Key Take-Aways

- 2023 continued the good trend started in the fourth quarter with global indices posting some of their best performances in decades.
- At the last Fed meeting, the Chair Jerome Powell said during the press conference on February 1st «The disinflation process has begun» and that monetary policy was close to restrictive territory. We still believe that the Fed will pause around 5% and probably not cut for a while. But that is entirely data dependent, both on the upside and downside.
- Europe is lagging the US a couple of months in terms of monetary policy. The ECB has for the second time in a row hiked more than the Fed and plans to continue hiking at the current pace.
- Hard economic data started to deteriorate. Producer Price Index, Industrial Production and Retail Sales fell below consensus as the economy is slowing down. The Housing market is slowing down and the news flow does not sound that positive either. Nevertheless, market participants are comforted by the idea and the sentiment that the worst is behind us.
- In Equities, after value outperformed growth stocks last year, value stocks underperformed by 5% in January. Unprofitable tech surged the most during January. But the value trend remains as long as we are in a rate hike cycle, quality should outperform growth stocks.
- Equity indices are technically well oriented to continue the rally. However, investors remain cautious and most analysts expect the equity rally to end and volatility to increase in the coming weeks.
- On the USD, highlight to the reverse of the bearish trend in February. The narrative supporting the Euro (the “catch up” effect in the relative ECB-Fed policy rate differential) has been fully exploited by forex investors and seems now entering in overcrowded territory.
- The Japanese Yen started February in a bearish trend. However, with the upcoming change of BoJ governor that will happen in March, the Yen is now entering in an uncertainty territory. The SNB is maintaining a policy approach that is totally supporting the CHF and the Swiss francs should remain in strong territory.

Review
A great start to the year

Despite a difficult year in 2022, 2023 continued the good trend started in the fourth quarter. Global indices posted some of their best performances in decades.

In the US, inflation continued to ease in December, with the ISM services and manufacturing indexes continuing to deteriorate, further underlining a slowing economy and pointing to an easing or at least a pause in the Fed's bullish cycle. The S&P500 rose by 6.28% in December, while the Nasdaq Composite rose by 10.73%. The Dow Jones posted a weaker relative performance, rising "only" by 2.93%.

In Europe, lower energy prices and the reopening of China, with the consumption that should go with it, pushed European stocks to post their best performance for a month of January. With the FTSE MIB leading the way, up 12.71%, the CAC 40 up 9.55% and the Dax up 8.65%.

The Eurozone also expanded on 1 January, with Croatia joining the monetary union and the Schengen area.

The MSCI Emerging Markets also performed well, rising 7.90%.

It should be noted that the report published on 24 January by Hindenburg Research accusing the Indian conglomerate Adani Group of manipulation and accounting fraud weighed on Indian shares. The MSCI India index ended the month at -3.90%.

On the fixed income side, the easing of US rates (-37 bps) as well as European rates (-29 bps for the Bund) allowed the global indices to start the year well. The Bloomberg Global Aggregate index rose by +3.28%, the EMBI index by +3.11% and the BBG Global High Yield by +4.18%.

The DXY index continued the easing it started at the end of last year, to 102.097 (-2.32% YTD).

The U 10-year yield ended the month at 3.51%, the bund at 2.29, the UK Gilt at 3.33% and the 10-year Swiss Confederation at 1.28%. Only Japanese rates rose by 7 bps to 0.50%.

The Bloomberg Commodity Index contracted 0.89% to end the month at 111.8.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,077	1.47	1.51	6.28	6.28	6.28	19
Nasdaq	11,585	1.67	2.22	10.73	10.73	10.73	27
Russell 2000	1,932	2.45	2.47	9.75	9.75	9.75	22
Euro Stoxx 50	4,163	0.12	0.25	9.94	9.94	9.94	13
Stoxx 600 EUR	453	-0.26	-0.04	6.76	6.76	6.76	13
FTSE 100	7,772	-0.17	0.18	4.35	4.35	4.35	11
SMI	11,286	-0.82	-1.06	5.19	5.19	5.19	18
NIKKEI 225	27,327	-0.39	0.11	4.73	4.73	4.73	16
CSI 300 China	4,157	-1.06	-0.59	7.38	7.38	7.38	12
MSCI EM Index	1,032	-1.20	-0.74	7.90	7.90	7.90	12

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,077	1.47	1.51	6.28	6.28	6.28	19
UTILITIES	351	0.74	-0.72	-2.00	-2.00	-2.00	18
ENERGY	691	0.89	-0.20	2.81	2.81	2.81	11
TELECOM	182	1.35	1.70	14.50	14.50	14.50	15
CONS STAPLES	771	1.08	0.91	-0.89	-0.89	-0.89	20
REAL ESTATE	255	1.89	2.81	9.90	9.90	9.90	19
CONS DISCRET	1,156	2.22	5.41	15.02	15.02	15.02	26
MATERIALS	533	2.23	1.86	8.98	8.98	8.98	18
HEALTH CARE	1,553	1.30	-0.13	-1.87	-1.87	-1.87	16
INFO TECH	2,373	1.44	1.27	9.32	9.32	9.32	24
FINANCIALS	608	1.34	2.15	6.86	6.86	6.86	13
INDUSTRIALS	862	1.71	1.11	3.72	3.72	3.72	19

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	102.097	-0.18	0.18	-1.38	-1.38	-1.38
EUR-USD	1.0863	0.11	-0.22	1.48	1.48	1.48
USD-JPY	130.09	-0.23	-0.06	-0.79	-0.79	-0.79
USD-CHF	0.9162	-0.94	-0.69	-0.90	-0.90	-0.90
EUR-CHF	0.9951	-0.87	-0.92	0.56	0.56	0.56
GBP-USD	1.2320	-0.26	-0.11	1.96	1.96	1.96
EUR-GBP	0.8816	0.35	-0.12	-0.42	-0.42	-0.42
JP EM FX Index	51.23	0.25	-0.09	2.67	2.67	2.67

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.51	-3	5	-37	-37	-37
Germany	2.29	-3	13	-29	-29	-29
UK	3.33	-0	5	-34	-34	-34
SWITZERLAND	1.28	-0	8	-34	-34	-34
Japan	0.50	1	8	7	7	7
US IG Spread	129	-2	-3	-14	-14	-14
US High Yield spread	463	-2	-5	-46	-46	-46
EUR High Yield spread	433	3	-12	-68	-68	-68

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	111.8	0.90	-0.10	-0.89	-0.89	-0.89
Gold Spot $/OZ	1928.4	0.27	-0.46	5.72	5.72	5.72
Crude Oil WTI	78.9	1.25	-1.14	-1.73	-1.73	-1.73

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	19.4	-0.54	0.20	-2.27	-10.48	-2.27

Source : Bloomberg 01/31/2023

Macro & Rates
Disinflation process has begun, but...

Federal Reserve Chair Jerome Powell said during the press conference on February 1st «The disinflation process has begun» and that monetary policy was close to restricitive territory. A message that has pleased all asset classes except the US dollar.

The month of January ended firmly positve across most asset classes. It has been a clear outright optimism fed by a strong narrative: inflation is abating, and the global economy is overall resilient.

Of course, in the US, the world's largest economy,economic activity has started to feel the pressure. Hard economic data started to deteriorate. Producer Price Index, Industrial Production and Retail Sales fell below consensus as the economy is slowing down. The Housing market is slowing down and the news flow does not sound that positive either. Indeed, th US yield curve is screaming an economic crash, the Washington Debt-ceiling show is about to start and big-tech job losses and layoffs are making the headlines.

Nevertheless, market participants are comforted by the idea and the sentiment that the worst is behind us and that the US economy can stomach the current slowdown. And there are some arguments for them.

Firstly, the US labor market. Assuming there is no irregularity in the data, US employment reports outsized strength in labor markets. 517,000 jobs last month, far more than the 188,000 expected by economists. The unemployment rate fell to 3.4%, the lowest since 1969.

Secondly, despite Powell repeating again and again, that a few more rate hikes were needed to ensure the peak in inflation, before eventually pausing for a long period, markets participants have decided «to fight the Fed» by expecting aggressive rate cuts for the second half of this year.

Fighting the Fed when it is close to the terminal rate and when pace of disinflation is the primary issue, is an open invitation...whether it will succeed is a different question.

Such expectations are visible in financial markets and sent contradictory signals: a sharp decline in global long-term interest rates and a boost in financial markets including risky and non-profitable companies, a massive inversion of the yield curve that suggests an imminent recession, a contraction of corporate spreads that suggests that probability of corporate defaults have eased and last but not least, a likely premature easing in financial conditions that poses a real challenge for central banks starting with the Fed.

We still believe that the Fed will pause around 5% and probably not cut for a while. But that is entirely data dependent, both on the upside and downside. Currently, fundamentals suggests an upside in yields.

Indeed, there is no doubt the disinflation process has begun but we are still far away from the Fed's target of 2% core PCE and the markets may be disappointed in its rate cut expectations. The resilience of the labor market and the recent uptick above 50 in the US ISM Services underline a possible reacceleration of the global economy which for sure will put serious doubts on the current disinflation process. An important point that Jerome Powell mentioned and that deserves a lot of attention in our view is about the shortage of workers. His sentiment is that this current shortage is more structural than cyclical which ultimately raises the question of the stickier part of the inflation.

On top of that, Financial conditions really are a forward looking indicator for credit growth. And if credit growth really accelerates, there is little doubt that the Fed will not only become extremely vocal but also come back with new rate hikes if adequate progress is not being made, a risk that is currently far from being priced in.

Bottom line, the Fed continues to stick with its monetary policy while the market believes that they are already above the curve. Fighting the Fed is clearly not futile as we approach the terminal rate but we have some doubts about an imminent success.

Fixed Income
"a disinflationary process has started"

As of writing, both the Fed and the ECB have anounced their latest decisions which were both in-line with expectations (a 25bps and 50bps hike, respectively). Investors are reassured by the absence of ugly surprises (such a higher than expected hike) and the fact that the Fed sees inflationary pressure easing, or as Fed chairman Powell said: «a disinflationary process has started». Quite a statement after all we've seen and heard over the last two years!

Indeed, recent data indicated that tightening financial conditions are successfully weighing on demand and price pressure. Both PCE and core PCE are trending down. US inflation expectations are gradually approaching the annualized 2% level. While the US labour market is still strong (latest US nonfarm and private payrolls more than double the expected figure), employment cost and unit labor costs are falling. The latest ADP Employment change was well below the expected figure. The quits/layoffs ratio, which indicates a softening labor market has also peaked. If the next ISM Manufacturing PMI figure (1.3.2023) will confirm the last reading below 50 (last: 47.4), many indicators for the Fed to hike 25bps with a dovish outlook or even pause soon will be in place.

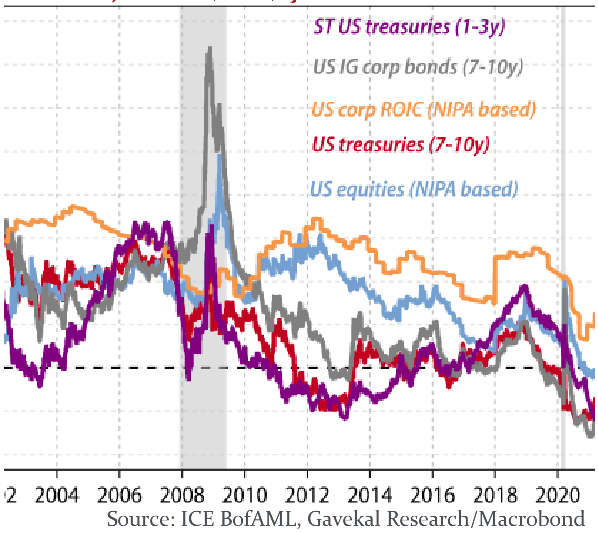
We repeat our recommendation that in USD, the short end of the Treasury curve appears particularly attractive. Short US Treasuries have the highest real yields. A positioning in high quality in the short- to medium-part of the curve is warranted for USD investors.

On top of that, a periodically returning technicality which will likely support shorter Treasuries is the debt ceiling in the US which has been reached. Until June, the US Treasury will likely reduce its holdings of cash and reduce bills-supply which tends to support the market.

Europe is lagging the US a couple of months in terms of monetary policy. The ECB has for the second time in a row hiked more than the Fed and plans to continue hiking at the current pace. Indeed, German Bunds today do not offer a yield which is compensating sufficiently for inflation – or in other words: rates will most probably have to rise more... with more pain to come for EUR bonds. The short end of the curve might well rise more, and with recession risks rising, the medium- to longer-part of the curve look probably more attractive if the inversion is to continue. An alternative might also be to consider higher-yielding bonds with a moderate duration as they provide a better buffer against rising rates – provided that Europe doesn't fall into recession.

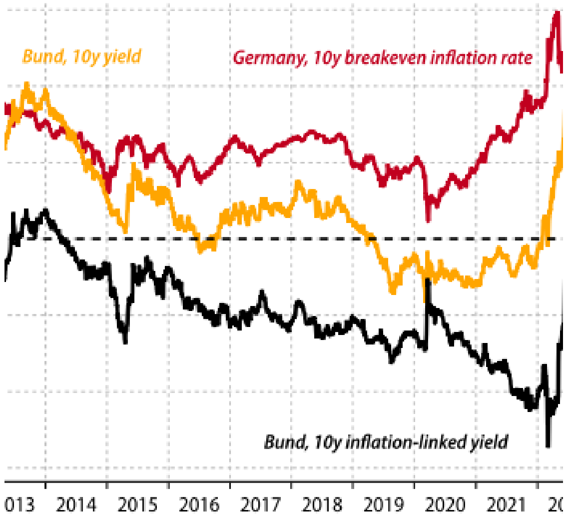
And that's exactly the question regarding fixed income allocation: soft landing or recession? Who is right? Equities (currently pricing a soft landing) or Treasuries (currently leaning to recession)? Not making the forecast easier is the fact that both US and European credit spreads, just like equities, do not currently price recession.

Risk-adjusted (real) yields



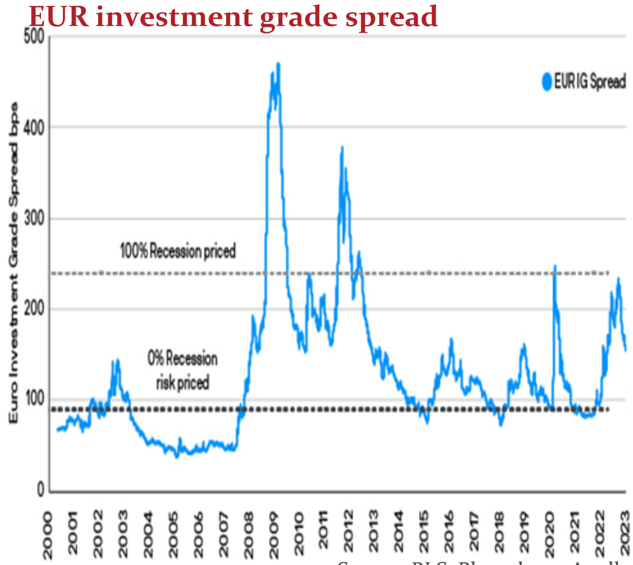
Source: ICE BofAML, Gavekal Research/Macrobond

German Bunds vs. inflation expectations



Source: Gavekal Research/Macrobond

EUR investment grade spread



Source: BLS, Bloomberg, Apollo

Equity
Are we in a new bull market ?

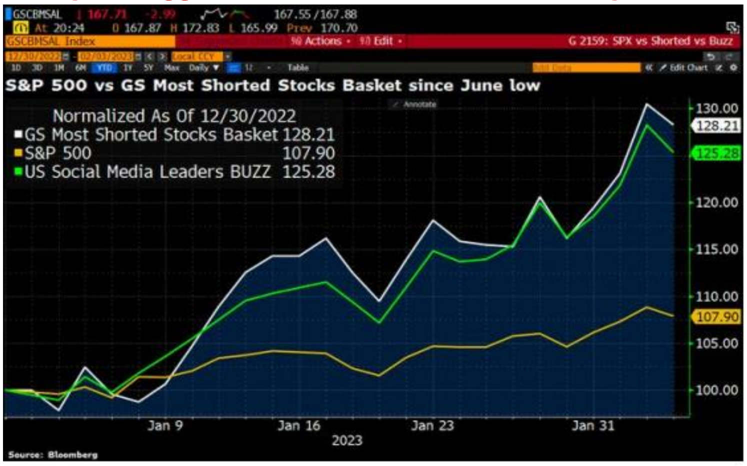
The Fed raised official short-term interest rates by an additional quarter point, as widely expected. Nevertheless, major indices jumped as investors seemed to interpret the overall tone of Mr. Powell's speech more dovish than expected.

Global equities rebounded in January with the S&P500 + 6,20%, Nasdaq 100 +10,6% and Stoxx Europe 600 +6,70%. After this strong start, most of US stock indices erased their December losses, helped by some positive surprises in economic data and fourth quarter earnings reports, as well as some dovish signals. The S&P500 had its best start since 2019 (+7,9%) and 1989 (+7,1%). The index just broke its resistance at 4100 which has now become a short-term support. But the place to be in January was clearly the emerging market up 9%. The MSCI China Index did even better and returned +12% bringing the total return since its October low to 50%.

The value versus growth trend is still relevant.

After outperforming growth stocks by 24% last year, value stocks underperformed by 5% in January. Tech and unprofitable tech stocks surged the most during this first month. Stocks like Coinbase, Roku, Tesla or Shopify were up more than 50% year to date. But the value trend is not over and as long as we are in a rate hike cycle, quality stocks should outperform growth stocks. Overall, the worst performing sectors and stocks of 2022 showed the strongest recovery in January.

Last year laggards are the winners in January



Earnings season boost the Nasdaq

Earnings season bring some surprises with Meta Platforms jumping 23% which gave the Nasdaq a boost. The stock was up 20% after announcing a $40 billion share buyback program and expected improvement in the group's profitability in 2023. However, some of the enthusiasm dissipated, following disappointing results from some big tech companies. Apple recorded its lowest level of activity in 4 years for the holiday season and missed the consensus expectation in Q4 for the first time since 2015. Alphabet suffered from a decline in online spending while Amazon saw a slowdown in its cloud business and customer spending, which had previously been a major growth driver.

Analysts expect the end of the rally

Overall, markets remain positive and indices are technically well oriented. However, investors remain cautious and most analysts at major institutions expect the equity rally to end and volatility to increase in the coming weeks. The earnings season is not over and apparently will not resolve the debate between the bulls and the bears.

Forex And Commodities
Dollar Back to Momentum, Noise Or Structural Trend ?

The key point for February is the reversal of the bearish trend on the USD. In other words, the greenback is back to momentum and continues to lead the forex market.

Among the reasons explaining the comeback of the USD, macro is still one of the main vectors (focusing particularly on the employment in US that is better than expected). Geopolitics must also be considered in particular related to rising tensions between China and the US that makes investors seeking the security of the US dollar. Although these factors could be qualified as short-term noise, other factors should also be considered having a longer term impact on the strength of the dollar. Among them, it could be the relative valuation of other major currencies that cannot override the attractiveness of the dollar.

It can be observed with the pair EUR/USD that after gaining 4.45% YTD it is now entering a pullback phase.

As a matter of fact, the narrative supporting the Euro (the "catch up" effect in the relative ECB-Fed policy rate differential) has been fully exploited by forex investors and seems now entering overcrowded territory. All the momentum came at once and sooner than expected and now investors fully accepted that despite the catch-up effect, the US terminal rate is likely to remain dominant. That will be the main break to a long-term increase in the EUR/USD. Therefore, the long-term view on the EUR/USD is now limited around 1.15 by the end of the year (top of 2022). On a shorter term, the bearish trend could consolidate below its 50-days moving average (1.07), if the support breaks there could be room for a more bearish trend to the next support at 1.05.

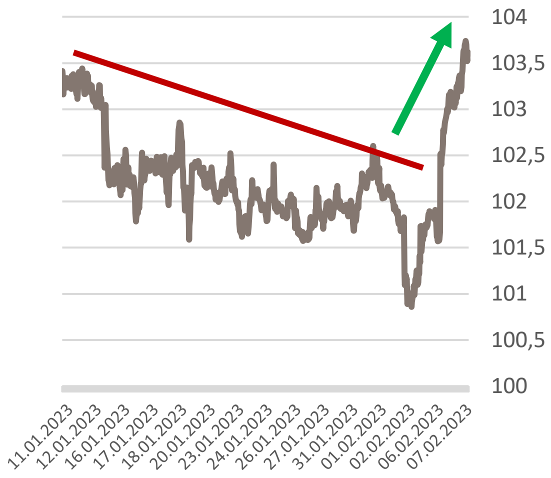
The Japanese Yen also started February in a bearish trend. However, with the upcoming change of BoJ governor that will happen in March, the Yen is now entering in an uncertainty territory.

Actually, the departure of governor Kishida, could put an end to a 10 year period of ultra-dovish monetary policy. Irrespective of whom Kishida appoints as successor, the market is expecting yield curve control (YCC) to end this year, as inflation, by its magnitude of growth, is reaching unsustainable levels in Japan. An end of the YCC, would definitely push the Yen to strengthen further. On the contrary, a candidate who is a proponent of ultra loose monetary policy, could trigger a bearish phase on the yen above 132, with a potential increase that could reach the 200-days SMA of 136.50 or go marginally higher.

Finally, the Swiss franc should remain in strong territory.

The SNB is maintaining a policy approach that is totally supporting the CHF, by remaining ready to sell FX to improve monetary conditions. Moreover, a change in the positioning of asset managers and Hedge Funds that were historically underweighted the Swiss Franc is now turning positively, and this could amplify franc upside in 2023. The target range for USD/CHF should remain 0.92-0.90 in the short term. The psychological support below 0.90 would be difficult to break. As for the EUR/CHF we should remain close to parity.

Dollar Index reverse its bearish trend



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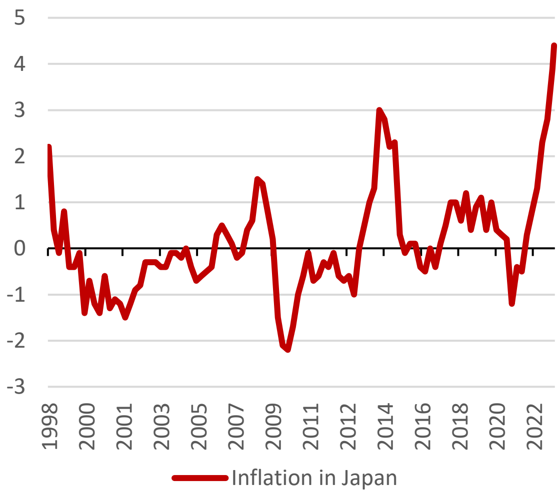
Could the magnetude of Inflation In Japan, put an end to the YCC ?



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