Market Insights

April 2023

BANQUE CRAMER

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Central Banks tightening cycle - mission accomplished?

The legendary investor Peter Lynch once said, "Although it's easy to forget sometimes, a share is not a lottery ticket...it's part-ownership of a business."

This quote emphasizes the importance of focusing on the underlying fundamentals of a company. Last month, we saw mixed equity markets, with some sectors and companies experiencing significant gains (US Consumer Staples +2.94%, US Healthcare +2.12% and EU Luxury +3.09%), while others struggled (US Industrials -1.22% and EU Auto -2.55%).

The quote of Peter Lynch also illustrates the importance of companies' earnings. Since last month, all eyes are on the Q1 reporting season in the US. Q1 is expected to register a decline in YoY earnings growth for the second consecutive quarter, fulfilling the conditions for an *earnings recession*.

Another parameter of current stress in the markets is the US debt limit which is being reached faster than expected. Weak tax collections in April suggest an increased probability that the limit will be reached in the first half of June. This would raise the possibility of a short-term ceiling extension, but it all comes down to the US Congress being able to reach an agreement - *which is not very likely*. The 1yr CDS on the USA reached an all-time high of 176 basis points - higher than some HY corporates!

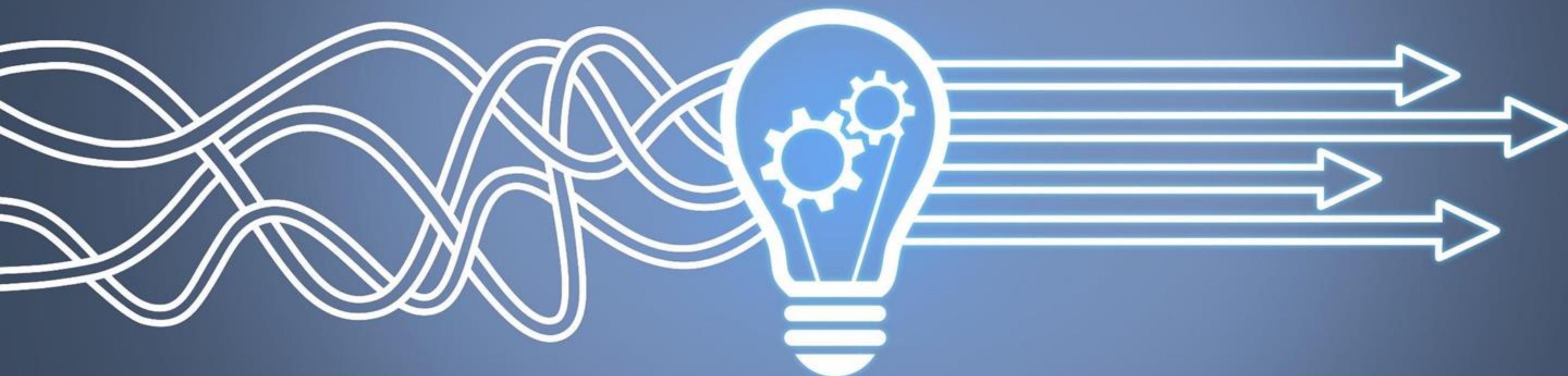
Most global central banks may be either close to a peak or already done with interest-rate hiking. May could cement a turn in what has been the most aggressive global tightening cycle seen in decades. A soft March CPI YoY (down from 6% to 5%) and PPI YoY (down from 4.6% to 2.7%), coupled with weak retail sales (-1.0%), is reviving talks that the inflation battle has been won.

The commodities complex has started to price in a weaker economic activity with industrial metals and energy prices softening during the month of April. The war in the Ukraine and supply constraints seem to be less of drivers for higher prices as well as the slower than expected reopening of the Chinese economy. This is partially helping inflation prices to continue its decline and should be supportive for the FED to achieve a soft landing and avoid a severe US recession.

However, the fight between Bulls and Bears is still ongoing and investors expectations continue to be divided about the outcome of the current slowdown.

Hans Itburrun

What keeps me up at night



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Dramatization the Debt ceiling - Don't overdo it!!

Let's first make sure we set the scene to better appreciate the "show":

What is Debt Ceiling? The debt ceiling, also called the debt limit, is a cap on the total amount of money that the federal government is authorized to borrow via U.S. Treasury securities, such as bills and savings bonds, to fulfill its financial obligations. Because the United States runs budget deficits, it must borrow huge sums of money to pay its bills.

The limit has been hit. What now? America hit its technical debt limit on Jan. 19. The Treasury Department will now begin using "extraordinary measures" to continue paying the government's obligations. These measures are essentially fiscal accounting tools that curb certain government investments so that the bills continue to be paid. Those options could be exhausted by June.

What is at stake? Once the government exhausts its extraordinary measures and runs out of cash, it would be unable to issue new debt and pay its bills. The government could wind up defaulting on its debt if it is unable to make required payments to its bondholders. Such a scenario would be economically devastating and could plunge the globe into a financial crisis.

Can the government do anything to forestall disaster? There is no official playbook for what Washington can do. But options do exist. The Treasury could try to prioritize payments, such as paying bondholders first. If the United States does default on its debt, which would rattle the markets, the Federal Reserve could theoretically step in to buy some of those Treasury bonds.

Why is there a limit on U.S. borrowing? According to the Constitution, Congress must authorize borrowing. The debt limit was instituted in the early 20th century so that the Treasury would not need to ask for permission each time it had to issue debt to pay bills.

Prior to 1917, Congress also authorized individual bond issuance to supplement tax revenue to fulfill specific spending allocations. Eventually, beyond a certain scale for fiscal spending during World War I, this practice became administratively untenable. From 1917 onward, Congress (the Legislative Branch) instead allowed the U.S. Treasury Department (part of the Executive Branch) to issue bonds as it sees fit, albeit constrained by a congressionally-set debt ceiling. Put simply, Congress stopped micromanaging Treasury bond issuance to fund spending authorizations but still retained its authority to ensure a division of powers by limiting the total amount of debt issuance, and still retained its power to authorize federal spending

CIO Synopsis

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In 1917, the U.S. federal debt was approximately $5.7 billion. Today is approximately $31 trillion, which represents a nominal increase of over 5,000-fold in 106 years. Due to constant deficits, the government has to constantly issue new debt to pay off maturing debt.

A ***very polarized Legislation branch and Executive Branch*** have to figure out how to agree on a path forward, ***with a nonzero chance that they temporary default along the way before coming to some sort of reconciliation***.

But one way or another, they will raise the debt ceiling after that, whenever their political dramatization (and/or their monetary donors) tells them it's necessary.

A handful of times in recent years, most notably in 2011, Congress has used the debt ceiling in order to pressure a presidential administration to either extract a bargain or for narrative gain, rather than to readily raise it.

A large permanent default is very unlikely, while a scenario of a temporary default is reasonably possible, given how polarized politics have become and how large the debt and deficits are now.

During the last debt ceiling US was enjoying a low inflation, robust GDP growth, a financial market awash with cheap credit/liquidity. The Fed and Treasury had enough space to fill in the budget gap without jeopardizing the US economy and financial markets. ***Today, gone such largesse and flexibility, Fed and Treasury will have a narrow room to maneuver.***

Three options are left to plaster the budget hole with each with their own set of limitation and collateral damages:

The Federal Reserve could capitulate, and begin buying Treasuries. This would mark the end of quantitative tightening and a shift towards quantitative easing, which if price inflation is still elevated would threaten Federal Reserve credibility.

Second solution could be the U.S. Treasury Department could issue a ton of T-bills to refill its general account, rather than issue long-duration bonds. This would reduce the average duration of government debt, and is currently the most expensive part of the Treasury curve to issue debt on, but it would likely suck cash out of reverse repos and allow the Treasury to refill its account without damaging commercial bank liquidity.

At last, if the dollar weakens enough, then foreign buyers might step back in to buy Treasuries with offshore dollars (accumulated trade surpluses). Combined with non-bank domestic buyers and large bank buyers (small banks are basically tapped out), this might be enough to avoid having the Federal Reserve or Treasury Department change their course. The challenge is we are at the beginning of a different era in which USD hegemony is being re-questioned and new accord, one parallel to the Bretton Wood agreement, is being re-negotiated. In such environment expecting foreigners to jump in and buy US treasuries will not be wise expectation.

In either cases in a credit tightening environment uncertainties tend to exacerbate volatility !

Hans Itburrun

Market review

Macro Outlook

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The US economy will expand 1.2% in 2023, 0.8% in 2024 and 2.0% in 2025, and chance of a recession happening over the next 12 months is 65% according to a Bloomberg survey. Economic activity continued to show signs of slowing. Both the ISM Manufacturing at 46.3 (vs 47.7 Feb) and the ISM New Orders at 44.3 (vs. 47 Feb.) are in contraction territory. ISM Services however is still above 50 but showed a significant decline to 51.2 (vs. 55 Feb.). The job market is reflecting a similar picture with Nonfarm Payrolls declining to 236k from 326k. The unemployment rate however stays at low 3.5% as participation rate increased. Inflation continues to decline but at a slower pace. CPI YoY is now at 5% compared to 6% one month ago. Retail Sales continue to decline and Inventories rose by 0.7% (estimated +0.2%). Annualized GDP growth for Q1 was at low 1.1% compared to the estimated 1.9%. The biggest unknown is the impact of tighter lending from US commercial banks for the coming quarters.

The Euro Area economy will expand 0.6% in 2023, 1.0% in 2024 and 1.6% in 2025. In Europe the economy is still stronger than previously expected. The Eurozone Composite PMI is at high 54.4 (versus 53.7 in March). Inflation remains elevated with CPI Core YoY at unchanged 5.7%.

Mixed signals are coming from China. The Caixin PMI Composite is holding steady at 54.5. Exports surprisingly increased by 14.8%, exceeding estimates of -7.1%. Retail Sales surged 10.6% in March, topping highest estimates. This is reflected in a strong YoY GDP growth for Q1 of 4.5%.

Zone	Item	2022a	2023e	2024e
US	Real GDP (YoY%)	2.10	1.15	0.80
	Industrial Production (YoY%)	3.41	-0.75	0.30
	CPI (YoY%)	8.02	4.20	2.60
	Unemployment (%)	3.64	3.90	4.60
	Current Account (% of GDP)	-3.71	-3.15	-3.20
	Fiscal Bal. (Budget, % of GDP)	-5.52	-5.30	-5.70
China	Real GDP (YoY%)	3.00	5.50	5.00
	Industrial Production (YoY%)	4.00	5.50	5.00
	CPI (YoY%)	1.96	2.14	2.30
	Unemployment (%)	3.96	4.10	4.10
	Current Account (% of GDP)	2.23	1.43	1.10
	Fiscal Bal. (Budget, % of GDP)	-4.70	-4.85	-4.60
EU	Real GDP (YoY%)	3.50	0.60	1.00
	CPI (YoY%)	8.36	5.60	2.50
	Unemployment (%)	6.73	6.90	6.90
	Current Account (% of GDP)	-0.73	1.50	1.70
	Fiscal Bal. (Budget, % of GDP)	-3.60	-3.50	-3.05

Source: Bloomberg (a = actual, e = consensus forecasts), as of 28/04/2023

Equities

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Global equity markets continued to trend higher in April with the exception of Emerging Markets and the HSCEI Index in Hong Kong. Volatility continued to decline, marking new lows in 2023. In the US, the focus partially shifted away from the FED's next actions in May to the Q1 reporting season. The impact of the economic slowdown and higher inflation on corporate earnings was key to justify current valuations. Global Banks kicked off the earnings season with positive results followed by surprisingly resilient Technology and Communication Services sectors. Commercial Banks, however, continued to see outflows and had to tap the FED's liquidity pool again. In terms of sectors performances, the shift to defensive sectors like Consumer Staples (+2.94%), Healthcare (+2.12%) and Utilities (+2.01%) underpinned the search for safety and quality stocks.

European indices clearly outperformed global markets reflecting a stronger than expected economic activity. The SMI in Switzerland was a clear outperformer with +3.0%, followed by the CAC in France +2.3%. The main contributors here were the banks and healthcare companies, as well as a very strong luxury sector.

Another top performer was the Nikkei in Japan (+2.9%) after the first BoJ's meeting under the new leadership calmed markets by keeping interest rates unchanged.

The Chinese local and Hong Kong markets suffered from weak consumer spending in April. The big reopening activity did not unfold yet, and the expected big stimulus packages from the government have not been implemented yet. Tensions around Taiwan are still holding back investors appetite for the region.

	As of 28/04/2023	1-month perf.	Year-to-date perf.
S&P 500	4 169.48	1.5%	8.6%
Nasdaq 100	13 245.99	0.5%	21.1%
Euro STOXX 50	4 359.31	1.0%	14.9%
STOXX Europe 600	466.64	1.9%	9.8%
SMI	11 437.14	3.0%	6.6%
DAXK	6 451.31	1.3%	13.3%
CAC 40	7 491.50	2.3%	15.7%
FTSE MIB	27 077.44	-0.1%	14.2%
IBEX 35	9 241.00	0.1%	12.3%
Nikkei 225	28 856.44	2.9%	10.6%
MSCI EM	977.05	-1.3%	2.2%
HSCEI	6 702.15	-3.8%	0.0%
IBOVESPA	104 431.63	2.5%	-4.8%

Source: Bloomberg

Rates & Credit

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Rates in the US continued to be volatile especially on the short end of the curve. The 2Y US Treasury traded between 3.65% and 4.28% before settling around the 4% level. T-Bills with 3-months maturity rose above 5%, as the fixed income market started to price in stress about reaching the US debt wall earlier than expected. The US 1Y Credit Default Swap rose to the highest level since the Great Financial Crisis.

The 10Y US Treasury however is yielding unchanged at 3.42%. The BofA MOVE Index, measuring the implied volatility, continued to drop to 122.46 after peaking at almost 200 in March. The corporate fixed income market is not projecting higher spreads because of the above-mentioned facts, trading at unchanged levels for Investment Grade and High Yield debt. If recession probabilities rise, HY spreads could start to move higher again.

In Europe, government spreads slightly widened for the second month this year, but still quoting lower compared to the start of 2023. The ECB is determined to move rates higher at least 1 to 2 times this year, as inflation is still far too high.

Generally speaking, the appetite for bonds remained strong with investors trying to lock in higher interest rates as expectations are rising for global central banks to complete their tightening monetary policy.

	As of 28/04/2023	1-month perf.	Year-to-date perf.
Euribor 3M	3.27	+23 bp	+113 bp
SOFR RATE	4.81	-6 bp	+51 bp
Germany 2yr yield	2.68	+1 bp	-6 bp
Germany 10yr yield	2.31	+2 bp	-26 bp
US 2yr yield	4.01	-2 bp	-42 bp
US 10yr yield	3.42	-5 bp	-45 bp
France 10yr spread vs. Germany	+57 bp	+7 bp	+3 bp
Portugal 10yr spread vs. Germany	+82 bp	-1 bp	-20 bp
Spain 10yr spread vs. Germany	+105bp	+3bp	-5 bp
Italy 10yr spread vs. Germany	+186 bp	+6 bp	-28 bp
iTraxx Main 5yr	+83 bp	-1 bp	-8 bp
iTraxx Crossover 5yr	+435 bp	-1 bp	-39 bp
iTraxx Financials Senior 5yr	+98 bp	-1 bp	-1 bp
CDX IG 5yr	+76 bp	n.a.	-6 bp
CDX HY 5yr	+466 bp	+3 bp	-18 bp

Source: Bloomberg

Commodities

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In April, the commodity market saw a mixed performance with some commodities posting gains while others experienced losses.

Oil prices remained volatile, with Brent crude hovering around $70 per barrel due to concerns over global demand and supply disruptions.
Higher inventories and warmer-than-expected weather in the US drove Natural gas prices higher (+8.75%).

Gold surged to a one-year high above $2000 per ounce within the month, driven by a weaker US dollar and rising inflation expectations. The same goes for Silver whose prices rose towards the $26 before lending at $25.05, as investors sought safe-haven assets.

Concerns over slowing economic growth in China, the world's top consumer of Copper, pushed the price of the metal lower (Copper lost -5.48% last month).

Iron ore prices tumbled -17.26% to a four-month low, as China's steel production curbs weighed on demand.

On the Soft Commodities, Coffee and Sugar prices rose due to concerns over Brazil's drought, which could lead to a smaller crop yield (Coffee +9.58%).
Record crop in Australia pushed Wheat prices further down (-10%).

	As of 28/04/2023	1-month perf.	Year-to-date perf.
Brent ($/bbl)	79.54	-0.29%	-7.41%
WTI ($/bbl)	76.78	1.47%	-4.34%
Natural Gas ($/MMBtu)	2.41	8.75%	-46.15%
Gold ($/toz)	1 990.00	1.05%	9.10%
Silver ($/toz)	25.05	3.96%	4.59%
Platinum ($/toz)	1 078.31	8.35%	0.37%
Palladium ($/toz)	1 506.87	2.94%	-15.94%
Copper ($/MT)	387.00	-5.48%	1.56%
Iron Ore Fines62% ($/MT)	104.81	-17.26%	-10.53%
Corn (c/bu)	636	-3.71%	-6.26%
Wheat (c/bu)	6333/4	-10.04%	-21.08%
Soybean (c/bu)	1 4191/4	-3.81%	-7.44%
Coffee (c/lb)	185.95	9.58%	11.61%
Cocoa ($/mt)	2 937.00	1.49%	12.96%

Source: Bloomberg

Currencies

CHF strengthened again last month (USD/CHF -2.3%, EUR/CHF -0.7%), and with a FED Pivot nearing and SNB probably still planning 1 or 2 interest rate increases in 2023, the odds for a continuing strong CHF are given. Also, the CHF continues to benefit from the strong Swiss economy, which is less impacted by inflationary pressures, compared to the EU Zone.

Stronger global growth and a narrowing of interest rate differentials between the US and the rest of the world explained why the US dollar has weakened since October (DXY lost -0.8% in April). The US dollar remains overvalued relative to its Purchasing Power Parity exchange rate, which has historically provided a reliable guide to the long-term direction of the currency.

With a CPI staying above 10% in the UK, mainly driven by increasing food costs, traders bet on 5% BOE peak rate, pushing GBP higher (GBP/USD +1.9%).

On the Emerging markets side, USD/CNY was trading sideways last month (+0.6%).
Turkish Lira surged to an all-time high after the Central Bank has begun to allow gold purchased with Lira in a move to ease pressure on the currency.
USD/BRL closed at 4.99 in April after the Brazilian Real lost more than -3% in the first half of the month.

	As of 28/04/2023	1-month perf.	Year-to-date perf.
EUR/USD	1.10	1.7%	2.9%
USD/JPY	136.30	2.6%	4.0%
EUR/GBP	0.88	-0.3%	-1.0%
USD/CHF	0.89	-2.3%	-3.2%
EUR/CHF	0.99	-0.7%	-0.4%
GBP/USD	1.26	1.9%	4.0%
USD/CAD	1.36	0.3%	0.0%
USD/CNY	6.91	0.6%	0.2%
USD/INR	81.83	-0.4%	-1.1%
USD/BRL	4.99	-1.5%	-5.5%
USD/TRY	19.45	1.4%	4.0%
USD/ARS	222.64	6.5%	25.7%
RUB/USD	0.01	-2.7%	-7.0%
DXY Index	101.66	-0.8%	-1.8%

Source: Bloomberg

The Month Ahead: Economic Calendar

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In the first week of May, the FED and the ECB are scheduled for another round rate increase of 25 bp each. More importantly will be the message they deliver about their expectations for the rest of 2023.

The expectations for the US Labor market are for a continued decline of Nonfarm Payrolls and a slightly increase of unemployment. Inflation data is expected to stay at current levels for April as sticky inflation is only changing very slowly.

The market will continue to closely monitor leading indicators that could give a more accurate picture if the economies are heading towards a soft or hard landing.

Zone	Item	Date	Survey	Prior
EU	CPI (MoM)	May 2	0.7%	0.9%
US	FOMC Rate Decision (upper)	May 3	5.25%	5.00%
US	Trade Balance (Apr)	May 4	-$63.5b	-$70.5b
EU	ECB Main Refinancing Rate	May 4	3.75%	3.50%
EU	PPI (YoY) (Mar)	May 4	5.9%	13.2%
US	Unemployment Rate (Apr)	May 5	3.6%	3.5%
US	Change in Nonfarm Payrolls	May 5	180k	236k
US	CPI (YoY) (Apr)	May 10	5.0%	5.0%
US	PPI Final Demand (MoM)	May 11	0.3%	-0.5%
CH	CPI (YoY) (Apr)	May 11	-	0.7%
US	Industrial Production (MoM)	May 16	-	0.4%
CH	Industrial Production (YoY)	May 16	-	3.9%
US	GDP (QoQ) (1Q S)	May 25	-	1.1%
CH	Manufacturing PMI (May)	May 31	-	49.2

Source: Bloomberg

Invest with our Thematics

Invest with our Thematics

Solid Balance Sheets in Europe & in the US

Actively Managed Certificates • Participation • Available in EUR, USD

Our proposal is to exploit the well-known Altman Z-Score framework in order to take refuge in the companies currently exhibiting the most solid balance sheets in Europe and in the US. The latter will resist better in the current environment marked by the pandemic, stress in the oil market and macro deceleration.

Global Jobs & Economic Recovery

Actively Managed Certificates • Participation • Available in USD

The Strategy objective is to benefit from global governmental policies helping people who have lost their job due to COVID-19 to go back to work. US has launched the "Build Back Better" scheme and similar political agendas are prescribed in other part of the world to accelerate job creation. The index invests mainly in Small and Mid-Cap companies which are the biggest employers on a size-adjusted basis which is true globally. Allocation between different regions will be actively managed and run from a Top-Down perspective while the Bottom-Up stock picking will be delegated to active fund managers. The strategy provides exposure to a broad sector allocation. Passive vehicles may be used to add momentum on any major political moves to put people back to work. The short leg of the index aims, first and mainly, to hedge beta exposure whenever the index sponsor deems necessary. On opportunistic and specific cases, short positions may be used to add value. The net exposure will at all-time be net long.

Resocialising & Reopening beneficiaries

Actively Managed Certificates • Participation • Available in USD

Many sectors have been harmed by Covid-induced measures such as international travel bans and social distancing: Travel, Leisure, Restaurants, Airlines, Aerospace among others. The extraordinary vaccination campaign on the one hand, and unprecedented, synchronized fiscal & monetary stimuli on the other have been helping the most negatively affected companies to be able to benefit from the ongoing global recovery.

Our proposal is, therefore, to build a comprehensive exposure to segments severely impacted by the pandemic but poised to reap the benefits of a rebounding economy through an Actively Managed Certificate.

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Apollo Equity Europe

Open end Certificate • Participation • Available in EUR

State interventionism in the economy has become central, especially as the world is preparing for an energy revolution, as the United States and China have entered into a "Cold War" and a resurgence of societal tensions are felt in many countries. Most of the great world powers are now committing to multi-year budgetary programs to meet the challenges they face. This is particularly the case in Europe, through the Green Deal and the Recovery Fund that has just been launched. The old continent (under the impetus of the Franco-German couple), which has experienced financial underperformance for 10 years, is in the process of breaking out of its rigorous political line centered on cost competitiveness to avoid further financial downgrading.

This change of strategy in the current environment is reminiscent of the turn made by the United States in the early 1960s following the election of JF. Kennedy. In a climate of cold war, the 35th American President launched his "new frontier" budgetary program to revitalize his country's economy. This initiative led to the Apollo mission and the first man on the moon.

Macro Long-Biased Asia

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