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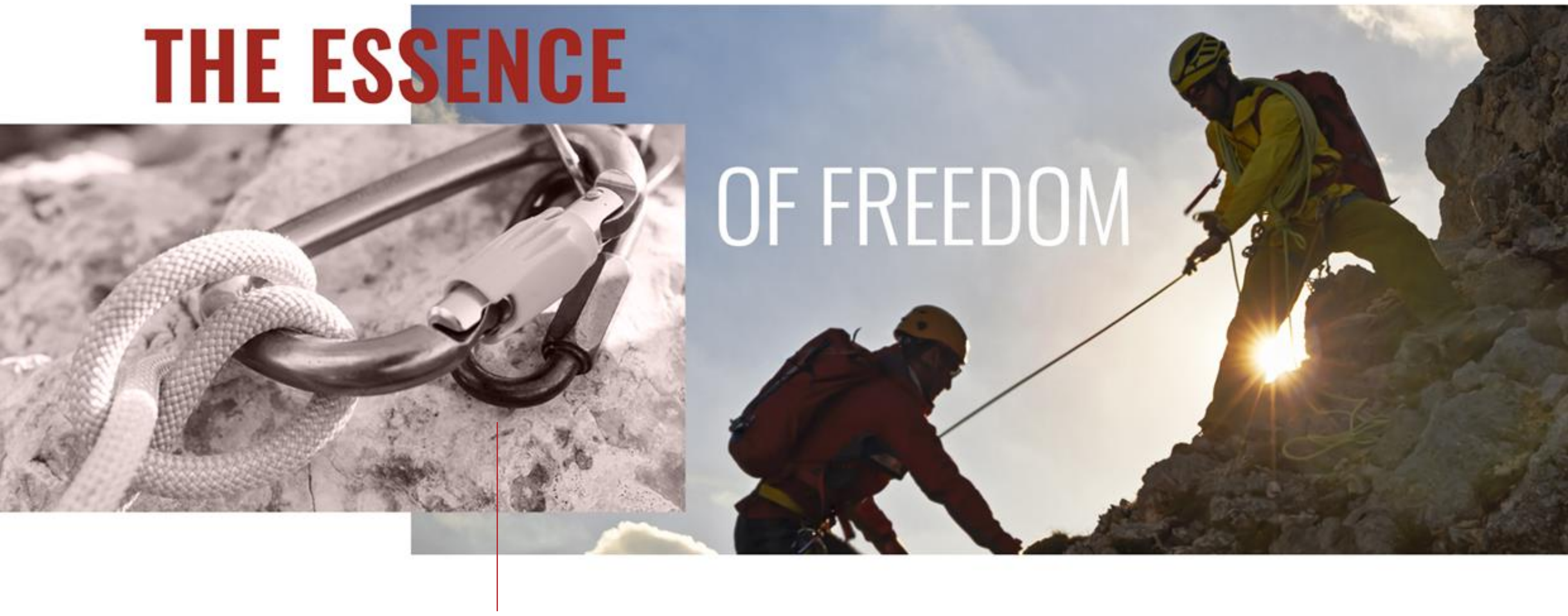
Newsletter: Uncertain Markets / September 2023



Key Take-Aways

- Central Bankers will keep all options on the table and therefore we might see divergence in monetary policies in 2024. The US economy is pointing in the right direction in the Fed's mind and markets expect that the Fed will start to cut rates in March 2024. In the meanwhile, Europe is still having an inflation issue and they seem more vulnerable to higher interests rates.

- China is under pressure and financial markets suffer from a lack of confidence from international investors. The People Bank of China is finally acting to stabilize and stimulate the economy for the first time.

- Both, the long-term and short-term yield have risen in August but the long-end yield rose even more which could be bad for companies' profits.

- Crude Oil WTI reached a new high for the year. A combination of production cut by Saudi Arabia and an increase in demand over the summer caused a price increase.

- NVIDIA: the company reported Q2 numbers above expectations. Revenues are up 101% from a year ago and the management announced an acceleration of its stock buyback.

- The USD should remain strong helped by favorable interests rates and yields in the US market. The Swiss Franc should continue to play safe haven and demonstrates its strength against most of its peers.

- The Yen continues to show negative momentum vs. USD. However, recent comments from the BoJ, could signal a potential change.

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Review

Slight Correction

- August was a weak month for equities with major indexes posting negatives returns. The S&P500 dropped -1.59% and the Russell 2000 stepped back -5.01%. The CSI 300 China fell by 6.02% with a YTD -0.55%. The Euro Stoxx 50 is down by 3.82%. British and Swiss equities are both in red, respectively, by 2.61% and 1.62%.

- Every sector from the S&P500 are in red for August except for the Energy sector 1.81%. The worst perfomers were Utilities (-6.16%), Consumer Staples (-3.57%) and Materials (-3.28%). Even though August was not a good month in general for equities, Telecom (45.16%), Consumer Discretionary (34.63%), IT (44.66%) on a YTD basis wich sustain the major part of the S&P500's performance YTD 18.72%.

- In forex markets, the dollar regained a bit and the dollar index rose by 1.73% in August. The EUR depreciated 1.40% vs. the dollar. The Japanese yen further depreciated by 2.28% vs. USD ending the month at 145.54. The dollar rose by 1.32% against the CHF with a YTD -4.45%. The EUR-CHF fell by 0.09% with a YTD -3.20% showing the strengthening of the Swiss franc. The pound depreciated vs. the dollar by 1.26% but strengthened against the EUR (EUR-GBP: -0.14%). Emerging currencies remained under pressure and depreciated even more, falling 1.89% MTD and -3.86% YTD on average.

- US treasury bond yield rose by 15 bps in August although a 13 bps correction happened in the last 5 days. The US 10 year yield ended the month at 4.11%. Only German government bonds and Swiss governent bonds saw a correction of -3 bps and -8 bps respectively for the 10 years yield.

- Spreads of investment grade rose by 4bps and the US high yield spread tightened by 3bps. The EUR high yield spread gained 17bps this month.

- While the commodity index posted -1.22% in August, performances were uneven within this group. Gold fell by 1.27% and crude oil added 2.24% this month.

- Equity volatility was flat and the VIX index remains around 13,6%, well below long-term averages.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 508	-0.14	3.06	-1.59	1.57	18.72	18
Nasdaq	14 035	0.13	4.26	-2.05	1.94	34.89	29
Russell 2000	1 900	-0.16	2.94	-5.01	0.80	8.93	20
Euro Stoxx 50	4 297	-0.42	1.53	-3.82	-2.12	16.65	12
Stoxx 600 EUR	458	-0.17	1.51	-2.51	-0.40	11.06	12
FTSE 100	7 439	-0.45	1.45	-2.61	-0.32	2.78	10
SMI	11 126	0.32	1.36	-1.62	-1.37	6.80	16
NIKKEI 225	32 619	0.88	1.09	-1.61	-1.65	26.54	18
CSI 300 China	3 765	-0.60	1.23	-6.02	-0.99	-0.55	11
MSCI EM Index	980	-0.80	-0.19	-6.14	-0.25	4.80	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 508	-0.14	3.06	-1.59	1.57	18.72	18
UTILITIES	318	-0.97	-0.28	-6.16	-3.84	-9.31	15
ENERGY	677	0.15	2.79	1.81	9.34	3.27	12
TELECOM	230	0.12	4.20	-0.37	6.55	45.16	16
CONS STAPLES	764	-0.44	1.19	-3.57	-1.51	-0.25	19
REAL ESTATE	232	-0.72	1.82	-3.00	-1.78	1.87	17
CONS DISCRET	1 345	0.54	4.83	-1.17	1.25	34.63	24
MATERIALS	521	-0.03	2.92	-3.28	0.02	7.76	18
HEALTH CARE	1 549	-1.20	0.48	-0.69	0.32	-1.17	17
INFO TECH	3 121	0.37	5.05	-1.32	1.32	44.66	25
FINANCIALS	571	-0.35	1.62	-2.65	2.07	1.53	14
INDUSTRIALS	913	-0.48	2.45	-1.99	0.85	11.13	18

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	103.619	0.45	-0.35	1.73	0.69	0.09
EUR-USD	1.0843	-0.73	0.31	-1.40	-0.61	1.29
USD-JPY	145.54	-0.48	-0.20	2.28	0.85	11.00
USD-CHF	0.8834	0.56	-0.12	1.32	-1.36	-4.45
EUR-CHF	0.9579	-0.18	0.18	-0.09	-1.96	-3.20
GBP-USD	1.2673	-0.38	0.56	-1.26	-0.24	4.88
EUR-GBP	0.8556	-0.36	-0.27	-0.14	-0.43	-3.36
JP EM FX Index	47.97	-0.42	-0.55	-1.89	-2.25	-3.86

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	4.11	-1	-13	15	23	23
Germany	2.47	-8	-5	-3	-11	-11
UK	4.36	-6	-7	5	69	69
SWITZERLAND	0.93	-5	-7	-8	-68	-68
Japan	0.65	-0	-1	4	23	23
US IG Spread	127	-1	-2	4	-16	-16
US High Yield spread	431	-1	-11	-3	-78	-78
EUR High Yield spread	450	7	-4	17	-51	-51

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	106.0	-0.09	1.09	-1.22	4.48	-6.01
Gold Spot $/OZ	1940.2	-0.11	1.21	-1.27	1.09	6.37
Crude Oil WTI	83.6	2.45	4.93	2.24	18.39	4.20

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	13.6	-0.31	-3.63	-0.06	-0.15	-8.10

Macro & Rates

Approaching a monetary policy pause

The main conclusion that we can make over Jackson Hole is that most of Western Central Bankers have now switched to a "data-driven mode". This means that Central Bankers will keep all options on the table and therefore we might see divergence in monetary policies in 2024.

The US economy is pointing into the right direction at least on a Fed point of view. We observe finally some signs of softening in the labor market with less job openings and creations and importantly a deceleration in wage growth.

In the last jobs report, The two-month revision came out negative at -110k explaining mainly the unexpected bounce in the unemployment rate at 3.8% from 3.5%. The Labor Force Participation reached 62.8%, its highest level since the start of the COVID pandemic in February 2020. This data is consistent with the idea that as excess savings get exhausted, more individuals are returning to the workforce…which thereby reduces wage pressures.

The economic activity remains resilient. The ISM Manufacturing bounced a bit from low level suggesting that the manufacturing sector may have reached bottom, meanwhile the ISM Services showed rising activity more or less across the board. Growth is likely to be higher than what one would have expected with the Fed tightening, due to the fiscal impulse. The Atlanta GDP FedNow (forecasting with live data the next GDP quarter) is showing an incredible 5.6% US GDP growth for the third quarter.

All-in, there are lot of arguments to say the risk of an imminent recession has eased substantially. This conclusion has several implications for the US monetary policy and financial markets.

In the short-term, the Fed is likely to skip the hike in September, keeping a hawkish tone of course as the economy is resilient. Also the impact of a 25bps hike sounds marginal in front of what they did and the 550bps cycle. The November and December meetings appear now as the last chance for the Fed to hike (33% probability) before switching to a pause.

In this context, monetary policy expectations in 2024 could changed drastically. As of today, markets expect the Fed will start to cut rates in March 2024 toward the end of the year by 100bps. The current macro environment suggests that the Fed might pause this year but keep rates "high for long". If correct, equity markets are capped on the upside and long maturity-bonds are vulnerable.

Europe, by contrast, is still having a serious inflation issue but the economy sounds much more vulnerable to higher interest rates.

On top of that, the recent increase in oil prices combined with a lower euro is clearly not the right recipe for European inflation. Therefore, the ECB will keep an aggressive tone as they are behind the curve but the recession risk is important (recession that if it occurs will help on inflation side). Still, the market expect a 50% probability of a last hike by the end of the year.

China is under pressure and financial markets suffer from a lack of confidence from international investors..

With low inflation, a sluggish growth, and the never ending issue on the real estate (all sectors of real estate represents more than 30% of the GDP), the Chinese economy is clearly disappointing relative to the great expectations from the "re-opening" earlier this year.

The People Bank of China (PBOC) are finally acting (mortgage rates, lower stamp duty on stock trades etc.) to stabilize and stimulate the economy but the sentiment is that they will have to do much more to bring back international investors in the party.

Fixed Income
From bear to bull steepening?

August was calm in terms of central bank activity as both the Fed and the ECB will take their next interest rate decision in September (20th and 14th, respectively). The Jackson Hole meeting of central bankers left bond-investors guessing how hawkish exactly central banks will be until year-end. US government bonds had a negative August on the back of rising yields and the YTD total return is now barely positive. High-yielding bonds have resisted the challenging environment best thanks to their spread-buffer and are up 5% (EUR) to 6% (USD) YTD.

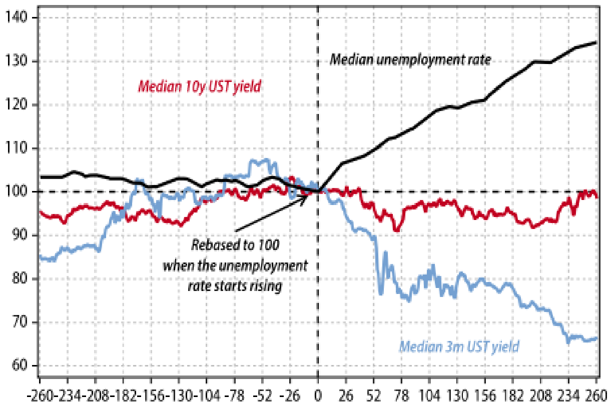
In August, the bear steepening of the US Treasury curve continued. A bear steepening occurs, when both short and long Treasury yields rise, but the long-end yields rise more than the short-end yields. Since May, the difference between the 3-month and 10-year yield has fallen from 190bps to 124bps. This disinversion of the yield curve is typically bad for corporate profits, as firms pay more interest on long-term debt and their interest expenses rise. At some point, the yield curve disinversion is going to have a weakening impact on the economy. Economic weakness will in turn weigh on long-term yields and the Fed will begin to cut short-term rates. Eventually, the result is the appearance of a «bull steepening» – a situation where both long and short yields fall, but the shorter-ones more. To figure out when this shift will happen, a look at the US labor market has been a good indicator in the past (chart 1). Last week's slightly weaker employment data in the US could be just one sign that we are approaching such a structural change.

A rising percentage of fund managers in the US continue to expect global CPI to fall and that rate cuts will follow (chart 2). And the market is now pricing a first rate cut in the US in the first half of 2024 (chart 3). If correct, this would also support the case for the appearance of a bull steepening.

So maybe its time to not only look at bonds, but also gradually begin to lock-in higher yields for longer by slightly extending the duration of the fixed-income bucket of portfolios. Focus on quality when doing so!

After the summer lull the primary market was again active, with corporates tapping the market. Examples in CHF are in the table below.

1. US Treasury 10yr and 3m yields vs US unemployment rate



Source: Gavekal

2. Global CPI and ST rate expectations

Source: BofA Global Fund Manager Survey

3. When is the Fed expected to cut?

Source: Bianco Research LLC

Recent and new issues in CHF

ISIN	COUPON	ISSUER	MATURITY	IND. PRICE	IND. YIELD	RATING
CH1290870901	2.75	Clariant	9/22/2028	100.7	2.6	BBB-
CH1271360625	2.875	Equinix	9/12/2028	100.6	2.7	BBB+
CH1290222335	2.2675	Swiss Prime Site	9/18/2028	100.5	2.2	A3
CH1293237983	1.9775	ABB	9/22/2028	100.6	1.8	A-
CH1293238007	2.2025	DZ Bank AG	9/18/2028	100.4	2.1	A+
CH1293238015	2.5	Axpo	9/22/2026	100.4	2.4	BBB
TBD	2.15	Partners Group	9/26/2028	-	-	A

Equity

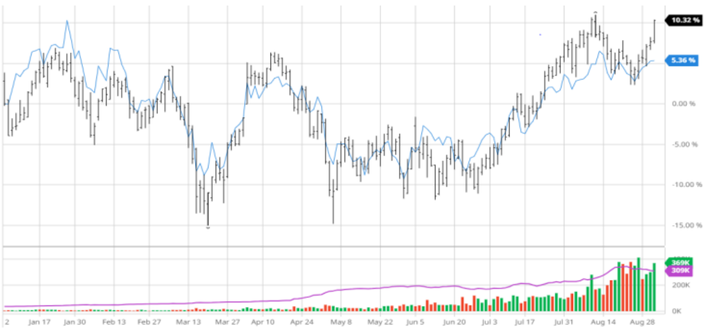
"Sell in May and go away!"

The famous adage turned to be wrong so far this year. Stocks did very well through the summer despite a small correction in August that ended five consecutive months of gains since April. S&P 500 is up 7.84% in the last 3 months, from July to August and corrected 1.77% in August. Second quarter earnings were positive, often beating earnings estimates especially with healthcare and IT companies. Real estate, utilities and financials lagged as they are facing challenges with higher interest rates.

Energy: new annual highs through the summer

The sector performed very well over the summer as WTI reached a new high for the year. The combination of a production cut of one million barrel per day announced by Saudi Arabia and an increased demand from travel during the summer season was the cause for the price increase. As a result, the Energy Select Sector SPDR (XLE) is up 11% over the past two months. Shell and BP announced increased quarterly dividends. Oil prices could remain high towards the end of the year while China is supporting its domestic economy.

WTI Oct '23 (CLV23) vs Energy Select Sector SPDR



China: Has an Inflection point arrived for A-share market?

The Politburo in July set a more positive policy tone. It exceeded market expectation in two aspects:

- the meeting proposed to 'adapt to the new dynamics of China's property market', rather than emphasizing 'housing is not for speculation', and to adjust and optimize property policies in due time;
- for the 1st time, the meeting proposed to 'stimulate the capital market and boost investor confidence'.

In the past week, authorities and local governments have launched a series of specific measures.

The China Securities Regulatory Commission (CSRC) proposed to take actions in response to the above request of stimulating the capital market in its mid-year seminar, planning to launch comprehensive measures covering investment, financing ad trading. Besides, we have seen intensive policy support for private economy, consumption and others. In our view, the stronger policy support will help gradually restore investor confidence.

Biotech: M&A flow ahead

Earlier this month, the US Federal Trade Commission (FTC) dropped its lawsuit that was blocking Amgen from acquiring Horizon Therapeutics for $28 bn. This now clears the way for the completion of the deal in December.
The two takeaways for us are:
it should enable more consolidation in the biotech field as some suitors were refrained from making deals given potential antitrust hurdles;
the same scenario could play out regarding the ongoing FTC challenge of the Pfizer / Seagen Therapeutics $43 bn deal.

NVIDIA: top performer of the S&P 500

The company reported Q2 numbers above the street consensus. Revenues hit $13.51 billion up 88% from Q1 and 101% from a year ago. Net income jumped to $6.19 bn, or $2.48 a share, from $656 million, or 26 cents, a year earlier. Nvidia expects fiscal third-quarter revenue of about $16 billion.
In addition, management announced an acceleration of its stock buyback. The board approved a further 25bn$ buyback plan which represents 2% of the market cap. The stock ended the month at an all-time high at $493.55 up 237% year to date vs. 18.73% for the S&P 500 TR and 34.88% for the Nasdaq TR.

Forex And Commodities

The Dollar's Hegemony Still Driving The Forex Market

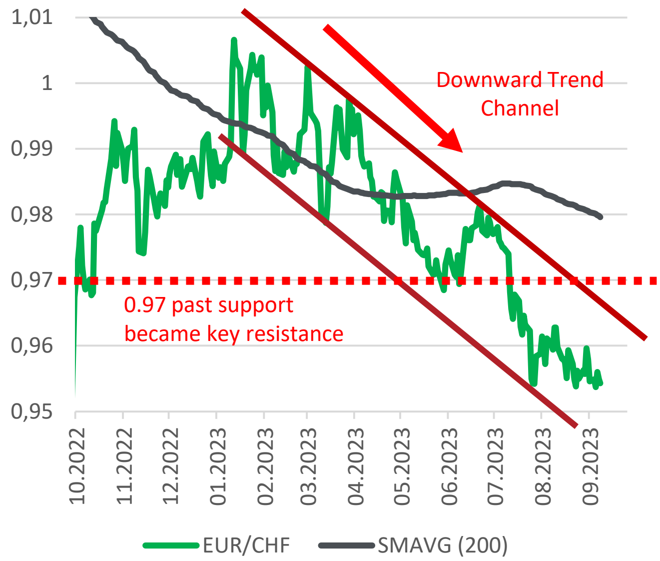
The strong US currency continues to be influenced by US interest rates and yields. The Federal Reserve remains concerned about inflation and is prepared for potential rate hikes based on future macroeconomic data. While the USD has already priced in this expectation with its high valuation, it remains highly sensitive to any surprises in macroeconomic data. In the long term, amidst the uncertainty, a strong USD can still be anticipated, especially by monitoring the dollar index (DXY), which is still trading above 100.

From a technical standpoint, September may witness the EUR/USD pair continuing to dip below 1.07 since it has already broken below the 200-day Simple Moving Average (SMA), currently at 1.08. The negative momentum could persist. However, Christine Lagarde's recent statement that the ECB will raise rates as long as necessary could put a break on the EUR's decline. Additionally, an oversold effect on the EUR could trigger a rebound. Below the 1.07 level, investors might view the EUR as a buying opportunity, potentially reversing the downtrend. *Therefore, in this uncertain market environment, the most likely scenario for September is that the EUR/USD pair will trade within a narrow range of 1.07-1.09.*

The Swiss Franc (CHF) continues to demonstrate strength against most of its counterparts. The CHF is still considered a safe-haven currency, favored by investors during periods of global risk aversion. Switzerland's inflation did not turn out as severe as expected, with the core Consumer Price Index (CPI) returning within the Swiss National Bank's (SNB) target range of 0-2%. This means the SNB doesn't need to adopt as restrictive a monetary policy as some other central banks. The CHF is likely to remain strong, particularly against the EUR, a key pair for assessing the Swiss Franc's direction. The downward trend in EUR/CHF is expected to persist in the short term. The recent break below the support around 0.957 (Fibonacci retracement) has opened the door to further declines within the downtrend channel. The next support to watch is at 0.94, which was the lowest trade in September 2022. The previous support at 0.967 has now become a new resistance level.

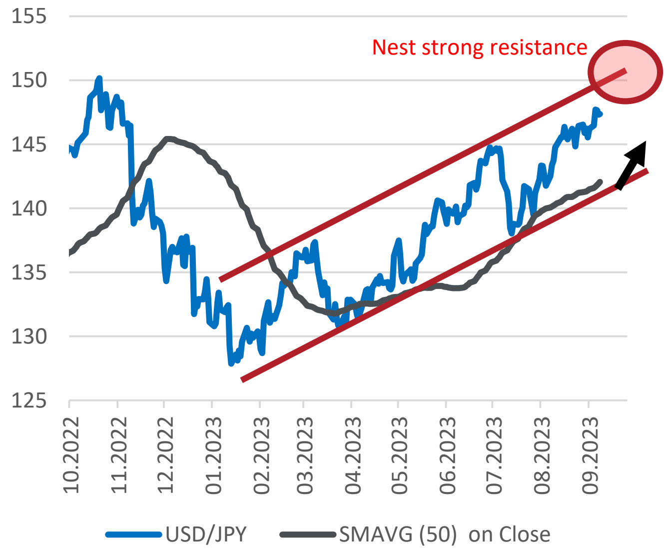
The negative momentum in the Japanese Yen (JPY) hasn't shown any significant relief. Despite some rumors, the Bank of Japan (BoJ) remains hesitant to take drastic measures to change its dovish monetary policy. Currently, Japanese inflation has not reached unsustainable levels, leading more investors to doubt the immediate need for the BoJ to intervene in the yield curve control. With this perspective in mind, the uptrend in USD/JPY is likely to continue, supported by a strong USD. The next significant resistance level could be around 148, and breaking through it could pave the way for an increase toward the 150 level.

EUR/CHF The Negative Channel Settled To Continue



Source : Bloomberg

Could The Upper Channel Resisitance Offer A Relief To The Yen?



Source : Bloomberg

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