CITĒ GESTION
PRIVATE BANK

Newsletter : Recession Or Soft Landing? | January 2023

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Key Take-Aways

- December was once again a harsh month for equity markets with the S&P500 falling -5.8%. With this, 2022 shall be remembered as one of the worst years for financial markets since the dot-com bubble of the 2000s and the subprime crisis of 2008.
- For the entire year, the S&P500 declined -18.1%, the STOXX600 -9.9% and MSCI Emerging Markets Index -19.9%. In fixed income, the Bloomberg Global Agg. Index fell -16.3% during 2022 and the BBG Global High Yield Index lost -12.7%. In this context, a traditional portfolio invested 60% in equities (MSCI ACWI) and 40% in fixed income (BBG Global Agg.) had a negative performance of -18.4%.
- 2022 was the year where inflation has peaked and as we move into 2023 we expect «disinflation» to be the key word. The Fed is expected to hike rates two more times in Q1 before pausing and then the market is pricing in that there will be rate cuts by the same amount still in 2023. We believe that investors are being too optimistic about how fast inflation will fall and how fast central banks will start easing their policy.
- In Fixed Income, nominal yields have risen and are looking attractive again. Nonetheless, as core inflation is still high and stickier, we continue to remain cautious, preferring short dated paper and staying within quality investment grade corporate and government bonds.
- Regarding equities, 2022 was finally a year where value stocks outperformed growth. As we move into 2023 we think this outperformance can continue as markets are, in our view, too optimistic in expecting a significant Fed easing. After a two year correction, we are now more constructive for Chinese equities with a preference for domestic equities A-shares on the backdrop of a reopening of the economy as well as regulatory easing.
- The first glimpses of a slowdown in the Fed's interest rate policy has started to change investors' perception against the dollar. Despite some volatility, the dollar can continue its bearish trend it has started in November. On the Yen side, it's testing its psychological resistance at 130, if broken there will be room for a 126-127 level.

Review: A year to forget

After two months of rising markets, the year 2022 ended as it began, in the red. It will remain in the minds of investors as the worst year since the internet bubble of the 2000s and the subprime crisis in 2008

December was again marked by various central bank meetings. The first was the Fed, which unsurprisingly raised its key rate by 50 basis points to a range of 4.25%-4.5%. It was followed by the European Central Bank which raised interest rates in the Eurozone for the fourth consecutive meeting from 1.5% to 2.0%, it also announced a balance sheet reduction programme (QT) while stressing the fact that it will have to raise interest rates further in order to fight inflation. The surprise for the market came from the Bank of Japan, which raised the ceiling of the 10-year interest rate band.

The S&P500 fell -5.8% in December and ended 2022 with decline of -18.13%, while the Nasdaq Composite fell -8.66% and ended 2022 at -32.51%. Only the Dow Jones finished below -10%, with an annual performance of 6.86%, thanks to its defensive stance. The EuroStoxx50 ended the month at -4.04%, the CAC 40 at 3.81 and the SMI at -3.58%, their annual performance was respectively -8.55%, -6.71% and -14.29%. In Asia, the Nikkei ended the month at -6.57% and the CSI 300 at +0.63%, closing the year with -7.38% and -19.83% respectively. As for the US sectors, Energy and Utilities were the only positive sectors in 2022, with performances of +65.43% and +1.56%.

On the fixed income side, global indices recovered slightly in December, with the Bloomberg Global Aggregate Index rising by +0.54%, the EMBI Index by +0.38% and the BBG Global High Yield by +0.66%. In Europe, the BBG Euro Aggregate Index continued to suffer from rising rates, with a loss of 3.64%.

The DXY index eased by -2.29% to end the year at 103.522 (+8.21% YTD).

The US 10 years yield ended the month up 27bps, the bund up 64bps and the UK Gilt up 51bps. All 10 years sovereign rates are now in positive territory.

The Bloomberg Commodity Index contracted by 2.80% to end the year at +13.75%.

The VIX rose by 1.09 points to close 2022 at 21.67.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,840	-0.25	-0.12	-5.77	2.30	-18.13	16
Nasdaq Composite	10,466	-0.11	-0.28	-8.66	-4.65	-32.51	19
Russell 2000	1,761	-0.28	0.08	-6.49	3.89	-20.46	17
Euro Stoxx 50	3,794	-1.47	-0.61	-4.04	10.70	-8.55	11
Stoxx 600 EUR	425	-1.27	-0.60	-3.30	5.31	-9.88	12
FTSE 100	7,452	-0.81	-0.28	-1.49	5.64	4.57	10
SMI	10,729	-1.18	-0.70	-3.58	0.02	-14.29	14
NIKKEI 225	26,095	0.00	-0.40	-6.57	-0.06	-7.38	14
CSI 300 China	3,872	0.39	1.22	0.63	-12.58	-19.83	10
MSCI EM Index	956	-0.11	0.18	-1.51	-2.92	-19.94	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3,840	-0.25	-0.12	-5.77	2.30	-18.13	16
UTILITIES	358	-0.96	-0.59	-0.53	2.13	1.56	18
ENERGY	672	0.76	0.60	-2.99	25.56	65.43	11
TELECOM	159	-0.03	-0.08	-7.84	-13.92	-39.89	12
CONS STAPLES	779	-0.47	-0.83	-2.82	5.25	-0.62	20
REAL ESTATE	232	-0.91	-0.37	-4.83	-7.63	-26.21	32
CONS DISCRET	1,005	-0.28	-0.25	-11.26	-6.26	-37.03	18
MATERIALS	490	-0.71	-1.08	-5.56	6.85	-12.28	16
HEALTH CARE	1,586	-0.32	-0.17	-1.91	6.96	-1.95	16
INFO TECH	2,172	-0.12	-0.15	-8.37	-1.76	-28.19	18
FINANCIALS	570	-0.28	0.72	-5.27	10.03	-10.57	11
INDUSTRIALS	831	-0.39	-0.15	-3.00	13.56	-5.51	17

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	103.522	-0.30	-0.76	-2.29	-1.11	8.21
EUR-USD	1.0705	0.41	0.83	2.87	2.11	-5.85
USD-JPY	131.12	-1.44	-1.35	-5.03	-3.39	13.94
USD-CHF	0.9245	0.14	-0.93	-2.24	-3.20	1.27
EUR-CHF	0.9896	0.54	-0.15	0.56	-1.16	-4.62
GBP-USD	1.2083	0.23	0.25	0.21	-0.78	-10.71
EUR-GBP	0.8853	0.10	0.48	2.59	2.84	5.23
JP EM FX Index	49.90	-0.00	-0.23	-0.76	-3.38	-5.07

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.87	6	13	27	236	236
Germany	2.57	13	17	64	275	275
UK	3.67	1	4	51	270	270
SWITZERLAND	1.62	7	9	50	175	175
Japan	0.42	-4	4	17	35	35
US IG Spread	143	1	1	-2	43	43
US High Yield spread	509	-1	15	8	239	239
EUR High Yield spread	501	-10	-7	-10	155	155

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	112.8	0.37	0.22	-2.80	-3.63	13.75
Gold Spot $/OZ	1824.0	0.50	1.44	3.14	0.93	-0.28
Crude Oil WTI	80.3	2.37	1.01	-0.36	-24.11	4.25

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	21.7	0.23	0.80	1.09	-24.52	4.45

Source: Bloomberg 12/31/2022

Macro & Rates: Perspectives for 2023

Moderating inflation and economic slowdown will likely characterize this new year which may mean the investment environment could slowly get back to normality.

Most investors spent the entire year 2022 waiting for the «inflation peak». In 2023, we expect the key word to be « disinflation».

There is little doubt that global inflation has peaked and that inflation deceleration is already in place and for sure this is a good news for the normalisation of financial markets.

A number of indicators suggests that the world economy is slowing down and combined with la ower inflation rate, market participants are now focusing on THE magic moment: the pivot from central banks.

In 2022Central banks have responded aggressively to the surge in inflation and at some points, effects start to become visible in their economies. The World Manufacturing PMI is in contraction (below 50) since September 2022 and quarterly annualised GDP growth is set to run at below potential for several quarters. Recently, the December US ISM Services surprised on the downside dropping below 50 for the first time since June 2020.

In the US, the Federal Reserve Bank (Fed), acknowledged the economic slowdown and the disinflation by reducing the rate hike path in December 2022 and signaling two more rate hikes in 2023 for a total of 85 basis points according to the «dots», before eventually making a pause.

A pivot means a change in monetary policy. This can be from a tightening cycle to an easing cycle... or a pause. The market has already made its choice by anticipating the Fed will cut rate in 2023 by the same amount it will hike in the first quarter of 2023.

Of course, U-turns in monetary policies have some precedents. But this time is different. The slowdown could be less painful than past recessions. Corporate and household balance sheets are healthy, both still have excess saving built during the Covid crisis, especially in the US. On top of that, the jobs market, particularly in the US remains strong, supporting wages, that could feed easily another leg of inflation.

We beleive investors are too optimistic about how fast inflation is likely to fall and how fast central banks will enter into a new easing cycle.

The biggest policy error that central banks made is to believe that the current inflation cycle was «transitory». This error has increased substantially their sensitivity to the risks of cutting rates before inflation has fully disappeared. Cutting rates sooner would risk another, even less controllable rise in inflation which would again destroy their credibilty.

While a pause is likely on the table for 2023, we think Central banks will require a subtantial contraction in the economy that persists for 3 or 4 quarters and observe a couple of percentage points increase in the unemployment rate to switch to an aggressive easing cycle. So far, none of those 2 dynamics have occured.

Nevertheless, It is likely that the Fed makes a pause, probably in April. But a Fed pause is not a sufficient justification to own or buy anything.

This aggressive rate cycle will leave us with either a soft or hard landing scenario with dramatically opposite consequences for corporate earnings and therefore credit spreads and equity multiples.

Fixed Income: new opportunities, but be careful!

When reading 2023 outlooks one has the impression that there is one new consensus building up: fixed income is finally attractive again as yields have risen significantly after a long streak of low or negative interest rates. While there are certainly new opportunities in fixed income, there are also some caveats to this view.

Firstly, fundamentals in the US and Europe are changing, and after a period where investors were mainly driven by interest-rate differentials and currency movements, bond vigilantes might reappear. According to the IMF, the US is expected to run a twin deficit totalling around 8%-10% of GDP in the next four years. What if the foreigners on the other side of this deficits no longer feel comfortable deploying as much capital to the US? Such a development could be negative for long Treasury yields.

In Europe, the ECB will stop reinvesting the proceeds from maturing bonds held starting in March. Moreover, while the ECB has absorbed the entire eurozone's net issuance of government bonds over the last eight years, it is planning to offload EUR 210bn between March and December 2023. This is unchartered territory as this will be the first time the ECB will actually reduce its bond holdings (QT). In the same time, the European Commission expects eurozone governments to run deficits amounting to EUR 513bn in 2023. If these deficits will be entirely funded by new debt issuance, then the new supply of eurozone government bonds could exceed EUR 700bn, the highest ever.

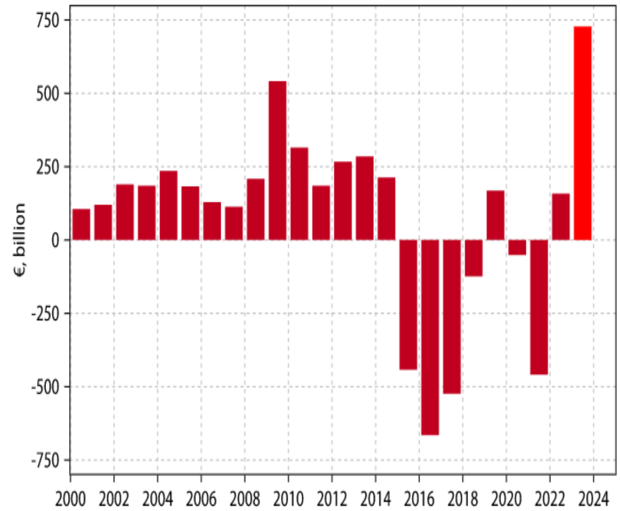
So while nominal yields are rising and look attractive again, the big question is: are they correctly pricing deteriorating fundamentals?

Secondly, it seems that underlying inflation (excluding the more volatile food and energy components) is still rising and stickier than expected. Inflation forecasts in general have been extremely poor over the last two years. Hence, what does it really mean if most analysts expect US inflation to be back in the range of 2%-3% by September 2023? Wishful thinking?

If history is a guide, then it could well take up to two years from the peak for inflation to fall back to 2%. The world is now, however, a different place than it was in the 70ies and 90ies, and we should not expect to return to the period of «great moderation». According to BlackRock, we will live with higher inflation due to three long-term trends which will constrain production capacity: aging populations leading to worker shortage, geopolitical fragmentation which impacts globalization and supply-chains and a transition to a lower-carbon world leading to supply-demand imbalances.

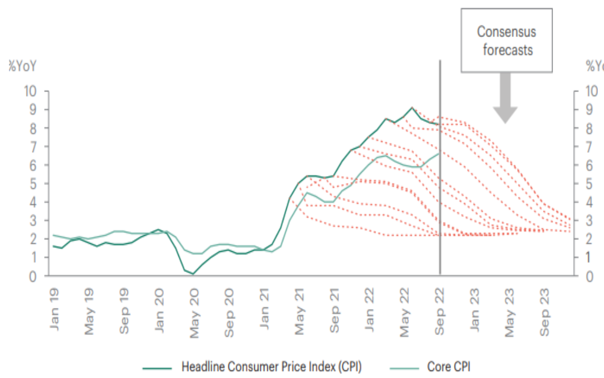
Therefore we recomment to remain cautious in fixed income in spite of the recent euphoria. Buy short dated government paper and stay with quality investment grade bonds. Be careful with the rest.

Net issuance of gvt. bonds minus net securities purchases by the ECB



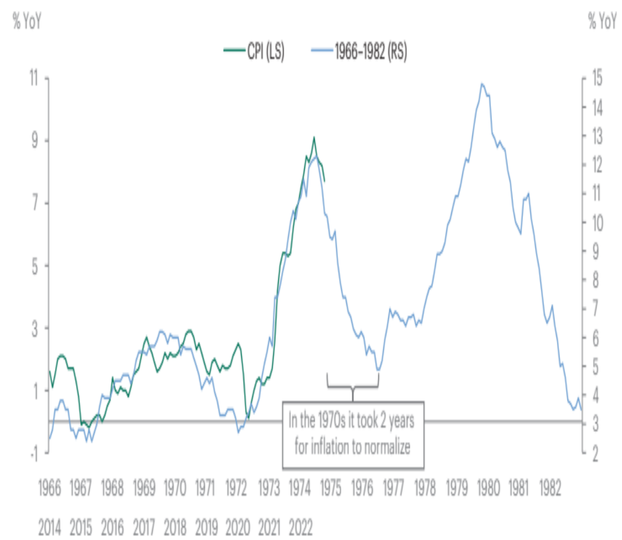
Source: Gavekal Research/Macrobond

Consensus forecasts of lower US inflation have been inaccurate



Source: Cleveland Fed, Bloomberg, Haver Analytics, Apollo

Historical inflation paths back to 2%



Source: BLS, Bloomberg, Apollo

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Equity: Stocks fall to end the worst year since 2008

Equity markets down 4% in December to end a difficult year.

In 2022, global stocks suffered a 20% decline, the 2nd worst year since 1974, as central banks fought inflation, markets face supply chain shortages and an energy crisis due to the COVID-19 pandemic and Russia's invasion of Ukraine. 2022 was twice as bad as the global financial crisis: nearly $40 trillion in stock and bond value vaporized. We note that while the Dow only fell 9% in 2022, the Nasdaq plunged over 33%. Over $7 trillion in stock market cap has been erased from the Nasdaq 100.

The main US stock indices ended the last trading weeks of the year mostly lower in thin trading. Consumer staples and materials shares fell the most, while consumer discretionary shares were the most resilient. But the global impact of China's relaxation of COVID containment rules was the key market driver over the last weeks. The zero Covid strategy and its strict confinements have suddenly been replaced by a total reopening despite the saturation of the health system. The Chinese PMI indices are deteriorating but the desire to boost economic activity seems to outweigh health considerations.

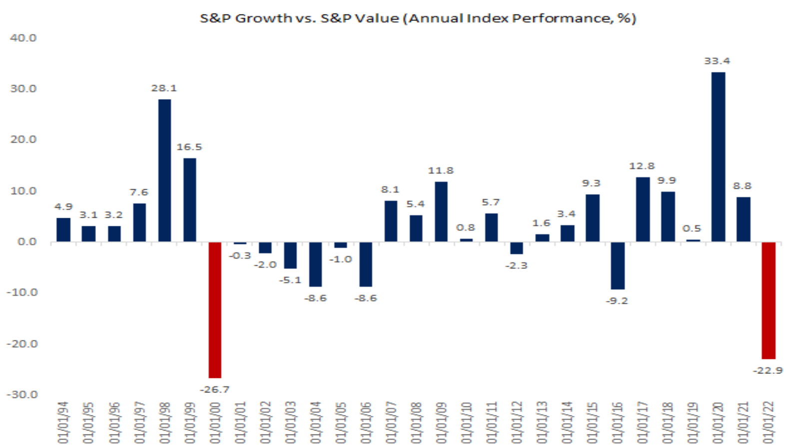
European markets continue to outperform US markets, supported by lower gas prices and China re-opening. Due to an abnormally mild winter, the price of spot gas collapsed to pre-Ukraine war levels. Thanks to energy, inflation is falling and European PMIs are improving a little with a composite index that is close to the expansion zone at 49.3 vs 48.8 expected and valuations are still looking cheap.

See below the movers over the year

After a two year correction, is the Chinese market investable again ?

As we have reached the end of the year, investors may look at the 2022 laggards to search opportunities. In this configuration we are constructive in Chinese equities with a preference for domestic A-shares in the consumer staples and utilities sectors. In addition, the market expects strong earnings growth in the region. The reopening, the political support and regulatory easing should also help the Chinese market.

The outperformance of value vs growth should continue in the beginning of this year.



Growth stocks vs value stocks in 2023 ?

It's clearly still too early to make a choice and we need to remain diversified as central banks have not indicated any radical change in their monetary policy. The market expects a pivot from the FED in the second half of the year, but this looks optimistic from our point of view. After the very good start of the year, we remain cautious on the equity markets and a return of volatility in the coming weeks cannot be excluded.

Forex And Commodities: Could 2023 Start With A Reversal For The USD?

Forex investors are likely to start 2023 still bracing themselves for the same macro-economic forces occurring in 2022. : potential pressure related to a recession, persistent inflation and Fed policy regarding interest rates direction.

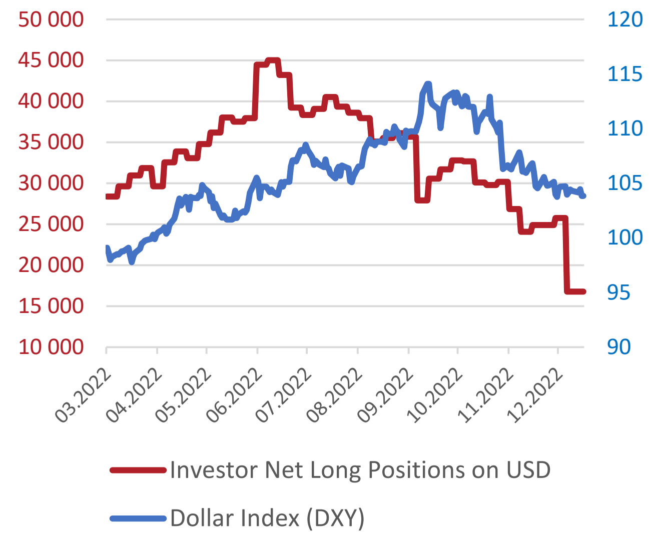
January should still be marked by the dominance of the USD. However, the new bearish trend observed since November could reverse the situation gradually. First glimpses of a slowdown in the Fed's hiking cycle following the moderation of inflation in the US has started to change investors' perception against the dollar.

The pair EUR/USD demonstrates well this new bearish view on the dollar. After suffering with a low below the parity over 2022, the pair saw a dramatic turnaround in the last quarter of the year. Reaching a high at 1.0737 by reversing more than 2/3 of the previous 9 months decline in only 6 weeks following lower than anticipated inflation numbers in the US. This sharp reversal demonstrated the asymmetric reaction of investors on the Dollar, with the downside surprises on inflation having a larger effect on the dollar than upside ones. In other word, the market is pending for any signs to cool down the USD. Similarly, the net long positions on the USD have been reduced by two since November. On a technical perspective, a "Golden Cross" has been reached on the EUR / USD graph. This major bullish technical signal is represented by the crossing of the 50-day SMA above the 200-day SMA. The crossing of both SMAs could trigger a higher EUR/USD around the resistance at 1.09 by Q1.

Regarding the pair USD/CHF, it is likely that the Swiss franc should remain on its actual range at 0.90-0.94. Swiss franc turned out to be less sensitive to the dominance of dollar. What should be determinant for the USD / CHF will be more related to the EUR direction. As observed during the last speech of the ECB, the hawkish tone immediately weighted on the CHF and thus reduced the USD/CHF. Therefore. the situation on Eurozone could be key for the further sensitivity of CHF. Furthermore, it is likely that the SNB will intervene if the USD/CHF breaks below the 0.90 support.

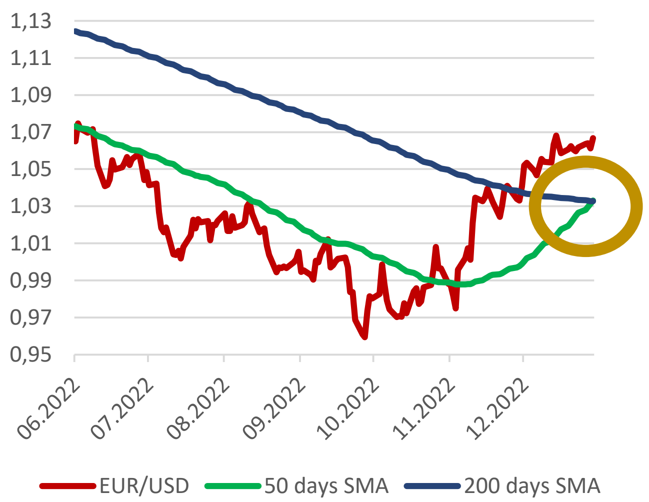
On the Yen side, the surprise decision from the BoJ to authorize its 10 years government bond to fluctuate to an higher range between -0.5% and +0.5% cap (from -0.25% to +0.25% previous cap) has immediately create a new bullish trend for the JPY. The action of the BoJ was a clear sign that its very accommodative monetary policy is not sustainable anymore. Japan has to cope with more and more inflation. Further hawkish actions could be expected by 2023, which will undoubtably bring back the USD/JPY to lower level. Despite a BoJ still very reluctant to increase its terminal rate, the Yen is now testing its psychological resistance at 130, if broken there will be room for a 126-127 level.

Investors Reduce Their Position On USD



Source: Bloomberg

Would the "Golden Cross" Push The EUR/USD Up?



Source: Bloomberg

Prospect of Bullish Trend for the Yen?

Source: Bloomberg

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