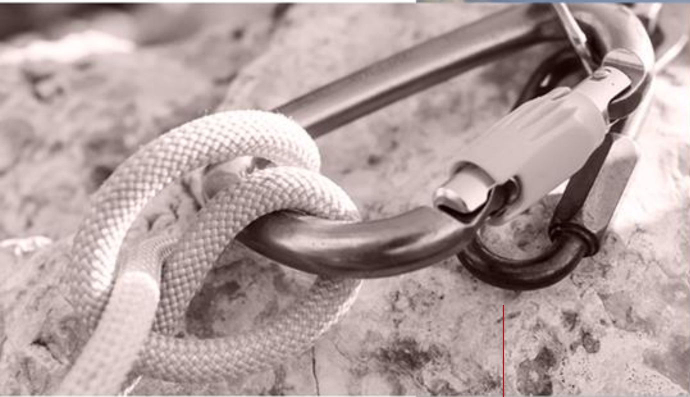
CITĒ GESTION
PRIVATE BANK

Newsletter: Soft Landing is gaining traction/ July 2023



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Key Take-Aways

- In June, several central banks made significant decisions regarding their monetary policies. The Federal Reserve (Fed) opted to pause, while the European Central Bank (ECB) and Swiss National Bank (SNB) implemented expected rate hikes. Surprisingly, the Bank of England and the Norges Bank both decided to raise rates by 50 basis points (bps).

- This series of actions by central banks in June clearly indicates that the battle against inflation is far from over. Moreover, the prevailing sentiment of "higher for longer" has once again taken center stage.

- The consequences of these hawkish messages from central banks were readily apparent in the form of a noticeable upward shift in yield curves. Consequently, bond markets experienced losses, making them the asset class with the weakest performance in June, trailing even behind gold. In the United States, the spread between the 2-year and 10-year Treasury yields has surpassed 100bps, and the yield curve has once again reached its highest level of inversion in the current tightening cycle.

- Although the likelihood of a recession has increased, investing in longer-duration assets remains a risky proposition. As an alternative, we recommend considering the money-market in USD and suggest sticking to shorter-dated high-quality bonds.

- The US equity market remains heavily influenced by a handful of stocks, exerting a disproportionate impact on the performance of major indices. Although US small-cap stocks have shown some signs of recovery during the month, they continue to significantly lag behind the mega-cap stocks that are driving the market's performance.

- Looking ahead, we envision two potential scenarios: either the overall market experiences a correction, triggered by profit-taking on the high-performing mega-cap stocks, or the market enters a sideways trading pattern, allowing small caps to regain ground against their mega-cap counterparts. In either case, we anticipate the gap between mega-caps and smaller caps to eventually narrow.

- Despite experiencing a depreciation in June, the US dollar still appears to be overvalued from our perspective. We anticipate further depreciation of the dollar until the end of the year. On the other hand, the British pound has become increasingly unpredictable due to the accumulation of problems in the UK economy. Meanwhile, the Swiss franc benefits not only from the Swiss National Bank's ongoing hiking cycle but also from its safe-haven status. Consequently, we expect the Swiss franc to maintain its strength going forward.

Review

Risk on in June

- June proved to be another robust month for equities, as major indices experienced significant gains. The Russell 2000 index, measuring US small caps, soared over 8% during this period. Additionally, the Nasdaq and the S&P 500 both recorded increases of more than 6%. The Japanese equity market continued its rebound, adding an impressive 7.5% in June. However, the FTSE 100 and the CSI 300 China index stood as exceptions, delivering negative returns.

- Within sectors, consumer discretionaries, materials, and industrials in the US exhibited the strongest performances, all surging by double digits in June. Year-to-date, telecoms remained among the top performers with a remarkable 36% increase. Conversely, defensive sectors such as utilities and telecoms experienced more modest gains. Information technology advanced by 6.6% over the month and remained the clear leader year-to-date, boasting an impressive 42.77% increase.

- In the forex markets, the US dollar surrendered most of its recent gains, with the dollar index falling by 1.36%. The euro appreciated by 2% against the greenback, reaching the 1.10 level once again. The yen markedly depreciated against the dollar, experiencing a 3.5% decline. Although the euro managed to appreciate by 0.37% against the Swiss franc, the latter continued to strengthen against a weakening dollar, rising by 1.66%. Emerging market currencies faced pressure and depreciated by an average of 1%.

- Throughout June, core rates predominantly traded within a range, with Bunds and Treasuries ending the month with slightly higher yields. The significant upward move in yields occurred primarily at the beginning of July. Spreads of private investment grade and high-yield issuers tightened by 15bps and 40bps, respectively.

- While the commodities segment as a whole witnessed a 3.59% rise in June, performance within this group varied. Gold, despite the risk-on sentiment of the month, experienced a decline of 2.21%. Conversely, WTI oil surged by an impressive 23.75%.

- Reflecting the exuberant market sentiment, equity volatility decreased once again, with the VIX index reaching levels below 13%, well below long-term averages.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 450	1.23	2.36	6.61	8.74	16.88	18
Nasdaq	13 788	1.45	2.20	6.66	13.05	32.32	29
Russell 2000	1 889	0.39	3.75	8.13	5.19	8.06	20
Euro Stoxx 50	4 399	1.02	2.98	4.35	4.25	19.18	12
Stoxx 600 EUR	462	1.16	1.95	2.45	2.69	11.50	12
FTSE 100	7 532	0.80	0.95	1.40	-0.42	3.11	10
SMI	11 280	0.98	0.53	0.58	3.04	8.29	16
NIKKEI 225	33 189	-0.14	1.35	7.56	18.48	28.65	19
CSI 300 China	3 842	0.67	-0.22	2.13	-4.03	0.45	11
MSCI EM Index	989	0.32	-0.04	3.83	0.97	5.02	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 450	1.23	2.36	6.61	8.74	16.88	18
UTILITIES	333	1.22	0.69	1.65	-2.53	-5.69	16
ENERGY	624	0.62	4.82	6.65	-0.89	-5.55	11
TELECOM	216	1.00	0.37	2.58	13.07	36.24	16
CONS STAPLES	779	0.93	0.58	3.24	0.45	1.28	19
REAL ESTATE	237	0.55	5.14	5.59	1.81	3.72	18
CONS DISCRET	1 331	1.37	2.48	12.07	14.58	32.97	25
MATERIALS	522	0.97	4.04	11.05	3.31	7.74	18
HEALTH CARE	1 549	1.08	0.58	4.36	2.95	-1.48	17
INFO TECH	3 086	1.82	2.93	6.59	17.20	42.77	26
FINANCIALS	561	0.91	2.96	6.69	5.33	-0.53	13
INDUSTRIALS	908	0.87	3.90	11.29	6.49	10.19	18

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	102.912	-0.42	0.01	-1.36	0.40	-0.59
EUR-USD	1.0909	0.40	0.14	2.06	0.65	1.91
USD-JPY	144.31	-0.31	0.42	3.57	8.62	10.06
USD-CHF	0.8956	-0.43	-0.16	-1.66	-2.15	-3.13
EUR-CHF	0.9770	-0.04	-0.06	0.37	-1.53	-1.27
GBP-USD	1.2703	0.71	-0.09	2.11	2.97	5.13
EUR-GBP	0.8593	-0.24	0.30	0.01	-2.25	-2.94
JP EM FX Index	49.08	0.14	-0.71	-1.09	-3.43	-1.64

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.84	-0	10	19	-4	-4
Germany	2.39	-2	4	11	-18	-18
UK	4.39	1	7	21	72	72
SWITZERLAND	0.96	-2	2	7	-66	-66
Japan	0.40	1	3	-4	-2	-2
US IG Spread	133	-4	-9	-15	-10	-10
US High Yield spread	475	0	-55	-40	-34	-34
EUR High Yield spread	440	-2	-22	-37	-61	-61

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	101.5	1.22	-0.85	3.59	-3.82	-10.04
Gold Spot $/OZ	1919.4	0.58	-0.10	-2.21	-2.54	5.23
Crude Oil WTI	70.6	1.12	2.58	3.75	-6.65	-11.99

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	13.6	0.05	0.15	-4.35	-27.33	-8.08

Macro & Rates
A Crucial month for Central Bankers

Last month was extremely busy for major central banks. In a nutshell, inflation remains too high and does not slow fast enough. The global economy is only slowly slowing, displaying, once again resilience. With the exception of the People's Bank of China (PBoC) and the Bank of Japan (BoJ), The US Federal Reserve (Fed), the European Central Bank (ECB), the Swiss National Bank (SNB) and the Bank of England (BoE) forecast higher rates and no rate cuts anytime soon.

As anticipated, the Fed decided to maintain rates at the range of 5.00%-5.25%, which was seen as a relatively hawkish stance for a pause. While the changes in the statement indicated the pause, the surprise came from the Dot Plot, which showed a shift upwards by 50 bps (equivalent to 2 rate hikes) to 5.625%. This shift was supported by the Economic projections, where GDP growth was revised higher for this year but slightly lowered for 2024 and 2025. Core inflation projections for this year also increased to 3.9% from 3.6%, and the unemployment rate forecast was downgraded to 4.1% from 4.5% in 2023. Currently, the market expects 1 to 2 more rate hikes before the end of the year, followed by a 100bps rate cut cycle in 2024 starting in February.

As expected, the ECB and the SNB raised rates by 25 bps without surprising the market. Both Christine Lagarde and Thomas Jordan hinted at more rate hikes in the future. The market now foresees 2 additional rate hikes by the ECB during the summer, followed by a pause until at least mid-2024, while another 25bps rate hike is already priced-in for the SNB.

Two central banks caught the market off guard. The Bank of England and the Norges Bank increased rates by 50 bps, while the market had anticipated a 25bps hike. Both banks also signaled that more rate hikes were on the horizon, which aligns with the surprising May inflation report from the UK. Contrary to expectations, the Consumer Price Index rose once again, with the Core indicator reaching 7.1%, marking the highest level in this cycle. The market now expects the Bank of England to implement a cumulative 1.4% rate hike until March 2024. If accurate, this would push the terminal rate in the UK to around 6.25%.

In contrast, two major central banks deviated from the tightening trend this month. The Bank of Japan maintained its dovish policy despite growing concerns that it may be falling behind the curve on inflation. On the other hand, the People's Bank of China (PBoC) reduced its one-year policy rates by 10 bps and introduced a small stimulus package, which has yet to convince the market.

Central Bank activity in June confirms that the fight over inflation is not over and that the "higher for longer" rhetoric is definitely back on track. This increases the risk of recession ahead as the resilience of the economy could force central bankers to make monetary policy mistake by over-hiking

It appears the bar for higher rates in developed markets is somewhat higher than before. In the US, both the residential and non-residential construction markets are on fire. The strength of the housing market has to make the Fed somewhat nervous as after a 500bps rate hike cycle, the most interest rate sensitive sector of the economy is not getting impacted yet.

We will have to see weakness in employment, real income growth and consumption for the Fed to rethink their approach but for now, this is not observable.

In the meantime, a scenario of a resilient economy suggesting "higher for longer" rates may have an nasty implication for fixed-income, in particular ultra-long maturity bonds. Currently, while the US 2 years is flirting with 5%., the 10 year to 30 year part of the US curve is yielding between 3.8% and 3.9%, which is simply too low. Cash at 5% is a much better value. We believe that the risk of a bear steepening of the US curve has increased somewhat. A re-test of the US 30 year yield at 4.4% cannot be exclude.

Fixed Income

Again contradicting signs

In June, both the ECB and the SNB hiked their interest rates by 25bps, and the Fed paused as expected. The tone on both sides of the Atlantic, however, remained hawkish. Not surprisingly in this environment, government and investment grade corporate bonds were among the worst-performing asset classes in June. European corporate bonds for example were up more than 4% in mid-January, but have ceded at least two percentage points of performance from their highs. Generally speaking, quality (govies, investment grade) underperformed while HY and EM bonds posted slightly positive returns over the month.

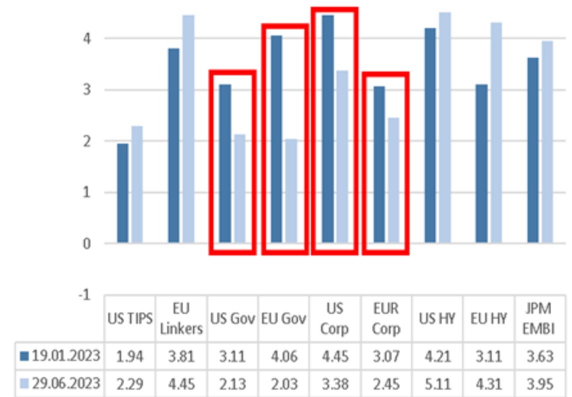
With the hawkish tone of central banks, yield curves shifted upwards. Even in the US, where the Fed paused, the entire curve moved upwards, and 3-year Treasury yields are now 100bps higher than two months ago. Currently, almost two more hikes are priced before year-end, bringing the expected terminal rate to 5.4%, and the first cuts are now expected later in 2024. This is weighing on bonds…

The US yield curve is now even more inverted as the spread between two-year and ten-year Treasuries has risen above 100bps. Historically speaking this has been a solid indication of a recession to come. Still, market participants seem to be split on that subject: spreads of both investment grade and particularly cyclical high-yield bonds have again fallen, currently standing at 130bps and 460bps, respectively. Clearly the strength of the US labor market is adding a question mark to the timing of the next recession. But as time passes, it seems clearer every day that central banks are determined to halt this new «exuberance».

We therefore believe that it is not a time to take on much risk in fixed-income. If anything, we would recommend to stay overweight in short Treasuries and investment grade bonds. Duration, while tempting, is a double-edged sword: if our base-case scenario doesn't materialize and inflation doesn't fall with a slowing economy in spite of hawkish central banks, then the losses on such positions can be high.

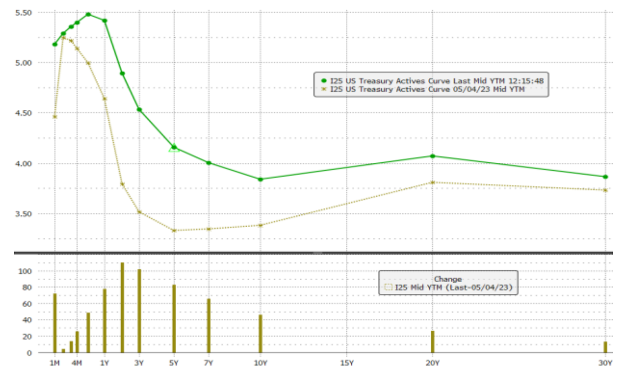
Given that the yield-curve is now even more inverted, some of the best opportunities are to be found in the USD money-market or simply Treasury bills. We are highlighting some examples hereunder.

YTD fixed income performances as of 19.1.23 and 29.6.23



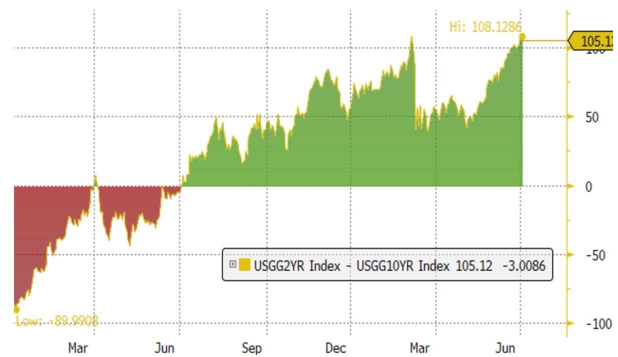
Source: Bloomberg

US Treasury yield curve 4.5.23 and 5.7.23



Source: Bloomberg

2-year 10-year Treasury yield spread



Source: Bloomberg

Coupon	Name	Maturity	Ask Yield to Maturity	Currency	ISIN
0	United States Treasury Bill	8/10/2023	5.20	USD	US912796XY07
0	United States Treasury Bill	9/12/2023	5.26	USD	US912797GS05
0	United States Treasury Bill	10/10/2023	5.32	USD	US912797HA87
0	United States Treasury Bill	11/16/2023	5.32	USD	US912797FK87
0	United States Treasury Bill	12/14/2023	5.41	USD	US912797FU69
0	United States Treasury Bill	1/4/2024	5.44	USD	US912797FW26
0	United States Treasury Bill	2/22/2024	5.20	USD	US912796Z285
0	United States Treasury Bill	3/21/2024	5.30	USD	US912797LL96
0	United States Treasury Bill	4/18/2024	5.32	USD	US912796CX52
0	United States Treasury Bill	5/16/2024	5.38	USD	US912797FH58
0	United States Treasury Bill	6/13/2024	5.36	USD	US912797FS14

Equity

Has the (unstoppable) Bull Market benefited everyone?

The S&P 500 posted a 6.47% return in June, taking the YTD total return to 15.91%. This strong performance was far from obvious at the beginning of the year with lots of portfolios still underweight equities and investors running after the rally. The underperformance is even more striking for those who had no exposure to the "Super Seven".

An impression of déja-vu: Can trees grow to the sky? If we look back, we witnessed two important factors in the past six months: a large underperformance of US small caps vs large caps. We can explain that. It is often the case that a bull market first benefits large caps, with investors putting money first into blue chips.

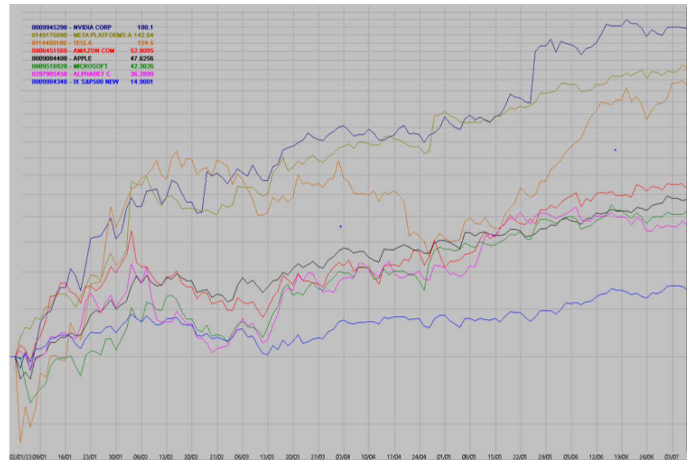
A few stocks drove the index higher, which translated into the "equally weighted SPX" lagging by more than 10% the S&P 500.

Tech companies are overbought, with P/Es back near all-time highs in the historical context, and it also opened up a big gap with bond yields. Into any downturn economical cycle, quality growth is likely to perform better than small caps, commodities, financials, industrials, value or cyclicals generally, but Tech and Quality Growth style is stretched in absolute terms.

A cyclical value rally needs rising bond yields and an accelerating PMI momentum. We do not see either, unless China surprises by unveiling a meaningful stimulus package, or unless manufacturing PMIs in the US and Europe rebound. It is more likely, in our view, that US bond yields move back down, the curve stays inverted, and the labor market sees some softening in 2H. We note a recent increase in claims and in the unemployment rate, on top of uptick in layoffs. This brings the focus to the overall market levels. The market is still extremely concentrated, and that is typically unhealthy. If the growth style does stall, and at the same time the macro conditions are not conducive to a sustained cyclical value bounce, then overall index levels could struggle to keep grinding higher. If markets correct, there could be a profit-taking on mega-caps and the spread between the market cap weighted S&P index and the equally weighted S&P index could tighten. In terms of opportunities, one can ask if allocating to US small caps today is the right timing. Those who believe that a wide correction is expected anytime soon will wait longer before making the move. Having said that, bulls and bears can agree that the decoupling between the SPX and the equally weighted SPW show a real opportunity. Solutions are available to play the narrowing of the gap without being net or long on the index.

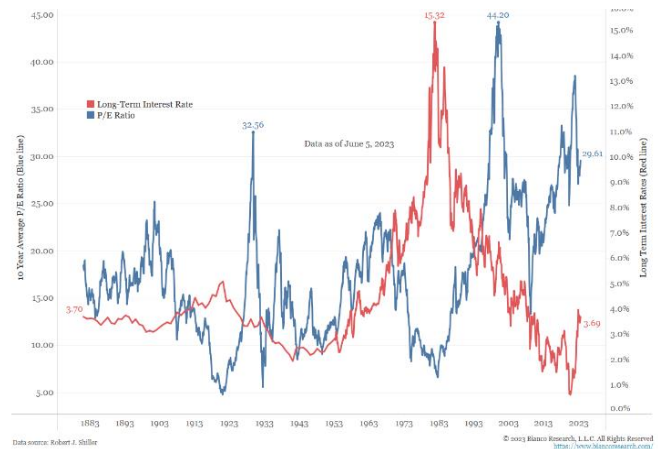
Japan provides many positive signals since the beginning of the year. The Japanese equity market is undervalued globally, offering an attractive investment opportunity due to companies increasing dividends and buying back their stocks. Nikkei 225 Index as of July 7th, 2023. Recent investments from Warren Buffet in Japanese companies apply pressure on underweight foreign investors; also, tax incentives encourage transferring private savings from bank/postal deposits to equity markets.

Super 7's vs the SPY : Apple, Nvidia, Tesla, Alphabet, Meta, Amazon, Microsoft vs. S&P 500

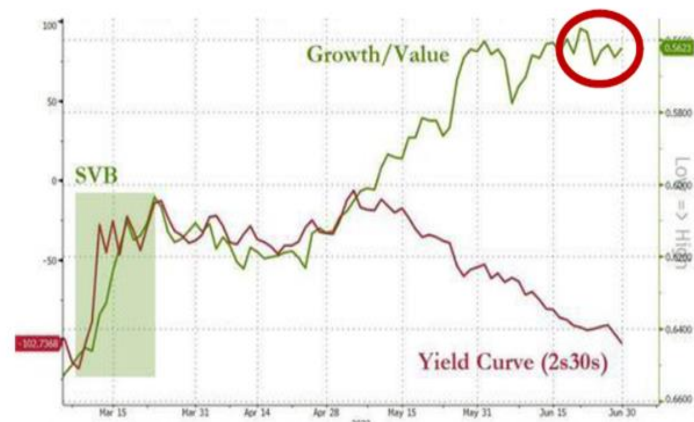


Source: G2

Long-Term Interest Rate vs P/E Ratio



H1 2023 saw the biggest outperformance of Growth over Value since H1 2020 completely decoupling from yield curve.



Forex And Commodities

Can The Dollar Go On Being Overvalued A While Longer?

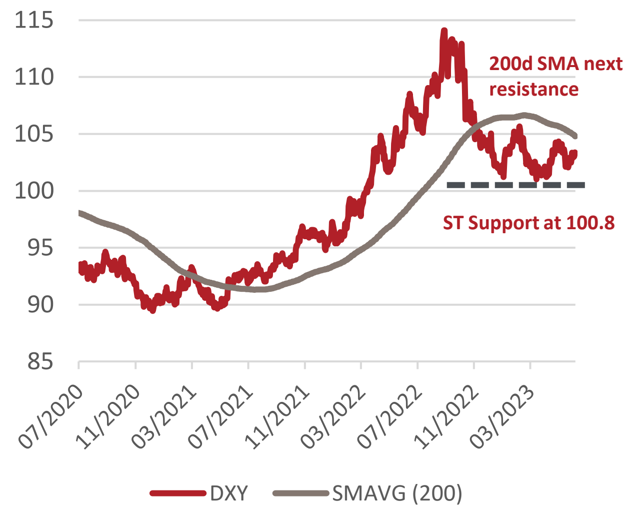
The US dollar has defied predictions of weakening and maintained its value in the first half of the year, trading around 103.3 on the dollar index (DXY). However, many still believe the dollar is overvalued, leading to expectations of potential weakness in the second half.

The expectation of a weaker USD, especially against the EUR, is partly based on the narrowing policy rate differential between the US and Europe. While the Fed did not raise rates in June, they have left the possibility open for future hikes depending on inflation and macroeconomic data. In contrast, Europe is expected to adopt a more hawkish stance, with clear indications of upcoming rate hikes. These policy rate dynamics suggest long-term favorability for the EUR against the USD, along with sentiment and growth differentials that attract capital away from the US and towards the Eurozone. *In the short term, however, uncertainty and lower trading volumes during the summer holiday period are expected to keep the EUR/USD capped in its lower range below 1.10, with support at 1.06. The year-end target for the exchange rate remains at 1.15.*

The Bank of England surprised the market with a hawkish stance at its June policy meeting by raising interest rates more than expected. Despite this hawkish policy move, the GBP continues to struggle in its performance. The British pound is currently fluctuating within a range of 1.285 and 1.25 against the USD. However, the GBP is trading below its fair value, considering the relative rate advantage it has against the EUR and the USD. The lack of stronger performance in the pound suggests that foreign exchange investors are still taking profits and view the UK market outlook negatively. Concerns about the deterioration of the UK's external imbalance and worries that the Bank of England is falling behind the curve could further weaken the pound. *A break below 1.25 could trigger additional downside pressure, with the next support level at 1.21. Conversely, if the GBP experiences a pullback above 1.28, it could signal a new momentum trend towards 1.33.*

The Swiss Franc (CHF) appears poised to remain one of the strongest performers among G10 currencies in the second half of 2023. This is due to the Swiss National Bank's (SNB) consistent and extensive interventions in the foreign exchange market, particularly by selling Swiss francs to prevent the currency from appreciating against the euro. Furthermore, the SNB has raised its monetary policy rate by 250 basis points to 1.75% and is expected to implement one or two additional 25 basis point hikes before the end of the year. *As a result, the CHF is likely to continue appreciating, albeit possibly at a slower pace than before, supported by its relatively low inflation compared to other G10 countries.*

Dollar Index may rebound on the ST but could be limited by its 200d SMA



Source : Bloomberg

EUR/CHF Close to resistance, with a new downward trend ?

Source : Bloomberg

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