Newsletter: US Default nightmare is over / June 2023

Key Take-Aways

- A debt-ceiling deal was agreed between President Biden and House Speaker Mc Carthy. Both sides made compromises: the debt ceiling will be suspended until January 1st of 2025. This is a good news or, more precisely, the deal is removing a catastrophic tail-risk from the market landscape from the table

- Macro data continues to send mixed signals with every day, new arguments to support a stagflation, softlanding or deep recession scenarios for the next 6 month outlook.

- The market has finally erased 75bps rate cut expected by the end of the year to finally anticipate a full 25bps rate hike with a probability of 80% for the next Fed meeting on June 14th

- The US technology sector is driving the overall US market recovery, surpassing key resistance levels. Currently, the S&P 500 is testing the upper range of its 8-month span around 4,200

- The Japanese equity market, represented by the Nikkei index, is at its highest level in three decades. Positive earnings reports and a weaker yen have driven the Japanese sector, benefiting exporters' shares

- After a first half of the year that saw the USD starting to retreat against its peers, June seems to be signaling a reinforcement of the Dollar.

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Review
Dispersion in equities and bonds

- Global equities were negative in May with the notable exceptions for the Nasdaq Index, Japanese equities and the S&P 500 Index respectively up 5.93%, 7.04% and 0.43%. European markets dropped by to 2% with the UK suffering the most (-5.04%) while China fell by -5.56%.

- In the US equities small cap indices such as the Russell 2000 (-0.93%) underperformed large-cap indices.

- Dispersion was not only observable geographically. Sector wise, in May when looking at the S&P500 index performances, a mixed picture appeared. Only three sectors out of eleven performed positively. IT, Consumer Discretionary and Telecom returned respectively +9.46%, +3.21% and +6.21%. Other sectors performed negatively among the worst, Energy (-10.04%), Materials (-6.85%) and Consumer Staples (-6.08%)

- Currency wise, the US Dollar had a strong month in general with the US Dollar index (DXY) up 2.62%. EUR is down 2.99%, CHF is down 1.80% , GBP is also down 1% and JPY is also down 2.23% versus the greenback.

- The Swiss Franc once again appreciates against the EUR +1.22% in May with a EUR/CHF at 0.97.

- In the fixed income space, the US 10 year yield rose by 22 bps to 3.64%. The 10 years German Bund decreased by 3 bps to 2.28%. There is a consequent repricing for the UK with the 10 year Gilt up 46 bps to 4.18%.

- Regarding the credit, corporate spreads were steady, both on the Investment grade and the high yielding segment.

- Commodities had a difficult month, led by Crude Oil that has collapsed by 11% over the period to USD 68 pb. The Bloomberg Commodity index is down 6.08%. Gold fell back from its peak of USD 2050.28 per ounce in May to USD 1962.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 180	-0.59	1.61	0.43	9.64	9.64	18
Nasdaq	12 935	-0.62	3.63	5.93	24.07	24.07	27
Russell 2000	1 750	-0.98	-0.94	-0.93	-0.06	-0.06	20
Euro Stoxx 50	4 218	-1.71	-0.92	-1.86	14.20	14.20	12
Stoxx 600 EUR	452	-1.06	-1.17	-2.31	8.84	8.84	12
FTSE 100	7 446	-1.01	-2.34	-5.04	1.69	1.69	10
SMI	11 218	-0.57	-1.38	-1.62	7.66	7.66	17
NIKKEI 225	30 888	-1.41	0.67	7.04	19.61	19.61	18
CSI 300 China	3 799	-0.97	-1.46	-5.56	-1.65	-1.65	10
MSCI EM Index	959	-1.21	-1.21	-1.66	1.15	1.15	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 180	-0.59	1.61	0.43	9.64	9.64	18
UTILITIES	328	0.96	-0.82	-5.87	-7.22	-7.22	16
ENERGY	586	-1.82	-4.92	-10.04	-11.44	-11.44	11
TELECOM	211	-0.05	2.03	6.21	32.81	32.81	16
CONS STAPLES	757	0.08	-1.41	-6.08	-1.89	-1.89	19
REAL ESTATE	226	0.67	2.42	-4.51	-1.77	-1.77	17
CONS DISCRET	1 188	-0.85	1.76	3.21	18.64	18.64	23
MATERIALS	471	-1.05	-1.47	-6.85	-2.99	-2.99	17
HEALTH CARE	1 486	0.85	-1.04	-4.29	-5.60	-5.60	16
INFO TECH	2 896	-1.08	6.75	9.46	33.95	33.95	25
FINANCIALS	527	-1.11	-0.33	-4.32	-6.77	-6.77	13
INDUSTRIALS	817	-1.37	-0.48	-3.16	-0.99	-0.99	17

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	104.326	0.15	0.42	2.62	0.78	0.78
EUR-USD	1.0689	-0.43	-0.57	-2.99	-0.15	-0.15
USD-JPY	139.34	-0.32	-0.09	2.23	6.27	6.27
USD-CHF	0.9107	0.53	0.64	1.80	-1.49	-1.49
EUR-CHF	0.9734	0.10	0.04	-1.22	-1.63	-1.63
GBP-USD	1.2441	0.22	0.61	-1.00	2.96	2.96
EUR-GBP	0.8592	-0.64	-1.17	-2.00	-2.95	-2.95
JP EM FX Index	49.62	-0.76	-0.81	-2.03	-0.56	-0.56

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.64	-4	-10	22	-23	-23
Germany	2.28	-6	-19	-3	-29	-29
UK	4.18	-6	-3	46	51	51
SWITZERLAND	0.89	-8	-17	-16	-73	-73
Japan	0.44	0	2	4	1	1
US IG Spread	148	2	-3	3	5	5
US High Yield spread	515	8	4	9	6	6
EUR High Yield spread	477	8	12	2	-24	-24

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	98.0	-0.37	-2.60	-6.08	-13.16	-13.16
Gold Spot $/OZ	1962.7	0.17	0.28	-1.37	7.60	7.60
Crude Oil WTI	68.1	-1.97	-8.21	-11.32	-15.16	-15.16

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	17.9	0.48	-2.09	2.16	-17.21	-3.73

Macro & Rates

US Default nightmare is over. We won't wake up in a new world

Last minute, a debt-ceiling deal was agreed between President Biden and House Speaker Mc Carthy. Both sides made compromises: the debt ceiling will be suspended until January 1st of 2025, in exchange for a cap in non-defense federal spending for two years. The next step is to have a corresponding bill being voted by the US Congress, starting with the House on Wednesday. We are reasonably confident it will pass.

There is no doubt this is a good news or, more precisely, the deal is removing a catastrophic tail-risk from the market landscape from the table. With the exception of the US T-bill curve, where we observed a massive disruption between May and June that has since normalized, the probability of a US default was very low anyway and this means that this doesn't really affect the big picture.

If we go back to fundamentals and Macro, clouds are accumulating for the quarters ahead: persistent inflation, higher interest rates for longer, constrained credit supply and now some level of fiscal drag are uncertainties at best, clear headwinds at worst, which are not reflected in the valuation of some asset classes. Fiscal policy is supposed to be the tool you use when the economy slows. The debt-ceiling deal might put a stop when the most needed in the next cycle.

Macro data continues to send mixed signals with every day, new arguments to support a stagflation, softlanding or deep recession scenarios for the next 6 month outlook.

There is little doubt that the two pillars of the US economy, to mention, the economic activity in Services and the employment are resilient in the current cycle. Indeed, while the Manufacturing sector surprises on the downside, Services indicators show a more positive picture proving that the US economy is more resilient than expected.

Employment also, continues to defy gravity. Payrolls once again blew through the consensus forecast, rising 339k, way above expectations. Add the upward revision from prior month at 93k, and the headline figure is indisputably a strong one. Nevertheless, the data is somewhat ambiguous as the unemployment rate rose from its cyclical low (3.4%) to 3.7%. The Jobs Openings and Labor Turnover Survey (JOLTS data) came also way above expectations at 10.1 million and prior month data was revised higher as well. The two recent indicators only confirm the tightness of the labor market and keep alive the perspective of further Fed rate hikes, which the market is quickly coming to view as a rather high probability.

Regarding inflation, the US report for April represents a "nothing to see here" release with both Headline & Core data in line with expectations. Another soft reading for services excluding rents (0.1% m/m) and a deceleration in shelter costs (0.4% m/m versus prior readings of 0.6%) continue to suggest the disinflation is on track but on a very slow trend with still some sticky part of the inflation components.

It should not be therefore a surprise if the market has finally erased 75bps rate cut expected by the end of the year to finally anticipate a full 25bps rate hike with a probability of 80% for the next Fed meeting on June 14th. Cumulative expectations are now set up for one more rate hike and a pause for the rest of 2023. Quite a big repricing.

Regarding the rest of the world, the days of optimism over China re-opening seem like a long, long time ago. The last month or two has seen a steady stream of disappointing Chinese economic data, with a slump in the official manufacturing PMI.

However, there are signs things might improve soon in China. The Caixin China PMI Services surprised on the upside in May at 57.1 vs 55.2 expected. Rumors that the PBOC could further ease its monetary policy combined with some stimulus could finally wake up the economic activity of the country in the coming quarters.

Europe is doing much better. Germany suffered its first recession since the start of the pandemic. The outlook continues to deteriorates in the first European economy with growing predictions for no growth in 2023. With the ECB on track to deliver a cumulative 50 bps by the end of the year, the risk for a spill over the rest of the continent, which for decades has relied on Germany to power growth, has substantially increase.

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Fixed Income
Volatility and uncertainty

As of writing, it seems that the debt-ceiling will be raised in the US, thereby removing a major tail-risk from markets. US Treasury yields rose across the curve before the bi-partisan deal as nerves were blank in fixed-income markets. The MOVE index, an index measuring bond market volatility rose above 132 which is above the 1-standard deviation upper limit of average volatility.

While the potentially catastrophic consequences of a US default are now avoided (or delayed?), market participants wonder what the huge cash-need of the Treasury means for markets: a $541bn shortfall will be filled with a deluge of new issues, potentially draining liquidity from the market, and especially risky assets, in the coming days and weeks.

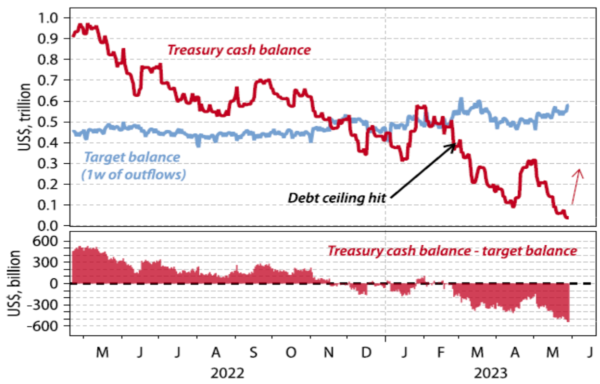
Older problems also remain unsolved: inflation continues to remain sticky and high, putting further pressure on the Fed to continue raising rates. Data is increasingly ambiguous (a strong labor market with other leading indicators stabilizing or falling) and a closer look at retail sales for example confirms that the real problem still is inflation: while retail sales grow at nominal rates, they have been flat in real terms. In other words, the buying power of the American consumer is eroding quickly, and «higher (nominal) retail sales» is not necessarily a sign of a «strong economy» under these circumstances.

The future path of US monetary policy is constantly being repriced by markets. While some weeks ago several cuts were priced to happen before year-end («pause», «step-down», and «pivot»), the best investors could hope for recently was a «skip» in June. But even this now seems far off as anothe 25bps hike is already priced.

The Treasury yield curve has thus steepened again, approaching the 2-10 spread reached in March. We believe that the Fed will err on the hawkish side to reign in inflation, even if this comes at a price for the real economy and especially the equity market. In the past, recessions happened between 311 and 487 days after the first inversion – this leaves us time until September up to the first quarter of 2024 to confirm or reject that «this time its different».

We recommend to remain cautious and to focus on govies and quality investment grade bonds with moderate duration. It is a good time to increase fixed income, especially in USD where real yields are >1.5%.

A $541bn cash shortfall at the US Treasury

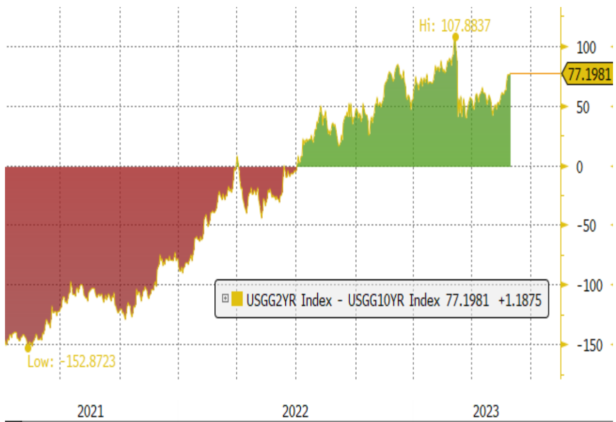


Source: Gavekal Research

Nominal vs real US retail sales

Source: Bianco Research LLC

2-year 10-year Treasury spread: US Treasury curve inversion increasing again



Source: Bloomberg

USD investment grade bond ideas (data indicative as of 2.6.23)

ISIN	COUPON	ISSUER	MATURITY	IND. PRICE	IND. YIELD	RATING
US023135CM69	4.7	Amazon	29.11.2024	100.14	4.59	AA
US931142EW94	3.9	Walmart	09.09.2025	99.03	4.35	AA
USU74078CR28	4	Nestlé	12.09.2025	98.79	4.56	AA-
US713448FQ60	4.55	Pepsico	13.02.2026	100.52	4.33	A+
US459200KT76	4.15	IBM	27.07.2027	98	4.69	A-
US742718FZ79	3.95	Procter & Gamble	26.01.2028	99.35	4.1	AA-

Equity

US Tech Sector Propels Recovery

The US technology sector is driving the overall US market recovery, surpassing key resistance levels. Currently, the S&P 500 is testing the upper range of its 8-month span around 4,200. While there is an improvement in momentum, it does not yet indicate a bullish signal. Further validation is needed to confirm a significant positive breakthrough, which would occur if it reaches the next resistance level at 4,325 (the peak in August 2022). However, short-term challenges like regulatory changes, geopolitical events, unemployment, and inflation could lead to a false breakout. Additionally, profit-taking at these levels could present a selling opportunity.

The primary driving force behind the S&P's performance remains the substantial weight allocation given to high-market-cap technology stocks in the index. Comparing the returns of the S&P 500 weighted by market cap versus an equal-weighted approach, it is evident that the performance is heavily influenced by high-market-cap stocks, with the majority being in the technology sector. The tech sector is expected to remain strong during the summer, especially after Nvidia's recent surge in stock price (+30%). However, relying solely on a few stocks for a market rally could pose problems, especially considering the impact of high interest rates on liquidity. If investors abandon these mega-cap stocks, it could lead to a significant reversal in US and global market.

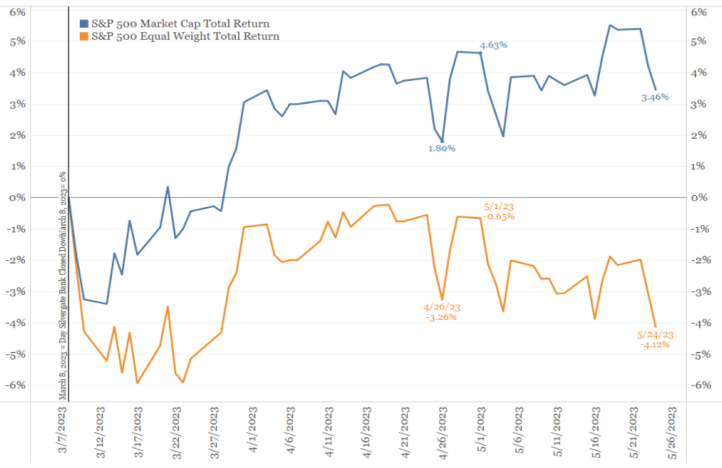
The Russell 2000, representing small and mid-cap stocks, has experienced a decline since its last peak in January 2022. The performance gap between small/mid-cap and large-cap stocks is evident, with the Russell 2000 showing a negative return year-to-date (-0.65%), while the S&P 500 is up (+8.9%). *Normalization in interest rates and increased volatility could trigger a recovery for small and mid-cap stocks. Currently, the Russell is stabilizing around its long-term support level at 1700, and approaching this level could generate a new "buy the dip" signal.*

In the European market, the Euro Stoxx 50 is attempting to break through the resistance level at 4,412, while the 100-day moving average serves as the new support level. The decline in inflation in major Eurozone countries could provide long-term momentum for the region. The DAX is on the verge of reaching a new all-time high, while the CAC has already peaked and might be entering a minor correction phase.

The Japanese equity market, represented by the Nikkei index, is at its highest level in three decades. Positive earnings reports and a weaker yen have driven the Japanese sector, benefiting exporters' shares.

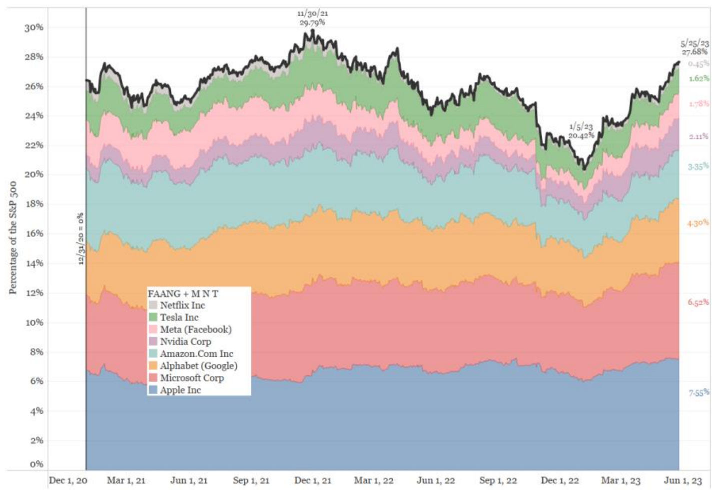
The Chinese equity is exhibiting weakness, primarily driven by the manufacturing sector, indicating ongoing challenges in the country's recovery from COVID-19 lockdown. *However, there is hope for stimulus from the tech sector in China, which is starting to influence investor sentiment.*

S&P 500 Return Market Cap Weight vs Equal Weight



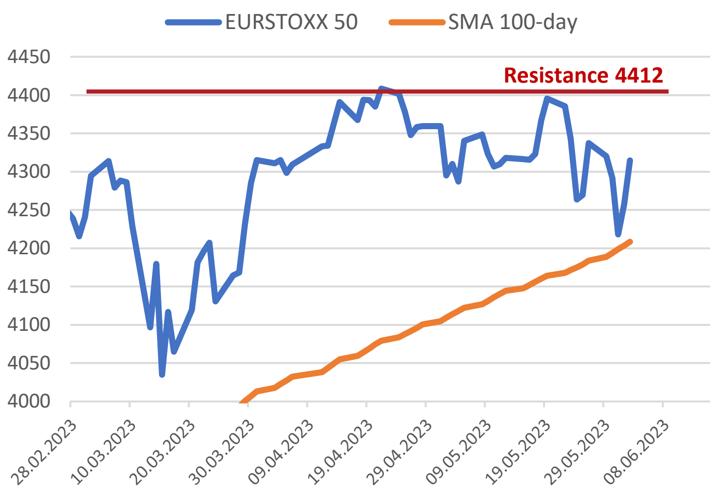
Source: Bianco Research

Top Stocks In The S&P 500



Source: Bianco Research

EURO STOXX 50 Could Reach A New High



Source: Bioomberg

Forex And Commodities

USD Gains Momentum, EUR weakens

After a first half of the year that saw the USD starting to retreat against its peers, June seems to be signaling a reinforcement of the Dollar. The dollar index has recovered from its peak in March at 104.70 and for the EUR/USD, the recent break below the support at 1.08 has put a halt on the longer-term bullish scenario, and further weakness in the short term may push it towards a new bearish support at 1.055 (200-day SMA).

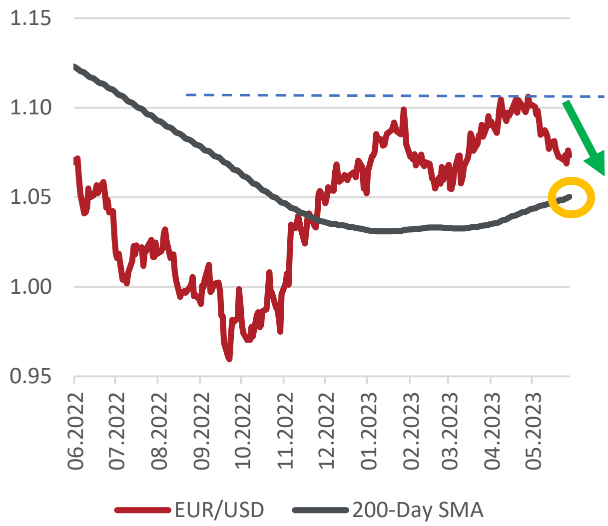
The factors behind this short-term perspective for a stronger dollar versus the EUR are primarily related to European inflation, which is cooling quicker than expected. Data published during the last week of May and the beginning of June showed that inflation, particularly in France and Germany, is slowing. This should reduce the pressure on the ECB to continue raising interest rates, which diminishes the euro's attractiveness relative to the dollar. Secondly, the recent successful vote in the US House, which passed a bill suspending the US government's debt ceiling, has brought some support to the USD as it could embolden the Fed to continue raising interest rates while inflation remains elevated. Finally, the USD should also benefit from the weak economic data coming from China, as China's factory activity shrank faster than expected. As this sector is a key driver of local growth, the market could expect a slowdown in foreign outflows, which would favor the USD.

The momentum in the USD has kept the Gold price below its main psychological resistance at USD 2,000. The precious metal is now moving in a range centered around USD 1,950. Gold is still waiting for a clear shift in interest rate policy in the US to make a decisive move.

The positive trend in the USD may continue to push the USD/JPY pair above the 140 territory, with the next rebound potentially extending towards 142. However, at this level, there could be significant "sell the rally" pressure, providing some relief for the Yen, which may move closer to its 200-day SMA around 135. Moreover, during the last session of the BOJ, a report indicated that Japanese officials have started to grow concerned about a weaker Yen and will closely monitor currency market moves and respond "appropriately" as needed. Although vague, this statement raises hope again for future intervention on the yield curve control, which could push the USD/JPY pair below 125 by the end of the year.

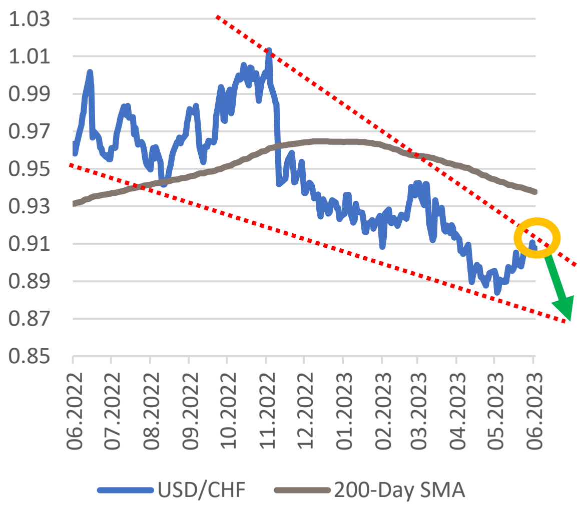
As for the USD/CHF pair, after a period of stagnation, it has bounced back above its resistance at 0.91. The next technical resistance level to watch is 0.92. If reached, it could be seen as a selling opportunity and may lead the pair back to its mid-term downward pressure, with the next resistance at 0.88. This positive trend will also be accentuated by bearish pressure on the EUR/CHF pair, which is known to reflect the true direction of the Swiss Franc against its peers. The EUR/CHF has fallen back below its 200-day SMA at 0.98, triggering a new bearish pressure. The next support level holds at 0.96. It should be noted that the recent rise in interest rates from the SNB has also had a positive effect on the Swiss Franc.

EUR/USD On A Short-Term Bearish Trend ?



Source : Bloomberg

Could USD/CHF Break The Resistance At 0.92?



Source : Bloomberg

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