become even more inverted - the 10-year to 3m spread is now negative for the first time since 2020, as the FED's hawkish stance as reduced the probability for a soft landing and increased the risk of a recession.

- Negative rates in Europe have now disappeared with the Euribor 1m rate and the Saron (CHF) 1m rate, having risen to 1.37% and 0.45%, respectively. As a reminder the Saron was still negative back in August.

- Equity markets rebounded from their lows in October with the S&P 500 +8%, Nasdaq 100 +4% and Stoxx 600 +6.4%, but their overall trajectory is far from linear with a lot of volatility. Intraday movements remain very significant – on Oct. 13, the S&P 500 closed up 2.6% after fluctuating more than 5.4% on the day.

- The earnings season has fueled market volatility with FANGs overall coming in with weaker than expected results (when estimates were already quite weak) and revising their guidance down.

- The BoE has delivered its first 75 bps rate hike in 33 years, which offered some relief to the GBP, with the GPB/USD likely to oscillate around a range of 1.08-1.10. To keep the Yen from falling, the Government bought JPY 6.35 trillion in October to avoid any speculative moves in the currency.

Review: Hopes up

October saw strong gains (MoM) in the world's major equity markets, driven by optimism and rumours that the FED may announce a pause in the pace of interest rate hikes. 70% of S&P500 companies that have so far released their third quarter results have surprised positively, but growth forecasts look a little gloomier. The FED meeting in early November has somewhat dampened expectations of a quick pivot.

Xi Jinping's re-election as China's leader did not suit the markets. His speech on his zero-Covid policy and wealth distribution as well as the forceful evacuation of the former Chinese president fuelled the fears of foreign investors.

- The zero-Covid policy is weighing heavily on the Chinese economy and its continuation will not help the situation.
- The once again hammered common prosperity policy suggests that we could see the government again attacking wealthy Chinese businessmen and their companies.
- The evacuation of the country's former strongman shows Xi's full powers.

Despite the government's interventionist risk, Chinese stocks remain extremely attractive in terms of valuation.

The consumer price index (CPI) in the US fell from 8.3% to 8.2% (year-on-year), revealing some resilience in high prices in the world's largest economy.

As for the Eurozone, inflation reached a record high of 10.7% (year-on-year), further increasing the pressure on the European Central Bank (ECB), which in turn raised interest rates by 75 basis points for the second month in a row, bringing its key rate to 2%.

As mentioned above, October ended up alleviating the negative performance accumulated over the past few months. The S&P500 rose by around 8%, as did the Nasdaq100, which also rose by 4%, reducing its year-to-date losses to -18.8% and -30.1% respectively. In Europe, the EuroStoxx50 rose by 9.1% (-13.15% YTD). In China, the CSI300 was down -7.72% (-27% YTD) and the MSCI Emerging Markets Index was down -3.09%. In terms of sectors, all sub-sectors of the S&P500 ended the month in the green.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,872	-0.74	1.98	8.10	2.81	-17.72	16
Nasdaq	10,988	-1.03	0.34	3.94	-0.12	-29.31	21
Russell 2000	1,847	-0.00	5.65	11.01	8.59	-16.86	19
Euro Stoxx 50	3,618	0.18	2.60	9.12	5.13	-13.15	11
Stoxx 600 EUR	412	0.37	2.61	6.36	1.86	-12.83	11
FTSE 100	7,095	0.66	1.15	2.99	0.11	-0.91	9
SMI	10,828	0.52	2.19	5.46	0.94	-13.50	15
NIKKEI 225	27,587	1.78	2.27	6.36	5.47	-2.25	15
CSI 300 China	3,509	-0.92	-3.43	-7.72	-20.90	-27.47	10
MSCI EM Index	848	0.31	0.66	-3.09	-14.18	-29.22	10

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,872	-0.74	1.98	8.10	2.81	-17.72	16
UTILITIES	339	-0.91	4.67	2.05	-4.06	-4.59	18
ENERGY	690	0.62	2.94	24.96	27.66	68.05	10
TELECOM	162	-1.68	-5.33	0.14	-12.59	-38.96	13
CONS STAPLES	757	-0.62	3.61	9.04	1.82	-3.86	20
REAL ESTATE	230	-0.21	6.04	2.04	-9.21	-27.47	31
CONS DISCRET	1,125	-0.69	-0.46	0.23	4.60	-29.73	20
MATERIALS	466	-0.89	3.08	9.00	1.24	-16.88	15
HEALTH CARE	1,547	-0.08	2.96	9.71	4.03	-4.64	16
INFO TECH	2,241	-1.34	1.49	7.82	1.12	-26.08	19
FINANCIALS	564	-0.72	4.07	11.99	8.51	-11.81	12
INDUSTRIALS	798	-0.34	4.96	13.92	8.54	-9.68	17

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	111.527	0.70	-0.41	-0.53	6.54	16.57
EUR-USD	0.9882	-0.83	0.08	0.82	-5.74	-13.09
USD-JPY	148.71	0.75	-0.13	2.74	9.57	29.22
USD-CHF	1.0013	0.55	0.04	1.45	4.84	9.68
EUR-CHF	0.9898	-0.26	0.14	2.32	-1.13	-4.60
GBP-USD	1.1469	-1.26	1.69	2.68	-5.82	-15.25
EUR-GBP	0.8621	0.46	-1.52	-1.76	0.13	2.46
JP EM FX Index	48.82	0.02	1.01	0.79	-5.47	-7.13

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	4.05	4	-19	22	254	254
Germany	2.14	4	-19	3	232	232
UK	3.52	4	-23	-58	255	255
SWITZERLAND	1.16	5	-17	-7	130	130
Japan	0.25	0	-1	0	18	18
US IG Spread	171	1	-4	-6	71	71
US High Yield spread	510	12	-26	-75	240	240
EUR High Yield spread	597	-19	-45	-62	251	251

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	113.4	1.43	1.55	1.67	-3.16	14.30
Gold Spot $/OZ	1633.6	-0.69	-0.98	-1.63	-9.61	-10.70
Crude Oil WTI	86.5	-1.56	0.35	8.86	-18.18	12.39

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	25.9	0.13	-3.97	-5.74	-9.86	8.66

Source: Bloomberg 10/31/2022

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Macro & Rates: High rates for longer

First, inflation was to be temporary, and then Fed hiking had to pivot quickly into easing. By now we know that both widely believed assumptions were wrong.

On 2nd of November, the Fed has hiked rates as expected by 75bps to 4%. This is thus the most aggressive hiking-path of the Fed in four decades. A strong labor market didn't leave the Fed much choice. There are almost twice as many job openings as there are unemployed people in the US and this puts upward pressure on wages. Just two days after the Fed's latest decision October nonfarm payrolls were published which increased by 261'000 vs. a median expectation of 193'000 – a roughly two standard deviation beat…

The expected terminal Fed funds target rate has now risen from 4.6% to at least 5%. Moreover, Fed chairman Powell has indicated, that rates will stay higher for longer. It seems that the Fed pivot is still far away, although future hikes might begin to be smaller depending on data released in November and December.

Whereas in the US higher consumption following pandemic fiscal spending is a driver of inflation, it seems to be mainly a supply shock in Europe. Eurozone YoY inflation stands at 10.7%. It is to a large extent the result of higher energy prices.

The ECB has also hiked rates by 75 bps to 2% on 27.10., a level not seen since 2009. Negative interest rates have now disappeard in both the eurozone and Switzerland.

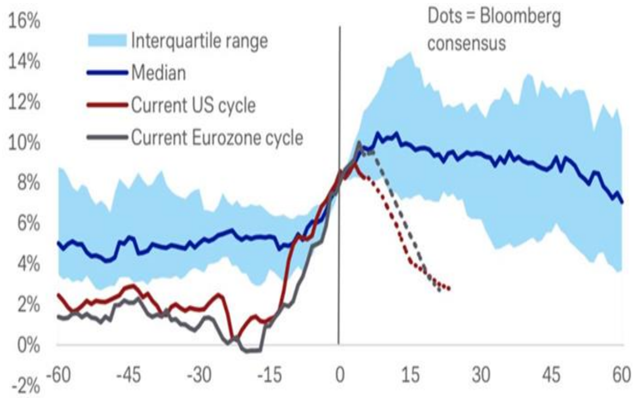
While the US labor market remains robust, rising rates are felt in real estate: mortgage rates have doubled reaching 7%. This has led to a sharp fall in real estate transactions.

Every past Fed hiking cycle was followed by some sort of crisis. Apart from a recession, the odds are increasing that something else will break, potentially with unforseeable consqeuences.

Japan, for example, has successfully been controlling the yield curve since 2016, keeping Japanese 10-year government bond yields virtually at zero. With the interest-rate differential vs the US widening recently, the yen bore the brunt and depreciated by about a quarter vs. the greenback, and this in spite of massive foreign exchange interventions by the BOJ. With inflation rising even in Japan – although to a modes 3% for now – expect something break here: central bank pegs often collapse quickly and violently (e.g. end of CHF peg in 2015 – 20% appreciation of CHF vs. EUR).

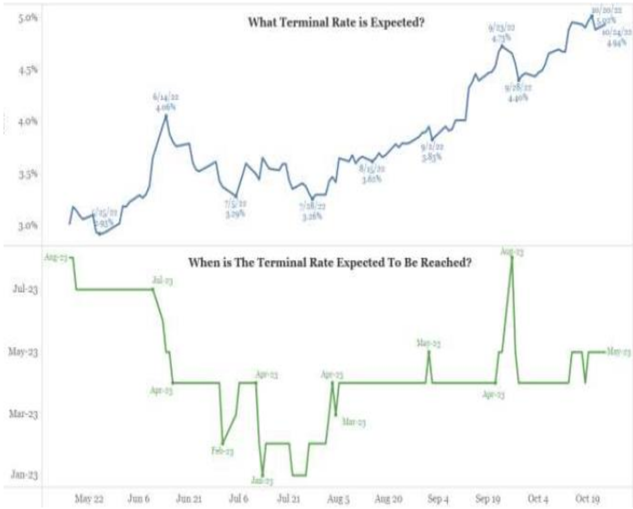
Finally, polls indicate that republicans will win both chambers in the mid-term election in the US this week. This might provide some support for markets.

Comparison of inflation in past cycles vs. current expectations



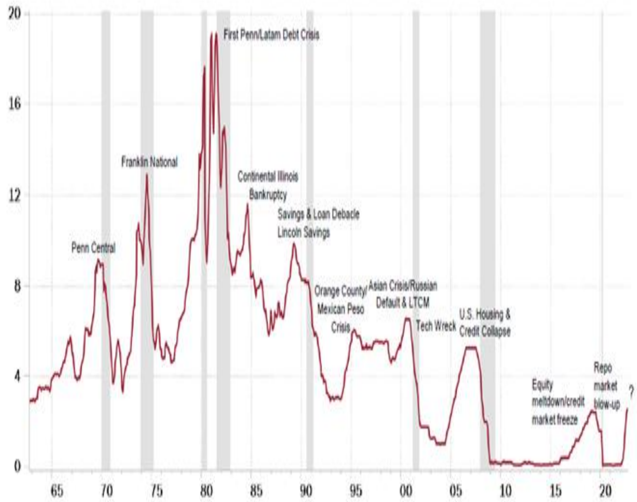
Source: Deutsche Bank

Expected terminal Fed funds rate and when it is expected to be reached



Source: Bianco Research LLC

Past crisis following Fed tightening



Source: Haver Analytics, Rosenberg Research

Fixed Income: Tightening continues

Consistently high inflation leaves central banks with no other choice than to continue with tightening. At the end of October, the ECB hiked interest rates by 75bps to 2%, a level not seen since 2009. On 2 november, the Fed hiked interest rates by another 75bps to 4%.

In the US, the Treasury yield curve is now firmly inverted. The 10-year to 3m spread is negative for the first time since 2020 during the peak of the pandemic. And it seems that the hawkish stance of the Fed begins to have an impact on expecttions: the risk of a recession in the US, as assessed by analysts and purchasing managers, seems to become higher. While backward looking indicators such as unemployment and jobless claims continue to show a strong economy, some leading indicators such as PMIs, the ISM and some University of Michigan indices have recently stabilized or even fallen.

In Europe, recent central bank hikes have also lead to a paradigm change: not only did rates rise quickly, but also negative interest rates have suddenly disappeared. The Euribor 1m rate and the Saron (CHF) 1m rate, have risen to 1.37% and 0.45%, respectively. The Saron was still negative back in August... Not surprisingly, the impact was felt across all asset classes, but especially in real estate and fixed income.

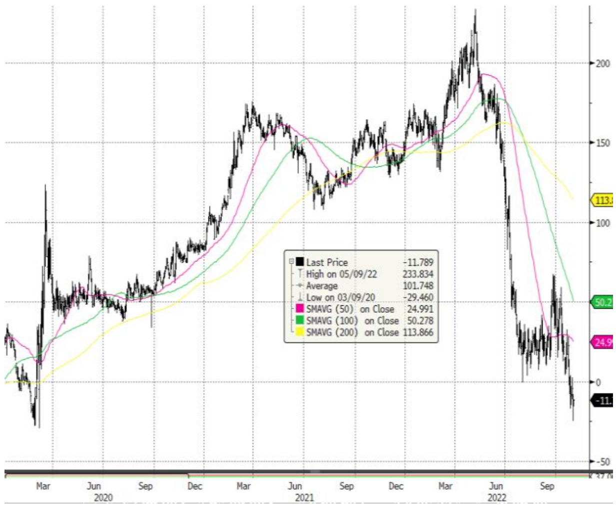
The summer lull with falling market rates and an equity rebound was short, and investors have waken up to an ugly third quarter where portfolios have double-digit negative performances as *both*, equity *and* bond indices, are down between 20% and 30% YTD. The Bloomberg Global Aggregate Treasury Total Return Index has fallen as much as 23.3% YTD as on 21 October.

A Bank of America study looking at bond market returns since 1700 found that 2022 is the fourth worst year ever. Only 1721, when the South Sea bubble burst, the end of the US Civil War in 1865 and 1920 (post World War I and Spanish flu) were worse for bond markets.

While talk of an imminent «Fed pivot» may be premature, it is clear that we are now getting closer to the end of this hiking cycle with every month that passes. Currently, the Fed funds rate is expected to reach 5.25% somewhere in 2023. A recent article in the WSJ highlighting increasingly varying opinions within the FOMC mentioned the chance of a «step down» as early as December, and markets cheered: the 10-year Treasury yield fell from 4.33% to 3.9% within days. The highest point on the US curve is now the 1-year maturity with a yield of 4.7%.

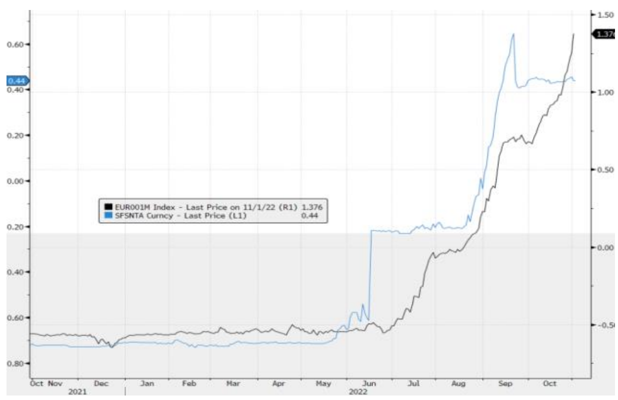
The short end of the curve now looks definitively attractive. Taking single-A spread risk provides additional yield pickup: 3y: 65bps = YTM of 5.1%, 5y: 100bps = YTM of 5.2%, 10y: 140bps = YTM of 5.5%. Finally, senior financial debt has benefitted from several structural changes since the GFC and currently looks relatively cheap. Rising rates are positive for banks as the net interest margin rises.

US Yield Curve Invesrion: spread 10y-3m since 1.1.2020



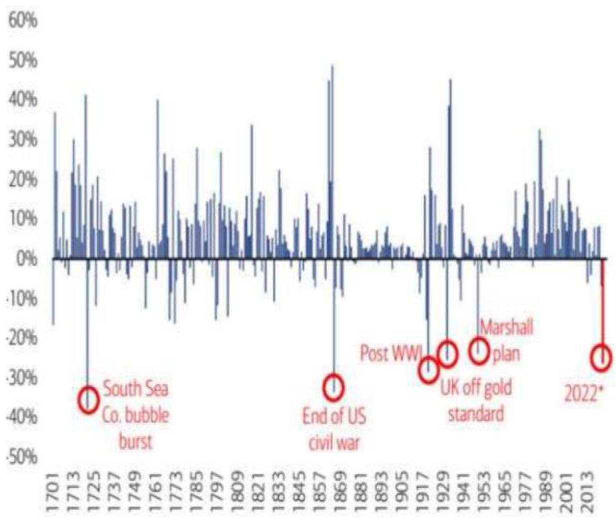
Source: Bloomberg

Euribor 1m and Saron 1m since October 2020



Source: Bloomberg

World government bond index annual return (%, GDP weighted)



Source: BofA Global Research

Equity: October rally in the bear market

Strong rally in October bolstered by some comments from FED officials and rumors.

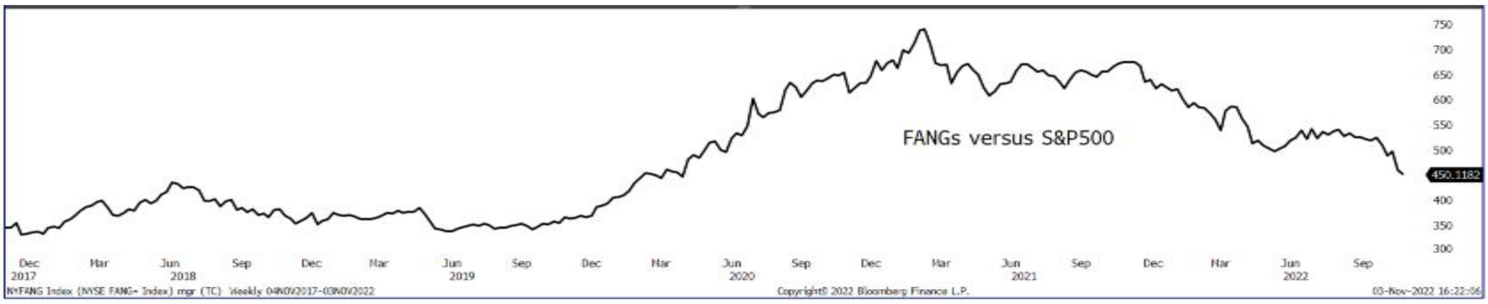
Global equity markets rebounded from their lows in October with S&P 500 +8%, Nasdaq 100 +4%, EuroStoxx 600 +6.5% and Russell 2000 +10%, but their overall trajectory is far from linear with a lot of volatility. Health care, housing and food costs have continued to rise, strengthening the case for another rate hike by the Federal Reserve.

Investors were nervous at the beginning of the month but markets recovered and made a sharp turnaround on October 13. The S&P 500 closed up 2.6% after fluctuating more than 5.4% on the day, the fifth largest intraday reversal since a low point in history, on the basis of bets that inflation peak might have been reached. Optimism was likely bolstered by isolated comments from FED officials last month, who warned about the risk of becoming too restrictive, while some have already emphasized the need to slow the pace of tightening if inflation began to decline. All sectors were positive in October, energy standing out as the clear winner with a gain of 25%. The sectors that suffered were communications services and customer discretionary which ended the month flat. Nearly half of companies in both US and Europe have reported third quarter results so far with around 70% reporting positive earnings per share and revenue surprises.

Signs of capitulation on big US Tech. Time to buy?

We saw sharp declines in several technology mega-caps following poor results, downgraded outlooks and record losses. **Amazon** sank after announcing that it expected to post 4th quarter revenue between $140 and $148 billion or annual growth of 2% to 8%, below analyst estimates. **Meta**, the social media giant reported mixed quarterly results on oct. 26 with massive spending significantly higher than investors had considered comfortable, raising concerns about the company's ability to generate margins in the coming quarters.

On **Microsoft**'s side, cloud revenue came below expectations and also missed expectations and hit its year to date low. **Alphabet** did not do much better and fell after its 3Q22 earnings release, as the company reported lower than expected earnings and revenue and said it would significantly reduce headcount growth. **Apple** has paused hiring for many jobs outside of research and development and said growth would slow over the holiday period.



On the positive side, we find **Netflix** jumping as it beat both the top and bottom lines in 3Q22 and announce the addition of 2.41 million net subscribers globally, more than doubling the additions the company had forecast a quarter ago, and well ahead of consensus estimates of one million. With the mixed results of the big US heavyweights, the S&P 500 index level held around 3750 and let us thinks that we probably hit the market lowest point in mid-October. The Fed opened the door for the pivot but Powell's speech indicates that it would not be very soon.

Brazil update

For the presidential election, the former left-wing president Lula defeated the right-wing leader Jair Bolsonaro with a very small margin, 50.9% of the vote. Despite the political uncertainties and the return of the left to power, the Brazilian market is doing well with a year to date performance of +12% and +3% since the election result.

Forex And Commodities: Dominated by the magnitude of terminal rates

The last November FOMC meeting has dashed hope that the Fed would soon start reducing the pace of its interest rate increases. In other terms, the dollar dominance shall continue driven by the divergence between central banks. On one side, there is the persistent hawkish Fed, focusing on bringing down inflation, which hinted a higher terminal rate. On the other side, all other central banks (ECB, BoE, BoJ, SNB among others) lead their policy rates to take into account the recent tightening of global financial market and the deteriorating growth outlook. This signals that the pace of tightening could start to slow down. Therefore, the Forex market should remain driven by the relative magnitude of the Central bank tightening policy, which should continue to support the currency with the highest terminal rate: the US dollar.

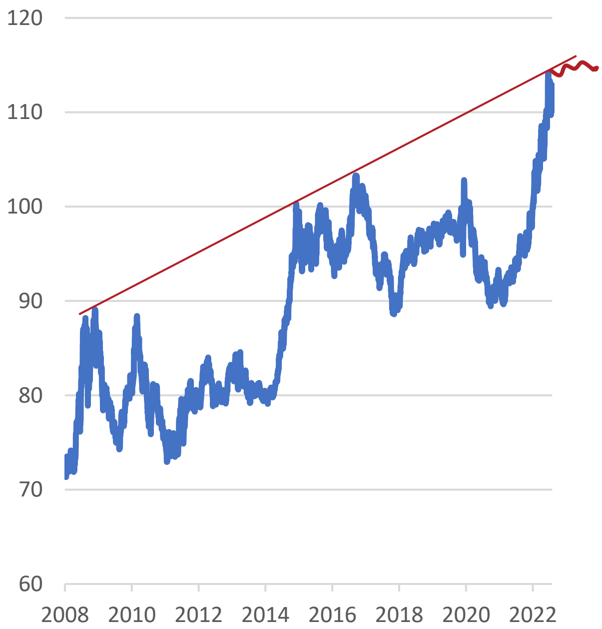
However, investors' appetite for the greenback could also find its limit once the rally will reach the uptrend channel's resistance observed on the dollar Index (DXY) that started in 2008. This resistance channel is located, at the time of writing, around the 114.5 – 115.5 range. Once reached, the DXY could enter in an M-shaped formation, which could relief the uptrend of the USD in the short term.

In such conditions, the EUR/USD pair could continue to move higher toward 0.98 in the short term. With parity level continuing to offer psychological resistance. The beginning of November short-term rebound has seen the price moving above the 50-days MVA (historical resistance since February). It could now consolidate between the range of the 50 and 100-days MVA. In the longer term, the EUR could return to the 0.95 level, as it remains primarily a function of the dollar that continues to put pressure on the pair.

As for the Starling, the BoE has delivered its first 75 bps jumbo rate hike, the biggest rate rise in 33 years. That offered a short-term relief on the pound. However, the economy is still critical in the UK, with a high likelihood that the country could enter in a recession in the coming months, while keeping a high inflation level. The BoE will lack of flexibility and could emphasize quantitative tightening over aggressive high rates. Therefore, the positive effect on the Pound could be limited. The GPB/USD is likely to oscillate around a range of 1.08-1.10.

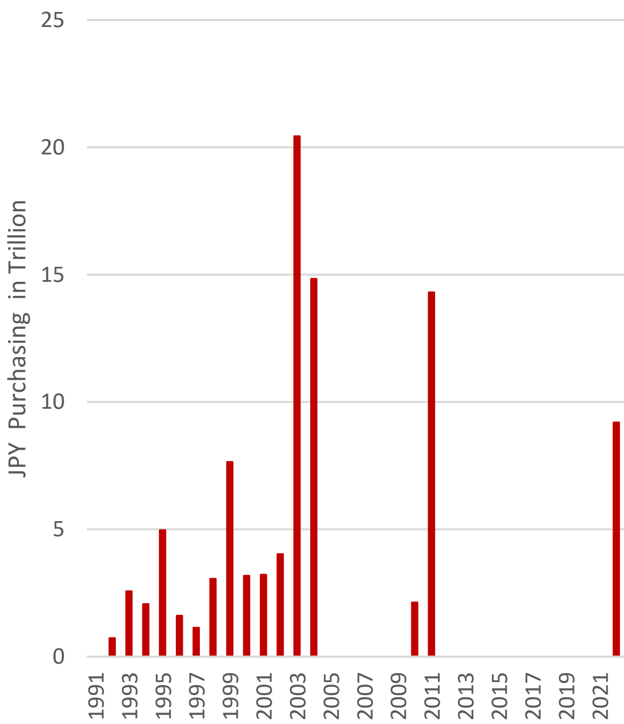
To keep the Japanese Yen from falling, the Government continued its purchasing intervention in October on the Yen (buying JPY 6.35 trillion) and has implied that such interventions will continue. It has been successful in putting a temporary floor on the yen around 148 vs USD. However, these stealth interventions could only have limited effect as the BoJ is still keeping ultra-low interest rates. The momentum on the USD/JPY is settled to continue as long as the interest-rate gap between the U.S. and Japan is widening. The fair value is estimated around 160-170.

Reached Long Term uptrend channel resistance on the DXY. With a new "M" pattern ?



Source: Bloomberg

Will the last Japanese interventions on the Yen provide efficiency to reduce the USD/JPY ?



Source: Japan Ministry of finance

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