CITĒ GESTION
PRIVATE BANK

## Newsletter: Soft or Hard Landing? / October 2023




# Key Take-Aways

- Markets are taking the Federal Reserve's "high for longer" message seriously. Long-term interest rates are increasing rapidly and significantly, which has significant implications for both financial markets and the real economy.

- Several major central banks decided to keep their interest rates unchanged. While the Federal Reserve's "hawkish pause" was anticipated, the fact that the Swiss National Bank (SNB) and the Bank of England (BOE) refrained from hiking rates came as a surprise. The European Central Bank (ECB) was the only one to proceed with the expected 25bps rate hike.

- It has been a tumultuous year for airline stocks. The expectations of a robust summer failed to materialize, primarily due to the impact of rising wages and oil prices.

- The excitement about addressing obesity is genuine, and the use of anti-obesity drugs is on the rise. These drugs are effective in reducing appetite, promoting weight loss, and ultimately decreasing mortality rates.

- Oil stocks have emerged as the standout winners this summer. The Crude Oil WTI sector saw a substantial rebound of 28.52% during Q3, bringing the year-to-date (YTD) increase to 13.12%.

- The U.S. dollar continued to exhibit a strong quarterly performance. This strength can be attributed to the Federal Reserve's hawkish stance on interest rates and the resilience of the U.S. economy.

- Gold experienced its most significant decline in over two years, falling below $1,900 in September. This drop was primarily driven by higher real interest rates and the perception of the U.S. dollar as a safe haven, which continued to exert sustained downward pressure on the price of gold.

# Review

# The Rise of Yields

- September proved to be a challenging month for equities, with most major indexes posting negative returns, except for the FTSE 100, which managed to gain 2.40% month-to-date (MTD). Notably, the Nasdaq and Russell 2000 indices posted the worst performances, showing declines of -5.77% and -5.89%, respectively. The CSI 300 in China fell by 1.96%, resulting in a year-to-date (YTD) decrease of -2.50%. The Euro Stoxx 50 was down by 2.77%.

- In the S&P 500, every sector ended the month in the red for September, except for the Energy sector, which saw a modest gain of 2.63%. The worst-performing sectors included Real Estate (-7.25%), Information Technology (-6.87%), and Consumer Discretionary (-5.98%). Overall, September was a challenging month for equities. However, on a YTD basis, the strong performance of sectors like Telecom (40.43%), Consumer Discretionary (26.58%), and Information Technology (34.72%) contributed significantly to the index's annual performance, which stands at 13.06%.

- In the forex markets, the dollar index rose by 2.47% in September. The EUR depreciated by 2.49% against the dollar, resulting in a YTD decrease of -1.23%. The Japanese yen also depreciated by 2.63% against the USD, ending the month at 149.37. The dollar strengthened by 3.61% against the CHF, resulting in a YTD decrease of -1.00%. The EUR-CHF pair rose by 1.02%, with a YTD decrease of -2.22%, indicating a softening of the Swiss franc against both the EUR and USD. The pound depreciated by 3.74% against the dollar and by 1.29% against the EUR (EUR-GBP).

- Emerging currencies remained under pressure, depreciating by 1.96% MTD and showing a YTD decrease of -4.17% on average.

- US treasury bond yields increased by 46 basis points (bps) in September, reaching a 70 bps quarter-to-date (QTD) increase. The US 10-year yield ended the month at 4.57%. Among government bonds, only Swiss bonds saw a yield correction of 51 bps.

- Equity volatility saw a slight increase, with the VIX MTD rising to 17.5, which is close to the long-term average.

| Equity % Change | Price | 1 day | 5 days | MTD | QTD | YTD | EST P/E |
|---|---|---|---|---|---|---|---|
| S&P 500 | 4 288 | -0.27 | -0.71 | -4.77 | -3.27 | 13.06 | 18 |
| Nasdaq | 13 219 | 0.14 | 0.07 | -5.77 | -3.94 | 27.11 | 27 |
| Russell 2000 | 1 785 | -0.51 | 0.55 | -5.89 | -5.14 | 2.51 | 19 |
| Euro Stoxx 50 | 4 175 | 0.31 | -0.77 | -2.77 | -4.83 | 13.42 | 11 |
| Stoxx 600 EUR | 450 | 0.39 | -0.63 | -1.64 | -2.03 | 9.24 | 12 |
| FTSE 100 | 7 608 | 0.08 | -0.89 | 2.40 | 2.07 | 5.25 | 10 |
| SMI | 10 964 | 0.42 | -0.45 | -1.33 | -2.68 | 5.38 | 16 |
| NIKKEI 225 | 31 858 | -0.05 | -1.08 | -1.74 | -3.36 | 24.34 | 17 |
| CSI 300 China | 3 690 | | -1.31 | -1.96 | -2.93 | -2.50 | 10 |
| MSCI EM Index | 953 | 0.93 | -1.16 | -2.61 | -2.85 | 2.07 | 11 |

| Equity % Change | Price | 1 day | 5 days | MTD | QTD | YTD | EST P/E |
|---|---|---|---|---|---|---|---|
| S&P 500 | 4 288 | -0.27 | -0.71 | -4.77 | -3.27 | 13.06 | 18 |
| UTILITIES | 299 | 0.21 | -6.92 | -5.63 | -9.25 | -14.41 | 14 |
| ENERGY | 694 | -1.97 | 1.31 | 2.63 | 12.22 | 5.99 | 11 |
| TELECOM | 222 | -0.73 | -0.01 | -3.26 | 3.07 | 40.43 | 16 |
| CONS STAPLES | 727 | -0.25 | -1.97 | -4.53 | -5.97 | -4.76 | 17 |
| REAL ESTATE | 214 | 0.39 | -1.41 | -7.25 | -8.90 | -5.51 | 16 |
| CONS DISCRET | 1 264 | 0.53 | -0.27 | -5.98 | -4.80 | 26.58 | 22 |
| MATERIALS | 495 | -0.18 | 0.24 | -4.78 | -4.76 | 2.61 | 17 |
| HEALTH CARE | 1 501 | -0.77 | -1.10 | -2.96 | -2.65 | -4.09 | 16 |
| INFO TECH | 2 906 | 0.39 | -0.08 | -6.87 | -5.64 | 34.72 | 24 |
| FINANCIALS | 552 | -0.88 | -1.55 | -3.14 | -1.13 | -1.65 | 13 |
| INDUSTRIALS | 858 | -0.59 | -0.44 | -5.96 | -5.16 | 4.50 | 17 |

| Currency % Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| DXY | 106.174 | -0.05 | 0.56 | 2.47 | 3.17 | 2.56 |
| EUR-USD | 1.0573 | 0.07 | -0.75 | -2.49 | -3.08 | -1.23 |
| USD-JPY | 149.37 | 0.04 | 0.67 | 2.63 | 3.51 | 13.92 |
| USD-CHF | 0.9153 | 0.03 | 0.96 | 3.61 | 2.20 | -1.00 |
| EUR-CHF | 0.9676 | 0.10 | 0.17 | 1.02 | -0.96 | -2.22 |
| GBP-USD | 1.2199 | -0.03 | -0.34 | -3.74 | -3.97 | 0.96 |
| EUR-GBP | 0.8666 | 0.09 | -0.34 | 1.29 | 0.86 | -2.11 |
| JP EM FX Index | 47.03 | 0.20 | -0.64 | -1.96 | -4.17 | -5.75 |

| 10 yr Yield Bps Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| US | 4.57 | -0 | 14 | 46 | 70 | 70 |
| Germany | 2.84 | -9 | 10 | 37 | 27 | 27 |
| UK | 4.44 | -5 | 19 | 8 | 77 | 77 |
| SWITZERLAND | 1.10 | -10 | 4 | 17 | -51 | -51 |
| Japan | 0.77 | 0 | 2 | 11 | 34 | 34 |
| US IG Spread | 131 | 1 | 6 | 4 | -12 | -12 |
| US High Yield spread | 431 | 0 | 1 | 0 | -78 | -78 |
| EUR High Yield spread | 438 | 6 | 15 | -12 | -63 | -63 |

| Commodity % Change | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| BBG Commo Index | 104.8 | -1.00 | -1.30 | -1.12 | 3.31 | -7.06 |
| Gold Spot $/OZ | 1848.6 | -0.87 | -3.98 | -4.72 | -3.68 | 1.35 |
| Crude Oil WTI | 90.8 | -1.00 | -0.37 | 8.56 | 28.52 | 13.12 |

| Volatility | Price | 1 day | 5 days | MTD | QTD | YTD |
|---|---|---|---|---|---|---|
| VIX | 17.5 | 0.18 | 0.32 | 3.95 | 28.92 | -4.15 |

# Macro & Rates
# This May not end with a soft-landing.

*Looking at the big picture, the Markets are finally taking the Fed's "high for longer" message seriously. Long-end rates are moving rapidly and dangerously higher with implications for both financial markets and the real economy.*

In September, several central banks, including the Federal Reserve, the Bank of England, the Swiss National Bank, and the Bank of Japan, opted to refrain from raising interest rates. It's becoming increasingly evident that the global interest rate hiking cycle is drawing to a close. However, the commonly held belief that the end of a tightening cycle should promptly usher in a "bull steepening" of the yield curve may not hold true this time.

Market participants are now taking the shift in policy direction ("the shift in dots"), the "high for longer" narrative, and the persistent commitment to combat inflation very seriously. This has direct implications for interest rates. While higher yields have been the expected outcome, the bond sell-off has also brought about a "bear steepening" of the yield curve, meaning that long-term yields are rising more rapidly than short-term ones. Notably, the US 30-year yield has reached 5%, a level not witnessed since 2007. Over the past three months, the spread between the US 10-year yield and the US 2-year yield has steepened by 80 basis points (bps), a significant move.

When looking at the historical consequences of such yield curve steepening moves since 1976, especially those exceeding 60 bps from inverted levels, a few key conclusions emerge. Firstly, such market shifts are often associated with future economic weakness rather than strength.

Secondly, bear steepening of the yield curve, which leaves it still inverted, signifies a less immediate threat of recession compared to bull steepening that pushes the curve into positive territory. On a positive note, the US 2-year to 10-year spread remains inverted. However, the less encouraging news is that, even with this more favorable trend, the average and median time to the onset of a recession is still only three to four months away.

It's worth acknowledging that the predictive power of the yield curve may be somewhat less accurate in today's economic landscape, given the influence of quantitative tightening and fiscal factors. Nonetheless, historical patterns indicate that aggressive yield curve steepenings have often heralded recessions on the horizon.

*In the meantime, macro data remains difficult to translate in the US particularly. Early signals of softening in the job market have disappeared meanwhile Manufacturing activity is bottoming.*

Following three consecutive months of decline, the latest Job Openings and Labor Turnover Survey (JOLTS) showed an increase in August, rising to 9.6 million job openings from the previous month's 8.9 million. Additionally, headline payroll growth brought a pleasant surprise, with an increase of 336,000 jobs – surpassing even the highest estimate among Bloomberg analysts. Interestingly, the trend in revisions has also turned positive, with the past two months seeing upward revisions of 119,000 jobs. Labor force participation remained at 62.8%, and the unemployment rate held steady at 3.8%. However, wage growth came in somewhat lower than expected, at 0.2% for the month and 4.2% for the year.

These two reports collectively put a pause on the idea that the labor market is significantly weakening and, of course, do not provide any relief from the upward pressure on yields.

Shifting to manufacturing activity, the US ISM Manufacturing Index reached its highest level since November 2022. Although it remains below the 50 level, which indicates contraction, the index does reveal positive trends in new orders, production, and employment, suggesting signs of improvement in the manufacturing sector.

# Fixed Income

## From bear to bull steepening?

In September, several major central banks held their interest rates on hold. While the «hawkish pause» from the Fed was expected, the fact that the SNB and the BOE didn't hike came as a surprise. Only the ECB hiked as expected by 25bps. Nevertheless the month was characterized by an appreciating USD and spiking US Treasury yields.

*Going forward, one can find many good reasons for both, rising and falling Treasury yields. In other words, both scenarios, the continuation of a bear steepening with longer rates rising faster as well as the beginning of a bull steepening, with short rates falling quicker, are a realistic possibility going forward.*

On one hand, the surprisingly strong economic outlook in the US coupled with rising energy prices and sticky inflation are the main reason to believe that yields could even go higher. Add to that a higher than usual Treasury issuance, the Fed's ongoing quantitative tightening and disappearing buyers of US Treasuries due to geopolitical reasons. Interest expenses for the US government will rise on the back of higher interest rates as well as a widening budget deficit. This puts the very sustainability of US debt into question and could also weigh on Treasuries for the forseeable future.

On the other hand, tightening financial conditions in the US and falling money supply have been solid indicators of recessions to come in the past. An inverted yield curve is another sign which has historically been a good recession signal – the question is rather one of «when» than «if». Finally, US Treasuries now offer higher real yields than the earnings yield of US equities, and this could be a «self-fulfilling» precursor of lower yields as it should only be a matter of time before more investors adjust their asset allocation accordingly.

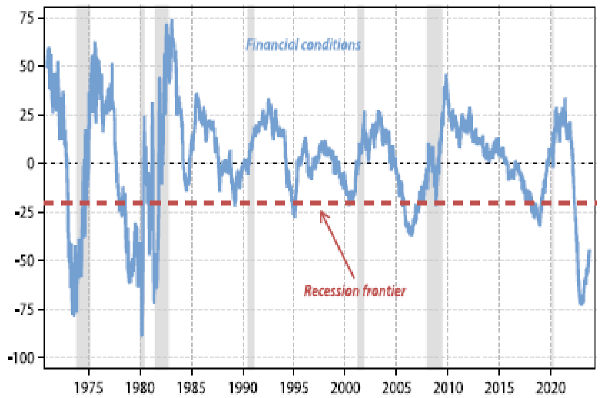
*Therefore, while there are good reasons for both, rising and falling yields, to materialize, we are gradually more confident that it will be the latter. Albeit with a big question mark regarding to its timing.*

Over the summer months, both equities and bonds have had negative performances. However, we believe that the downside going forward is rather limited for bonds, while the correction in equities could well continue. Hence we recommend to hold bonds and where necessary add to this asset class.

Within bonds, we favor quality. Concretely we prefer Treasuries over credit and high-yielding bonds. The recent bear-steepening makes refinancing for corporates more expensive and will at some point in time weigh on margins. This will lead to a spread widening which could accelerate in case of a recession.

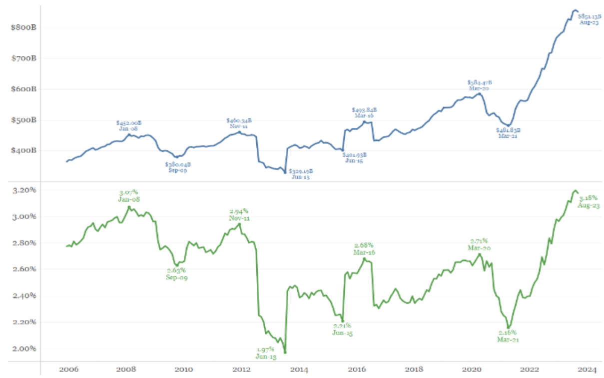
Finally, while uncertainty remains high as to the future path of yields, we are becoming more comfortable with slightly increasing duration.

### US financial conditions signal recession



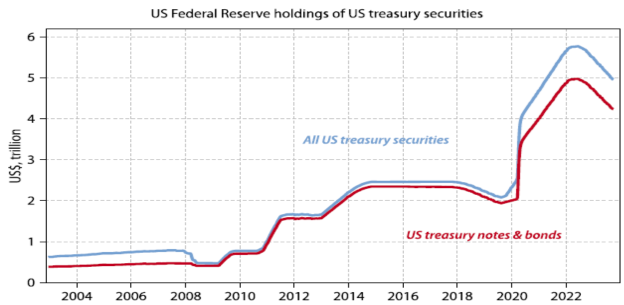

Source: Gavekal

### Annual (blue line) and as % of GDP (green line) US interest expense



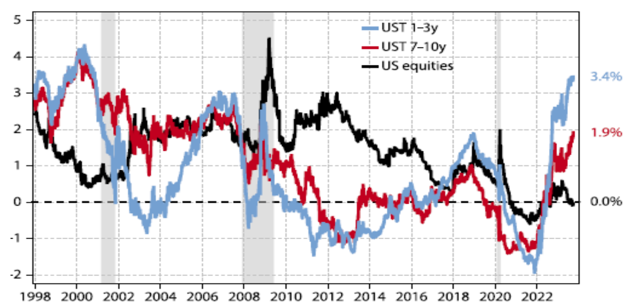
Source: Bianco Research LLC

### The Fed' quantitative tightening is ongoing




Source: Gavekal

### Bond real yields vs. equity earnings yield




Source: Gavekal

# Equity

# “Trend reversal for stocks after summer rally” (1/2)

*September was a tough month for the stock markets following the Fed's 25 basis point hike and the perception that rates will remain higher for longer. The SP 500 marked a second consecutive month of decline – the worst this year.*

## The summer rally is erased

Since the year's high reached in August, the S&P 500 lost 6.55%, but 2023 still looks like a good vintage as the index shows a rebound of 11.68% compared to a loss of 19.44% in 2022. True, but... 2023 has shown several up and down cycles. An investor who did not have stocks on January 1st, or who did not buy them in mid-March – at the peak of the American regional banking crisis – does not profit from the rebound. This reminds us once again that trying to beat indices over the long term by "timing the market" is difficult.

The same is true if we consider specific sectors. The dispersion of returns between the S&P 500 and S&P 500 equally weighted (SPW) remains high. The latter has not benefited from the correction of the former despite being less exposed to the "7 magnificent." The delta between the two even increased during Q3 by 1.62%. The SPW is flat this year with a performance of +0.27%.

In Europe, the market follows the same trend with lower amplitude as the Eurostoxx 50 (SX5E) is up 10.04% year-to-date and down 5.10% over the quarter. An investor who missed January 1st and the Credit Suisse drama entry point has a greater chance of showing a negative return. The old continent is hit by Germany, which continues to suffer from energy costs and the drop in Chinese demand.

As we are about to start the last quarter, we know that October is historically a perilous month for stocks. With long-term US yields approaching the 5% threshold, markets should remain uneasy, and we could expect increased volatility. Higher borrowing costs are bad news for stocks.

However, many institutional investors are focusing on the resilience of the economy, but leading indicators still signal that a recession is not excluded during 2024. Therefore, a question remains: Will a US recession be unfavorable for stocks if it materializes? On one hand, it will slash corporate profits; on the other, it will help get rates cut faster. Recession?

In the current context, it would be appropriate not to exceed the weighting for equity markets and to remain selective on regions. Favoring high-quality stocks, i.e., those with strong cash flow, sustainable and growing dividends, and a low level of debt, is one way to reduce the volatility of your portfolio in the uncertain markets that we currently see.

## Oil sector bounced during Q3

Q3 saw a strong rise in oil prices (CL1 is up 28,52% or $14,69) which continued to support oil stocks, which, are this summer’s big winners. In New York, performance in New York: TotalEnergies SE +14,09%, BP PLC +9,72%, Exxon Mobil Corp +9,63%, Shell PLC +6,62%).

S&P 500 and Eurostoxx 50 YTD since January 1st, 2023

Source: Bloomberg

# Equity

# "Trend reversal for stocks after summer rally" (2/2)

## Asia

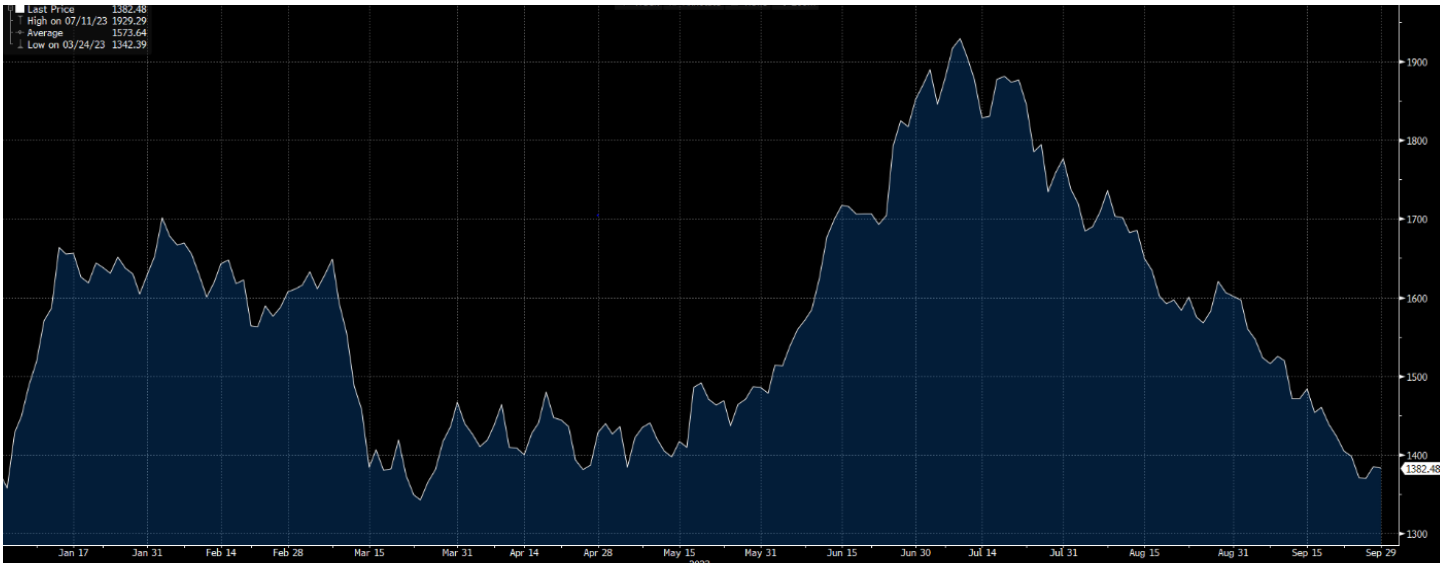
In China, investors watch macroeconomic data and corporate profits to judge whether the economy is improving. Investor sentiment is leaning toward pessimism and the market could remain volatile in the near term. However, it would be unreasonable to take an even more bearish stance. Recent developments in China's semiconductor industry could ease some concerns over U.S. technology restrictions, which could stabilize Chinese stocks.

In Japan, market observers expect the Japanese Central Bank to relax its policy of controlling the yield curve. The era of deflation appears to be coming to an end, domestic demand is expected to remain strong and companies are increasing returns to shareholders. All these reasons make Japan become a credible alternative in Asia.

## Airlines on a bumpy ride

Airline stocks are facing a turbulent year. They initially benefited from the end of travel restrictions and the re-opening of mass tourism. A strong summer was widely anticipated as demand was strong. But wage negotiations kicked last Spring, increasing volatility until June. Those who took flights in July/August could witness that expected demand materialized and benefited to stocks until oil bounced: rising oil prices during Q3 had an obvious negative impact in a depressed environment for stocks. Over the long term, the sector is known for its cyclicality. Airlines stocks are not buy and hold but buy and trade.

Dow Jones US Airlines Total Stock Market Index




Source: Bloomberg

## The obesity euphoria

Anti-obesity drugs are currently re-pricing several sectors (from healthcare to consumer staples and consumer discretionary). We had the opportunity to recently meet with key scientific opinion leaders in the US, to discuss their impact.

These drugs are so-called GLP1 agonists (such as Novo-Nordisk's Wegovy/Ozempic and Eli Lilly's Mounjaro). They mimic the action of a hormone secreted by the intestine and certain neurons from the nervous system, decreasing appetite. They have shown activity in obesity (up to 20%+ weight loss and 20% mortality reduction, comparable to bariatric surgery), type 2 diabetes (ability to eradicate insulin needs with no risk of hypoglycemia), sleep apnea, as well as a liver condition (non-alcoholic steatohepatitis). They are also being evaluated in other diseases such as Alzheimer.

While some companies may be contained into a GLP1 trap for some time, demand for the above conditions will be delayed but not eradicated due to 1) access issues (1'000+ USD monthly cost, with insurers unwilling to cover broadly, however generics launch of liraglutide in 2024 could put pressure on pricing), 2) tolerability issues (nausea/vomiting will make patients drop out after 1-2 years of treatment per doctors, with weight recovering, and conditions too), and 3) safety risk (risk of thyroid cancer and pancreatitis flagged by regulators). As always, the devil will be in the details.

# Forex And Commodities
# USD Dominance, CHF Strength and Gold Decline

In September, the forex market witnessed dynamic movements driven by global interest rate policies, particularly the resilience of the United States Dollar (USD). The Federal Reserve's hawkish stance and the robust U.S. economy were key factors behind the USD's continued strength.

This macroeconomic environment has led to the belief that U.S. interest rates will remain on an upward trajectory for an extended period, further supporting the USD. Technical indicators for the EUR/USD pair suggest a bearish trend, with the pair breaking key support levels, reaching new yearly lows. A critical support zone between 1.05 and 1.04 is providing resistance. If the psychological support at 1.04 is breached, it could potentially lead to a further decline, possibly approaching parity.

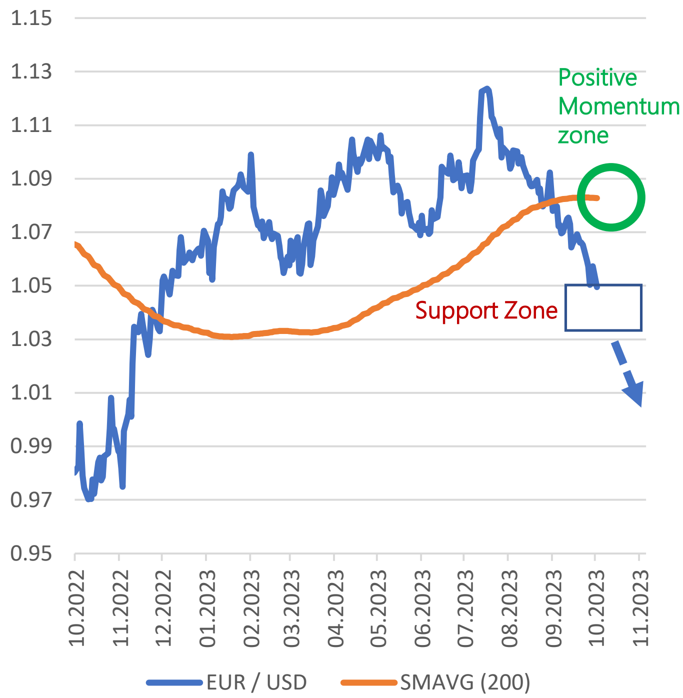
However, the descent to such low levels presents an oversold condition, offering an opportunity for hedge funds and asset managers to strategically capitalize on lower prices to enhance long positions in the EUR. This could provide a temporary halt to the descent and a short-term boost to the EUR/USD. A sustained shift in momentum would require softer U.S. economic data and a more aggressive stance from the European Central Bank (ECB) in its monetary policy. Additionally, a significant break above 1.08, marked by the 200-SMA, could signal a positive momentum shift.

Turning to the Swiss Franc, its recent strength paused briefly after the Swiss National Bank decided to maintain a flat interest rate. The USD/CHF pair breached key resistance levels at the end of September, indicating potential upward momentum. Despite a lower yield compared to the USD, Switzerland's positive economic data continues to attract investors seeking the safety of the Swiss Franc. In the short term, the USD/CHF pair is expected to trade within a range of 0.91 to 0.94. The strength of the Swiss Franc is further evident in the EUR/CHF pair, which remains within a bearish channel at 0.97, indicating a bearish medium-term outlook for the EUR/CHF and a stronger CHF. A shift to a bullish trend would require a significant rise above the 200-SMA at 0.97.

The Japanese Yen has started sliding towards 150 per dollar, reminiscent of levels observed in September 2022 when the Bank of Japan (BoJ) intervened in its Yield Curve Control to strengthen the Yen. Investors are now anticipating the possibility of a new BoJ intervention to bolster the Yen.

Gold experienced its most significant decline in over two years, dropping below $1,900 in September. Higher real interest rates and the perceived safety of the USD contributed to sustained pressure on gold. A critical support level is at USD 1,820, marked by the 100-SMA crossing below the 200-SMA, known as a "death cross." A continued cross, along with elevated U.S. real rates, could lead to further declines, possibly around USD 1,700.

### More Momentum Possible For The USD ?




Source : Bloomberg

### EUR/CHF Acts As A Barometer To Anticipate the Direction Of CHF


Source : Bloomberg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