

Investment letter

***Monthly review of global
financial markets***



SWISS
CAPITAL^{IB}

MAY 2022

MACROECONOMICS

The war in Ukraine continues and, for now, a rapid fulfillment of Russia's revised military goal remains elusive, as does a credible diplomatic resolution. This is leading to more severe sanctions, now moving to oil and gas embargoes which will prove to be more costly economically, with supply side inflation pressures remaining sustained in the short term.

The price action in fertilizers and agricultural commodities along with a strong US dollar are pushing food prices to extreme levels, leading to economic, social and political stress in a rising number of EM countries.

The surge in Covid cases in China along with the severe sanitary restrictions imposed by the government have led to a collapse in Chinese PMIs in April, signalling a much weaker short term growth outlook and extended global supply chain pressures.

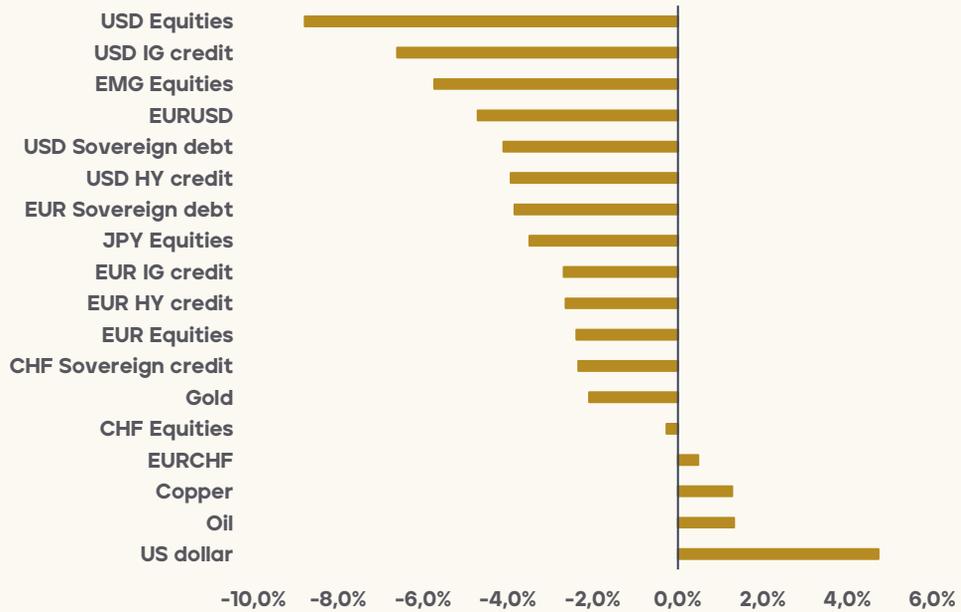
"rising recession risk"

Headline and core inflation remain at very elevated levels in developed markets, leading to a significant squeeze in households' real disposable income. Consumers have increasingly resorted to credit cards to maintain spending levels close to unchanged however, this is unlikely to prove sustainable, implying a weaker consumer spending outlook.

As government bond yields continue to rise, mortgage rates have been rising sharply across developed markets, almost doubling on standard 30y fixed mortgages in the US in a few months. Combined with very rapid home price appreciation in the last few quarters, this has left affordability measures at their worst levels since 2006. Refinancing rates have collapsed, and the marginal homebuyer has all but disappeared with homebuilders pointing to materially lower traffic.

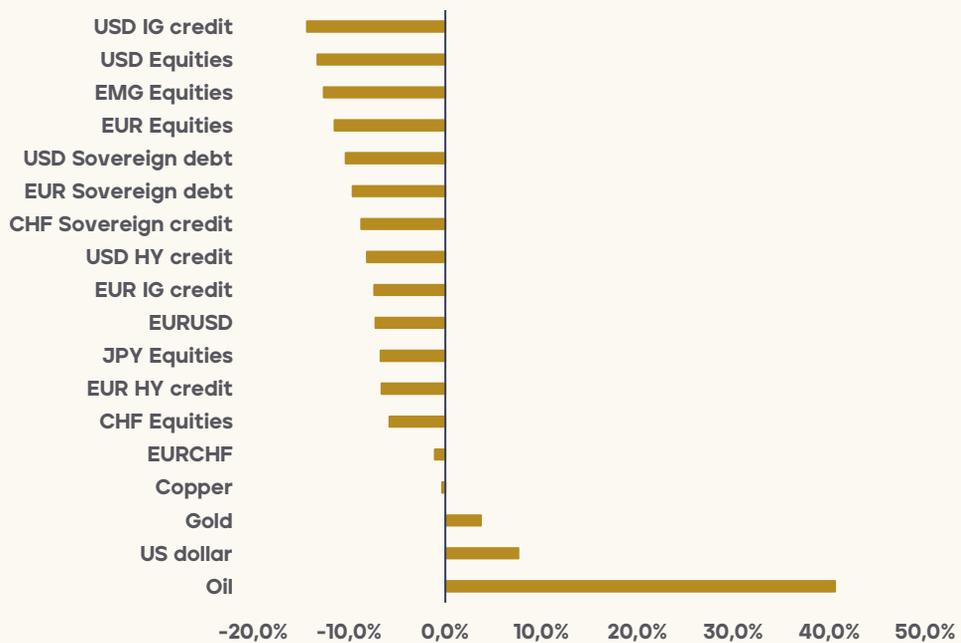
OVERVIEW

MAIN ASSET CLASSES MONTHLY PERFORMANCE



Source: Bloomberg, 29/04/2022

MAIN ASSET CLASSES PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 29/04/2022

MACROECONOMICS (continued)

Central banks continued to hike or signal higher rates. The Fed intends to move Fed Funds Rates at or above neutral levels in short order. The ECB is now likely to end its asset purchase programme and hike rates for the first time in more than a decade in July. As equities soften and credit spreads widen, financial conditions are tightening fast.

The combination of rapid tightening in monetary policy and sharp rise in energy prices has always led to a recession. It is unlikely that this time will prove different.



Soft landing
unlikely

EQUITY MARKETS



Lower lows

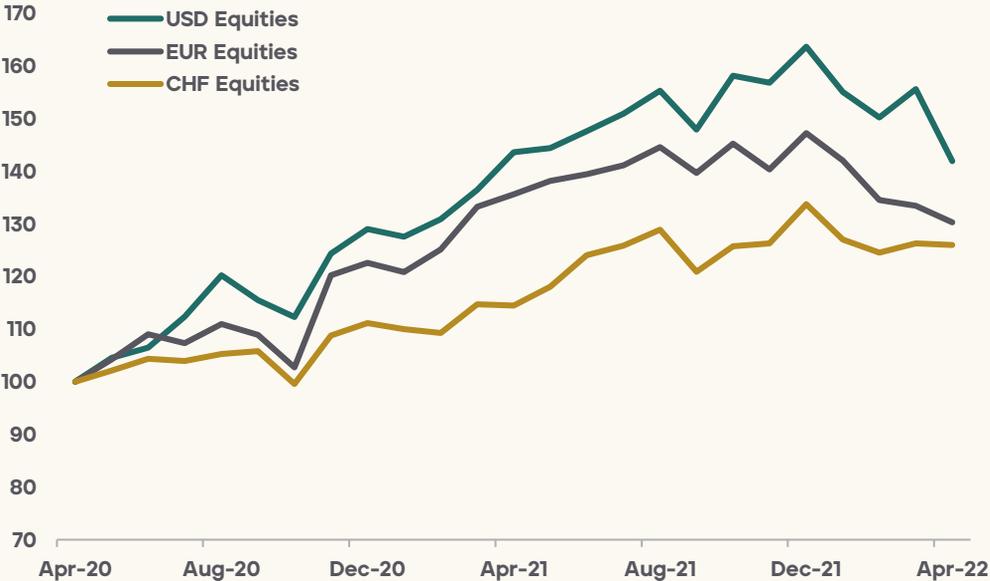
Equity markets went back to the lows of the YTD range as elevated rates volatility, a strong USD and a deteriorating earnings outlook weighed on major indices. US equities underperformed international equities, led by tech shares as the Nasdaq recorded its worst monthly performance in decades.

Staples was the strongest segment (+2%) while segments more sensitive to the economic cycle underperformed (Consumer Discretionary -12%).

EM equities were no exception with the EEM ETF reaching new lows with recent outperformers sliding as well (e.g. Bovespa).

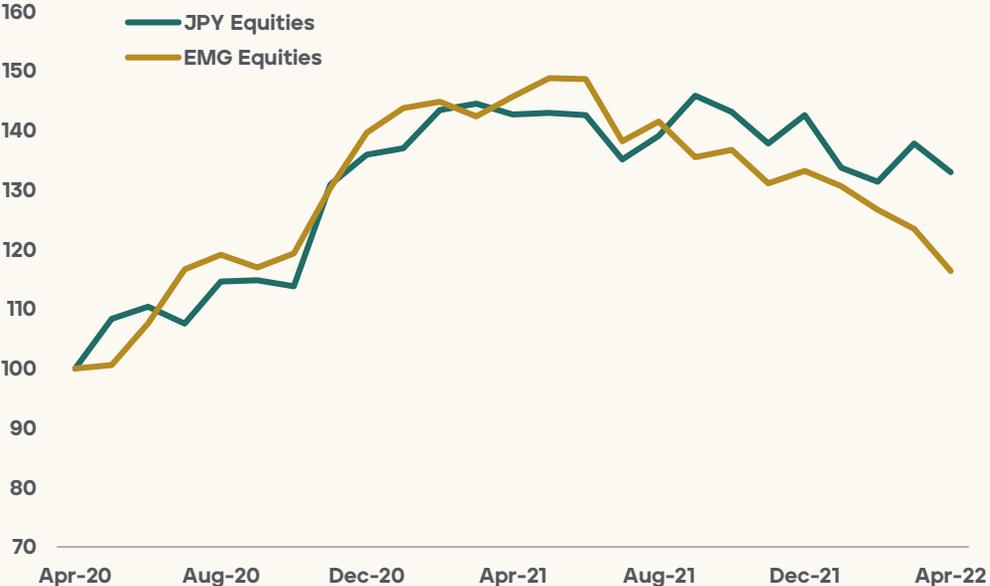
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 29/04/2022

EQUITY MARKETS JAPAN - EMERGING MARKETS PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 29/04/2022

BOND MARKETS

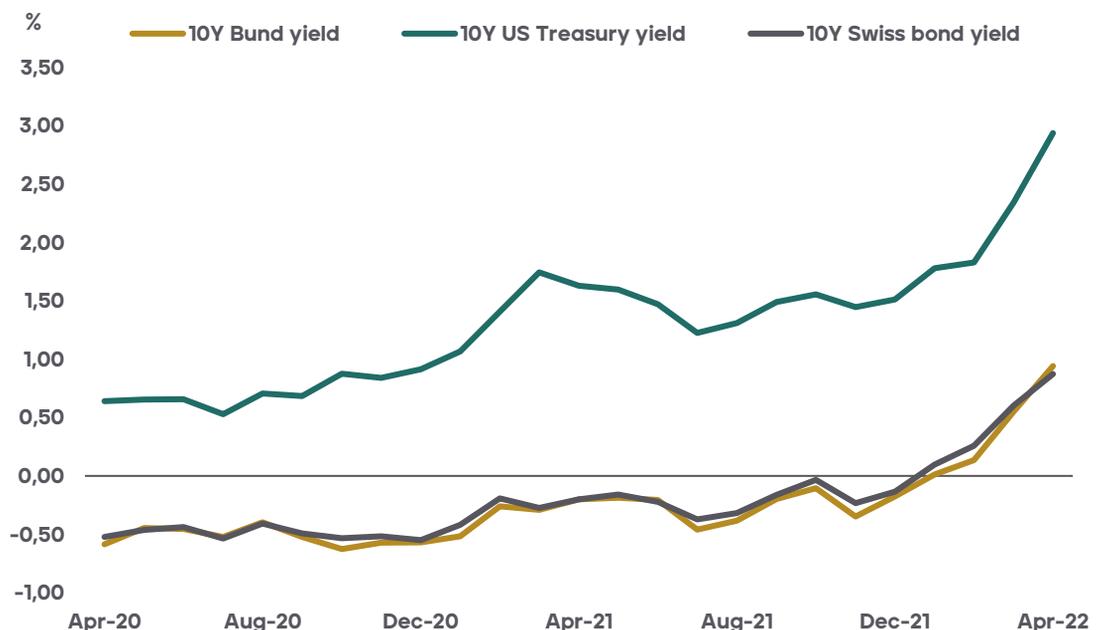
Government bond yields continued to move higher despite stabilizing breakeven inflation rates, implying a material move higher in real rates. The US Treasury curve re-steepened as expectations of Fed hikes start to stabilize and term premium increased. European government bonds underperformed as the ECB signaled earlier rate hikes, with July now firmly on the table. BTPs underperformed materially as investors prepare for lower technical support.

Credit spreads widened back out as fund flows turned negative again and investors positioned for a more material growth slowdown. The EUR HY market remains shut, a symptom of reduced capital availability. Conditions point to a likely new default cycle emerging in 2023, with over-levered borrowers and cyclical issuers most exposed.

Financial credit was not immune to the wider selloff as AT1s revisited their early March lows despite reassuring Q1 earnings. Issuance was focused on senior bonds from higher quality issuers.

“rates selloff mature,
credit stress increasing”

10Y SOVEREIGN BOND YIELDS EVOLUTION OVER 2 YEARS



Source: Bloomberg, 29/04/2022

CURRENCIES

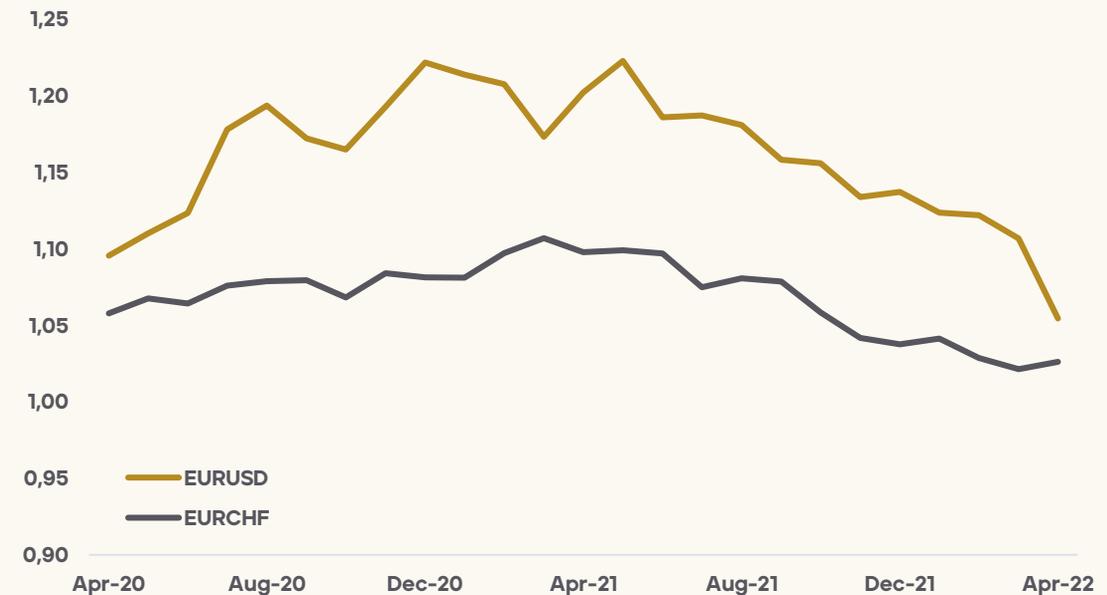
The US dollar strengthened materially against all major currencies with the dollar index reaching highs not seen in decades. The EURUSD cross reached 1.05 towards the end of the month despite the market pricing earlier rate hikes from the ECB. The British pound underperformed severely following the 25bps hike and the MPC's prediction of an upcoming recession.

By far the most striking currency move came from the yuan which depreciated more than 5% against the USD in April, catching up with the recent yen weakness.

In emerging markets, this year's best performers struggle to maintain their positive momentum, with the Brazilian Real trading above 5 again.

USD & CHF

EVOLUTION OVER 2 YEARS AGAINST THE EUR



Source: Bloomberg, 29/04/2022

COMMODITIES

OIL

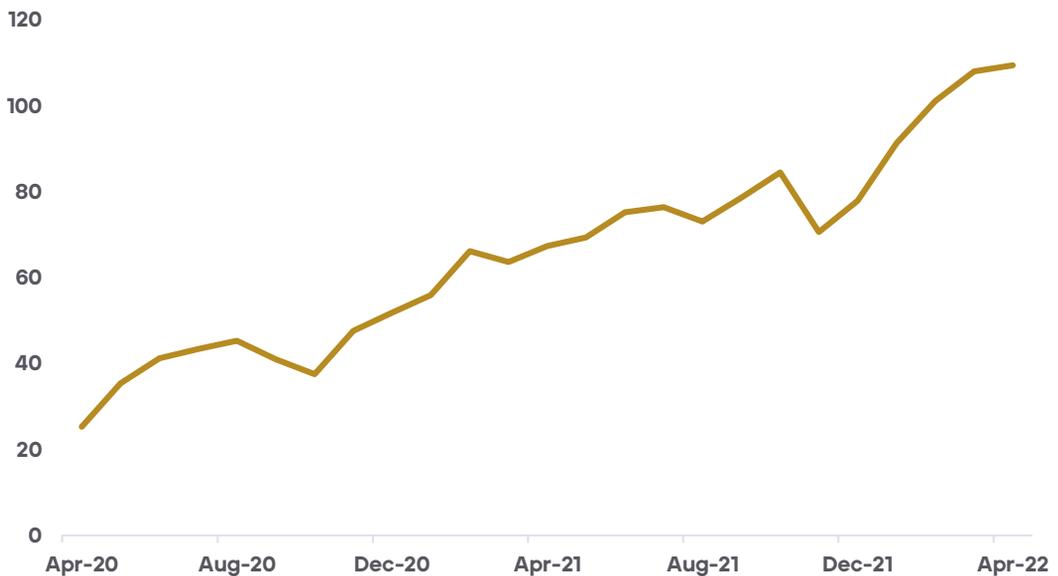
Oil prices were roughly unchanged on the month despite the challenging backdrop as the supply picture remains very tight and outweighs for now the likely weakening of demand.

The European Union and G7 are highly likely to agree to an embargo of Russian oil and gas with a progressive phasing out. Meanwhile, the US is sending conflicting signals on the management of its strategic reserves, lately signaling that it will look to rebuild them after the recent releases.



Oil on the boil

OIL EVOLUTION OF BRENT PRICES OVER 2 YEARS



Source: Bloomberg, 29/04/2022

COMMODITIES

GOLD

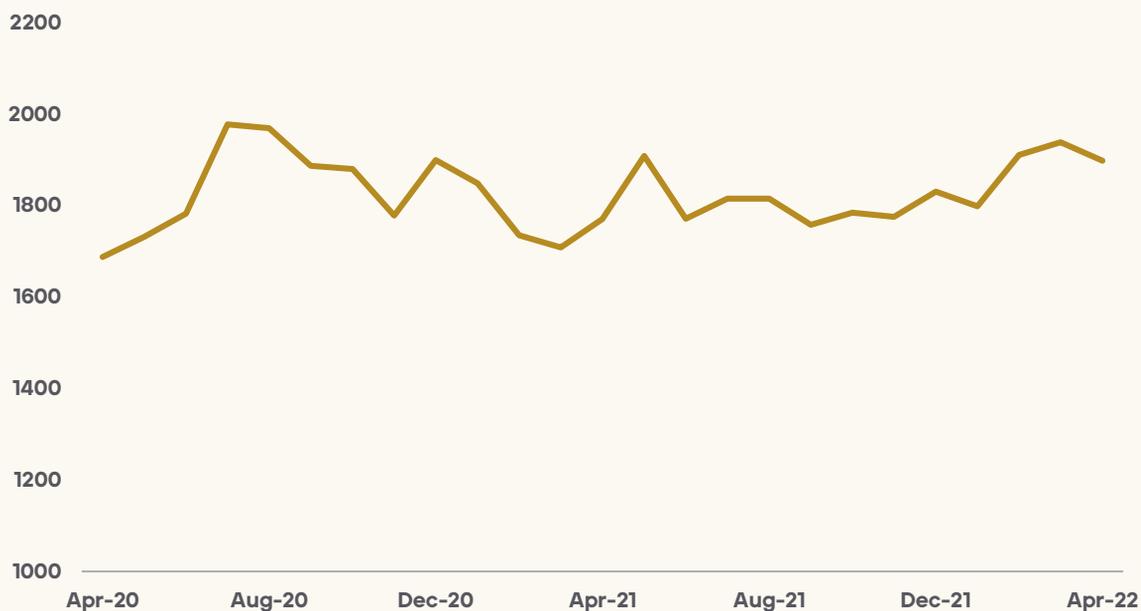
Gold traded marginally lower last month, failing to act as a defensive asset in a wider market selloff as some of the geopolitical risk premium starts to erode.

The yellow metal screens as expensive against the price action in the USD and real rates.



Weak RV

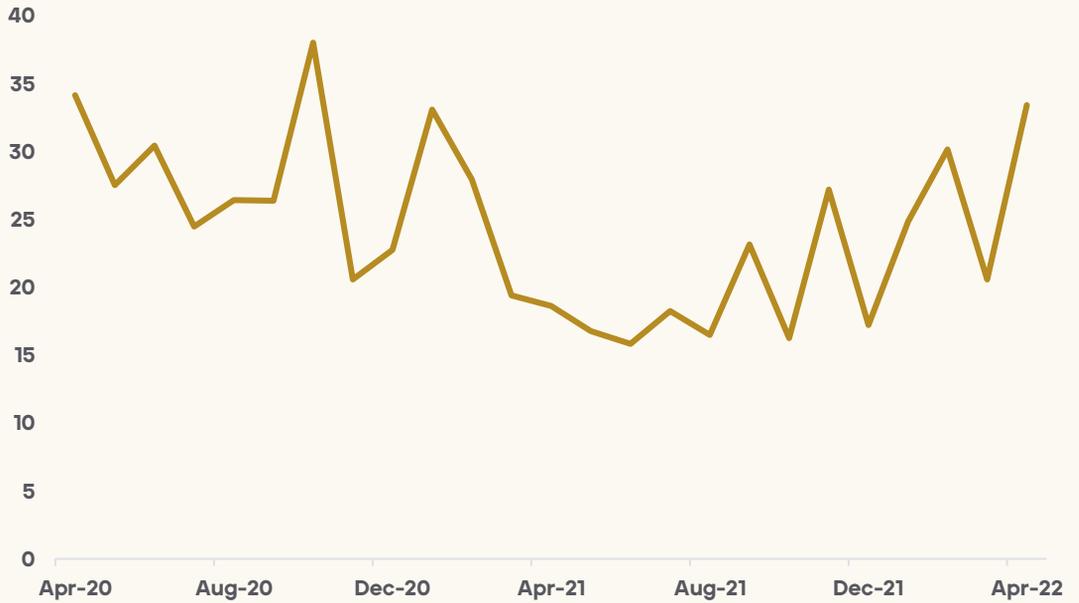
GOLD EVOLUTION OVER 2 YEARS



Source: Bloomberg, 29/04/2022

VOLATILITY

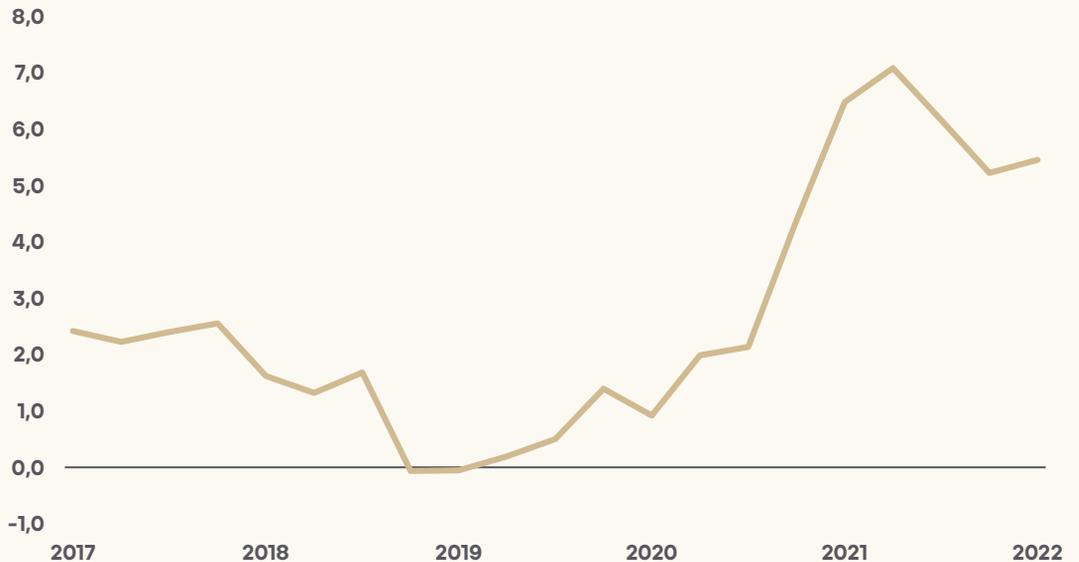
VOLATILITY - VIX INDEX EVOLUTION OVER 2 YEARS



Source: Bloomberg, 29/04/2022

REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE ANNUAL PRICE CHANGE



Source: Bloomberg, 29/04/2022

CALENDAR

Date	Country	Economic Data	Period	Previous
11 May	US	Inflation (YoY)	Apr-22	8,5
	China	Inflation (YoY)	Apr-22	1,5
12 May	UK	Real GDP (QoQ)	Mar-22	1,3
13 May	US	Consumer Confidence	May-22	65,2
	Eurozone	Industrial Production (MoM)	Mar-22	0,7
16 May	China	Retail Sales (YoY)	Apr-22	-3,5
	China	Industrial production (YoY)	Apr-22	6,5
17 May	US	Industrial Production (MoM)	Apr-22	0,9
	Eurozone	Employment (QoQ)	Mar-22	0,4
	Eurozone	Real GDP (QoQ)	Jun-22	0,2
	France	Unemployment Rate (%)	Mar-22	7,4
	UK	Unemployment Rate (%)	Mar-22	3,8
18 May	UK	Inflation (YoY)	Apr-22	7,0
	Japan	Industrial Production (MoM)	Apr-22	0,3
	Japan	Real GDP (QoQ)	Mar-22	4,6
19 May	US	Philadelphia Fed Business Survey	May-22	17,6
23 May	Germany	Ifo Business Climate	May-22	91,8
24 May	Eurozone	Markit Manufacturing PMI	May-22	55,5
	Eurozone	Markit Services PMI	May-22	57,7
	UK	Markit Manufacturing PMI	May-22	55,8
	UK	Markit Services PMI	May-22	58,9
	Japan	Nikkei Manufacturing PMI	May-22	53,5
25 May	US	Fed minutes	Mar-23	
	Germany	Real GDP (QoQ)	Jun-22	0,2
26 May	US	Real GDP (QoQ)	Jun-22	-1,4
31 May	Eurozone	Inflation (YoY)	May-22	7,5
	France	Real GDP (QoQ)	Jun-22	0,0
	Italy	Real GDP (QoQ)	Jun-22	-0,2
	Switzerland	Real GDP (QoQ)	Mar-22	0,3
	Switzerland	KOF Leading Indicator	May-22	101,7

3x3 – SUMMER HIKING

KEY POINTS



Broadening and acceleration of financial conditions' tightening.



Real GDP growth slowing faster than expected as recession odds climb.

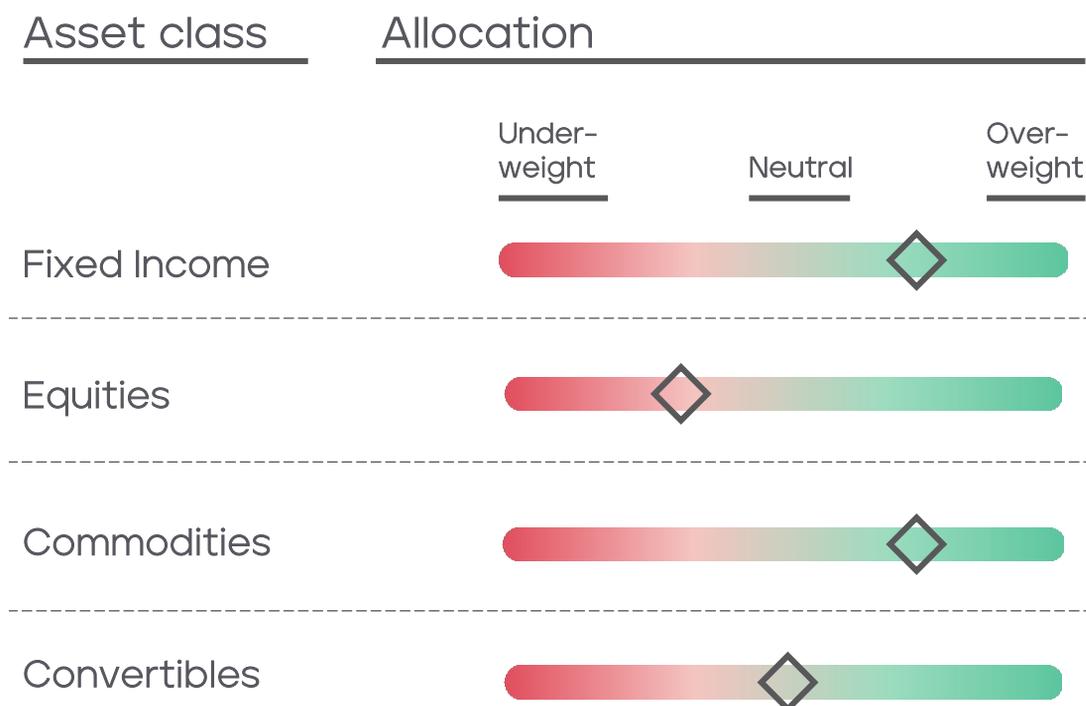


We are overweight fixed income with a preference for core government bonds and high quality non-cyclical credit.



We remain cautious on equities despite improving valuations as the earnings outlook slides.

CROSS ASSET ALLOCATION



Fixed Income: overweight

We are overweight the long end of the US Treasury curve, core euro sovereigns and non-cyclical IG.

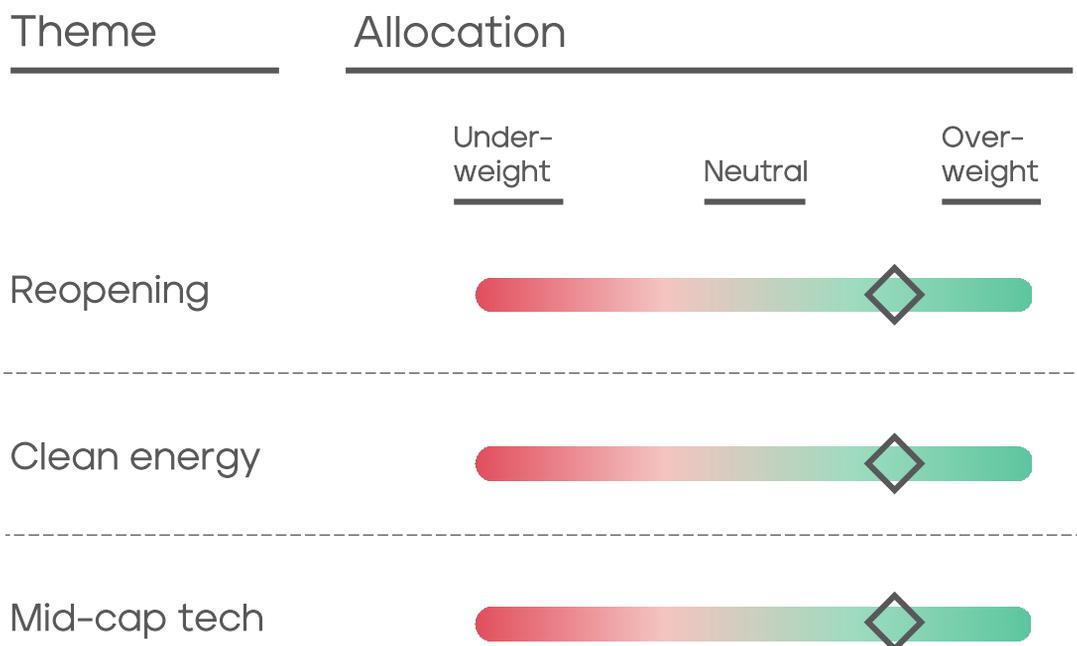
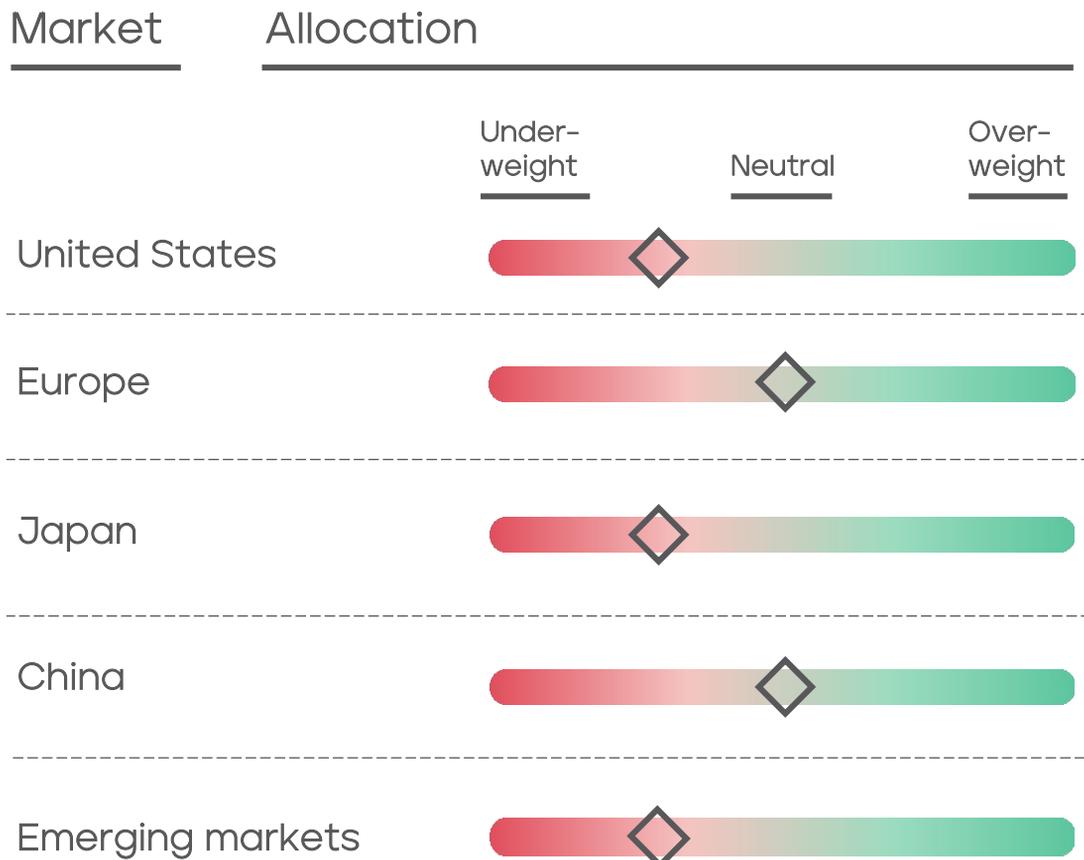
Equities: underweight

Risks have shifted from multiples to earnings, but reward is asymmetric. The dispersion is high, and some segments are attractive.

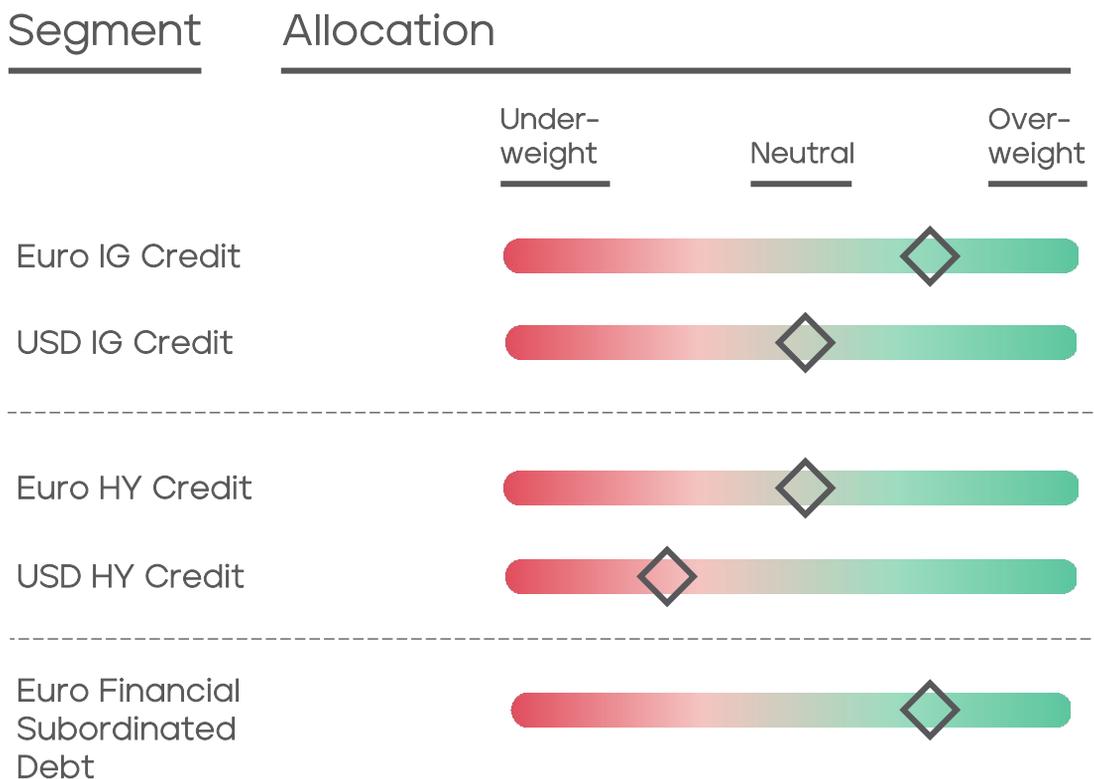
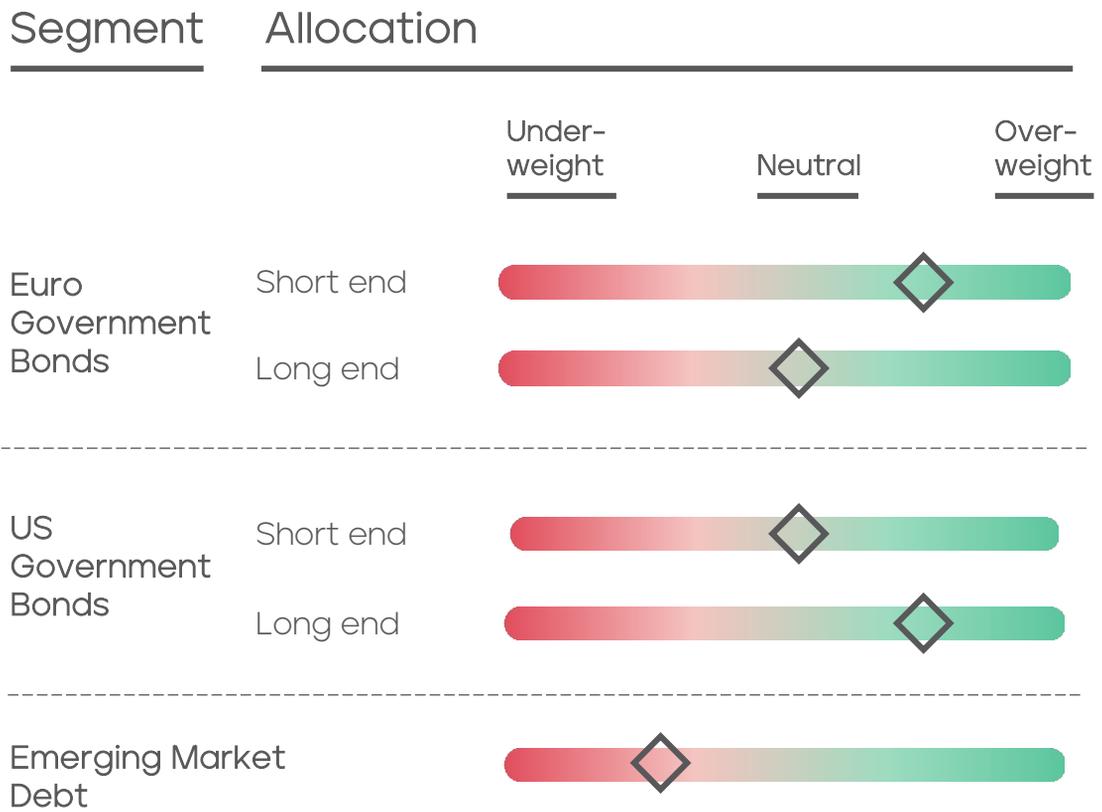
Commodities: overweight

Fundamentals are tight in most commodities and the asset class remains a hedge in coming weeks. Gold looks rich considering the recent surge in real rates.

EQUITY ALLOCATION



FIXED INCOME ALLOCATION



Let's talk about it.

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