



Investment letter

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



SWISS
CAPITAL^{IB}

AUGUST 2022

MACROECONOMICS

The deterioration in leading growth indicators continued in July, with US and European manufacturing and services surveys missing to the downside and sliding further. Subcomponents such as new orders, employment and inventories continue to point towards lower levels of activity in the coming months. However, the “prices paid” component is falling fast in line with mounting evidence on easing price pressures in manufacturing, commodities and transportation.

Despite supply tightness, oil prices continued to slide as investors weigh sharply lower demand ahead. However, European gas prices are making new highs on elevated uncertainty surrounding deliveries from Russia through Nord Stream 1. If prolonged, this will likely extend pressure on headline inflation in Europe and create significant downside risk for European growth in coming quarters.

The implementation and lifting of sanitary restrictions in China remain relatively unpredictable, possibly contributing to the anemic character of the growth rebound. Geopolitical tensions around Taiwan continue to simmer and intensified ahead of Pelosi’s visit.

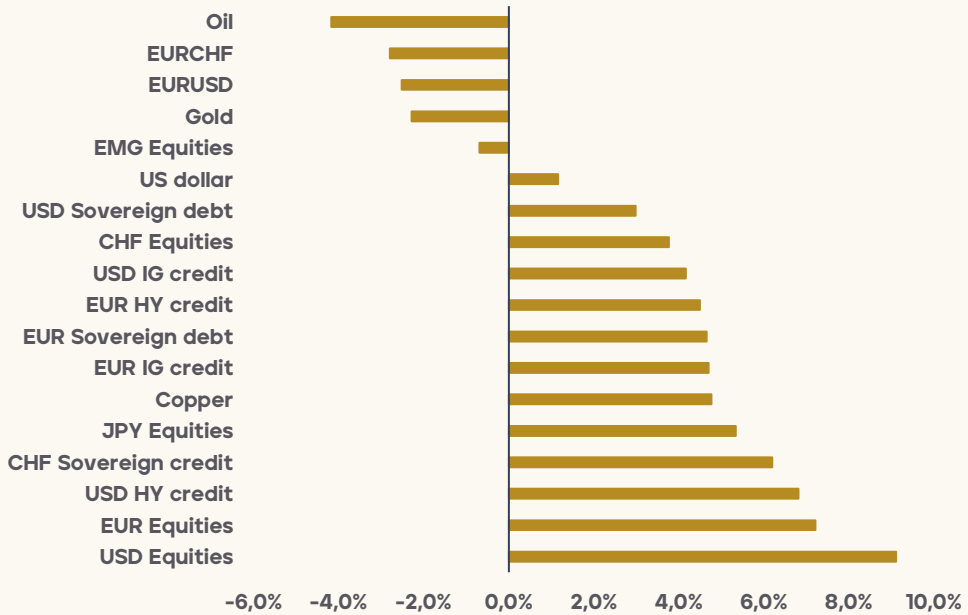
“while premature at this stage, a fed pivot is likely getting closer”

While inflation numbers have remained elevated on both sides of the Atlantic, the rapidly deteriorating growth outlook, fading supply chain issues and falling commodities prices all point to a high probability of core inflation sliding back towards policy targets in 2023. However, sticky and late cycle components such as rents are likely to keep inflation data in the uncomfortable zone for Central Banks in the short term.

Despite better clarity on the medium-term inflation outlook, the macro picture remains challenging as Central Banks are likely to keep tightening monetary policy in a slowing growth backdrop. The consequences of the shrinking availability and rapid rise in the cost of capital are already visible in the more speculative ends of credit markets, in emerging markets and in housing. Lending standards are also being tightened rapidly and contribute directly to the deteriorating HY and EM default rate outlook.

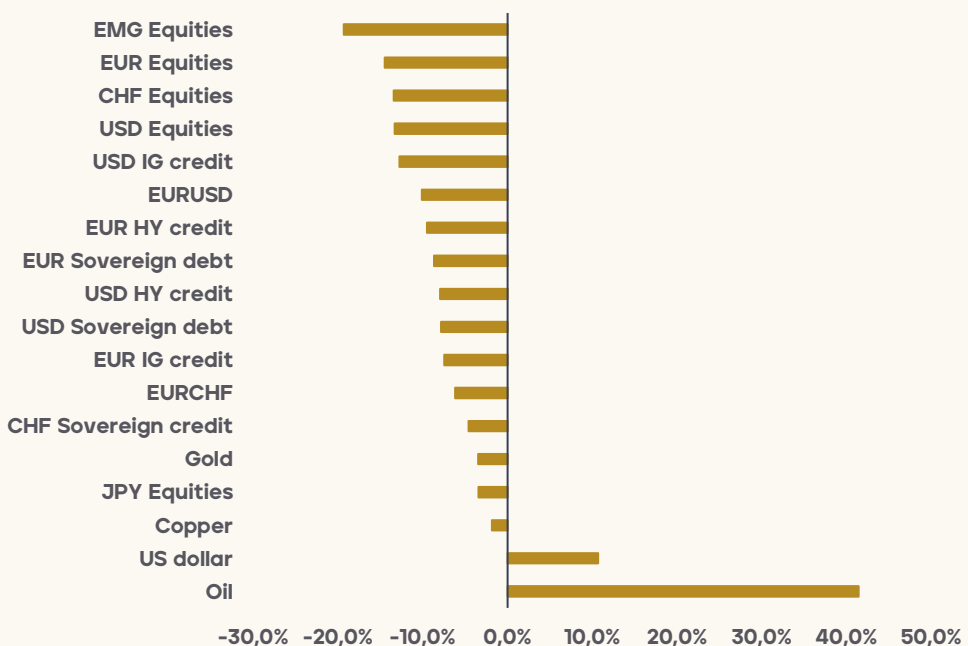
OVERVIEW

MAIN ASSET CLASSES MONTHLY PERFORMANCE



Source: Bloomberg, 31/07/2022

MAIN ASSET CLASSES PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 31/07/2022

MACROECONOMICS (continued)

A surprisingly dovish post-FOMC press conference from Powell led real rates materially lower, which likely doesn't align with the Fed's objectives regarding financial conditions and inflation credibility. The subsequent dovish pivot narrative helped fuel an "everything rally" as government bond yields fell, equity market rallied, credit spreads tightened, and implied volatility fell across asset classes. However, talk of a pivot is likely premature and suggests the short-term risk-reward has deteriorated across the board.



Recession consensus

As the growth slowdown intensifies, a defensive asset allocation remains relevant.

EQUITY MARKETS

Equity markets rallied materially as positioning reached extremely negative levels, Q2 earnings didn't come materially lower than expected and lower UST yields helped multiples retrace somewhat.



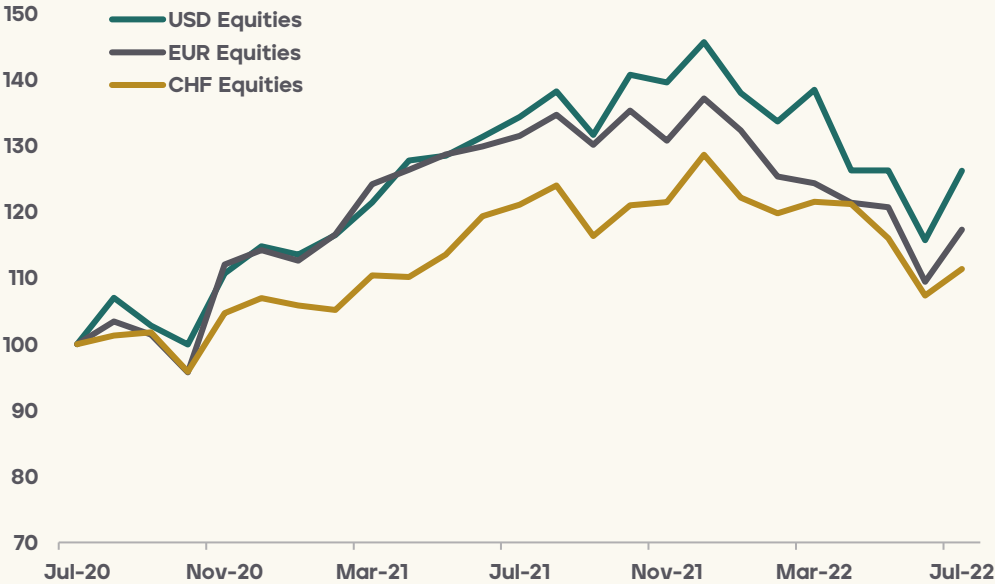
Equity rally amidst extremely negative positioning

Consumer discretionary, tech and utilities were amongst the best performing sectors while gold mining stocks had another negative month, underperforming the wider sector and market.

EM equities performed poorly, lagging the rally seen in DM equities, with Chinese equities a notable underperformer.

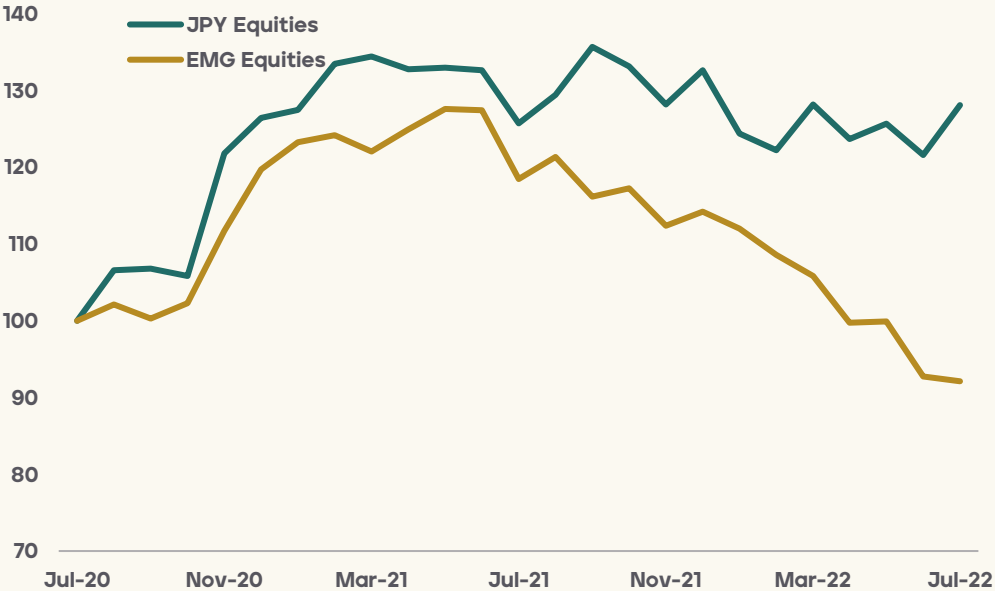
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 31/07/2022

EQUITY MARKETS JAPAN - EMERGING MARKETS PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 31/07/2022

BOND MARKETS

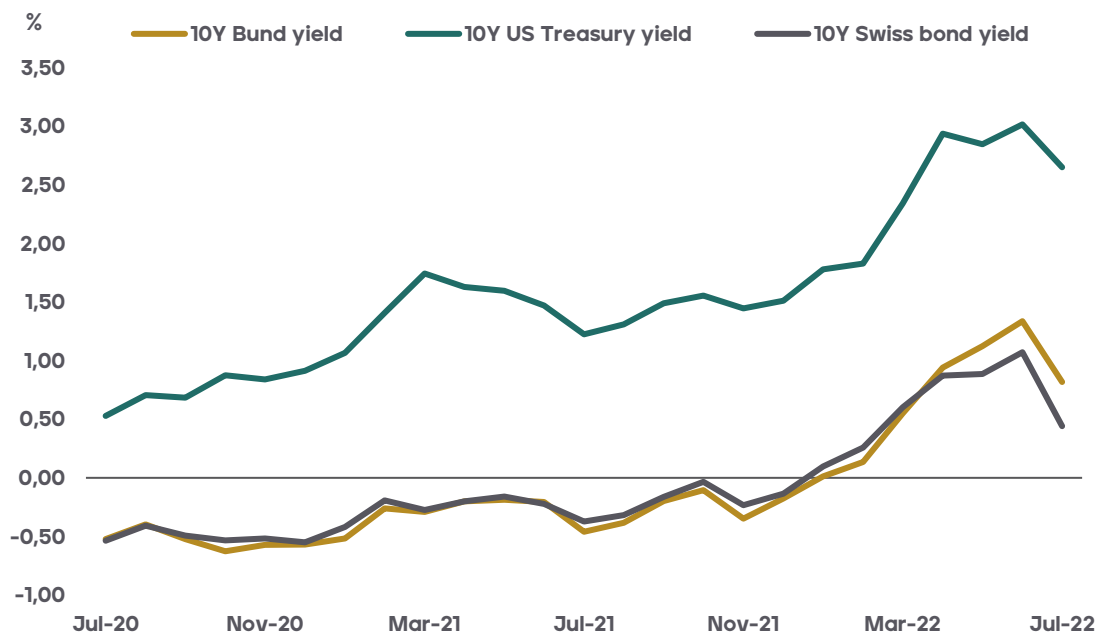
Government bonds extended their rally from the June lows despite sizeable hikes from the Fed and the ECB (respectively 75bps and 50bps). Investors priced a higher likelihood of inflation moderating in the coming months and a shifting Central Bank reaction function as growth worries start to replace an exclusive focus on inflation fighting. This contributed to lower terminal rates and flatter yield curves. The Fed and the ECB both ditched forward guidance and indicated a flexible and data dependent approach to future hikes. Powell's suggestion that policy rates were now at neutral levels sparked hopes of an upcoming Fed policy pivot, which reads somewhat premature.

Credit spreads tightened as technical conditions improved materially: interest rate volatility declined, outflows from bond ETFs and funds stopped, positioning remained cautious and net issuance remained depressed. While spreads retraced, the distressed ratio remained elevated and continues to indicate an increase in default rates from 2023.

Financial credit performed strongly, supported by attractive relative valuations and robust credit fundamentals as evidenced by Q2 earnings reports. Issuers remain able to tap investors for the most subordinated instruments.

"high likelihood of cycle peak in government bond yields"

10Y SOVEREIGN BOND YIELDS EVOLUTION OVER 2 YEARS



Source: Bloomberg, 31/07/2022

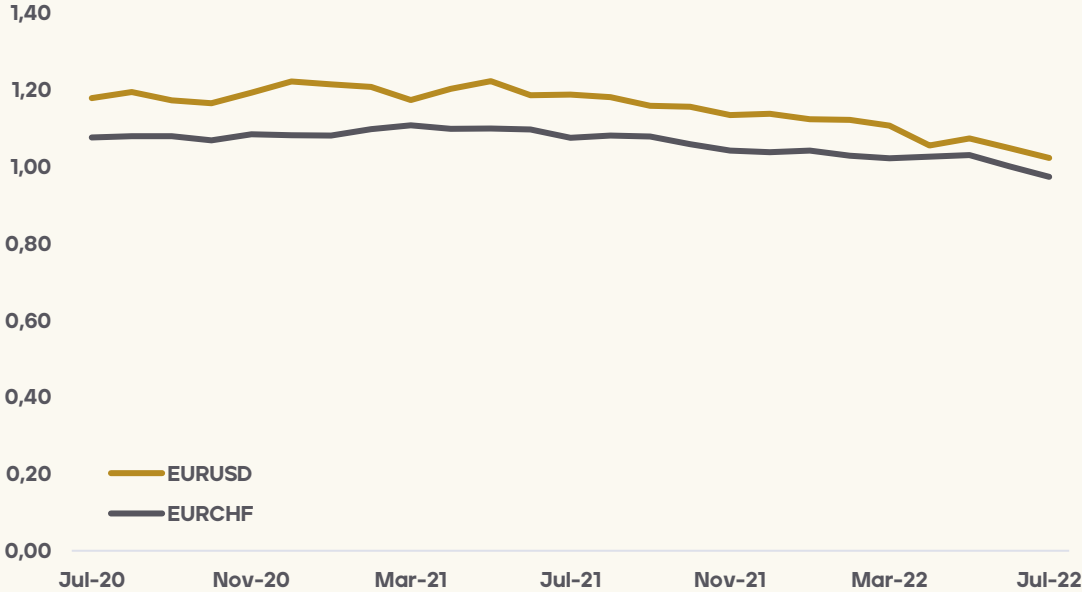
CURRENCIES

The dollar rally paused as investors priced a higher probability of peak global inflation pressure and peak Fed hawkishness.

The Japanese Yen was a logical outperformer in this context. However, the EUR and GBP bounce were shy at best as both currencies face serious stagflation headwinds from H2 given regional gas and electricity short term price dynamics.

EM currencies' slide stopped or slowed in July, in line with the wider macro picture.

USD & CHF
EVOLUTION OVER 2 YEARS AGAINST THE EUR



Source: Bloomberg, 31/07/2022

COMMODITIES

OIL

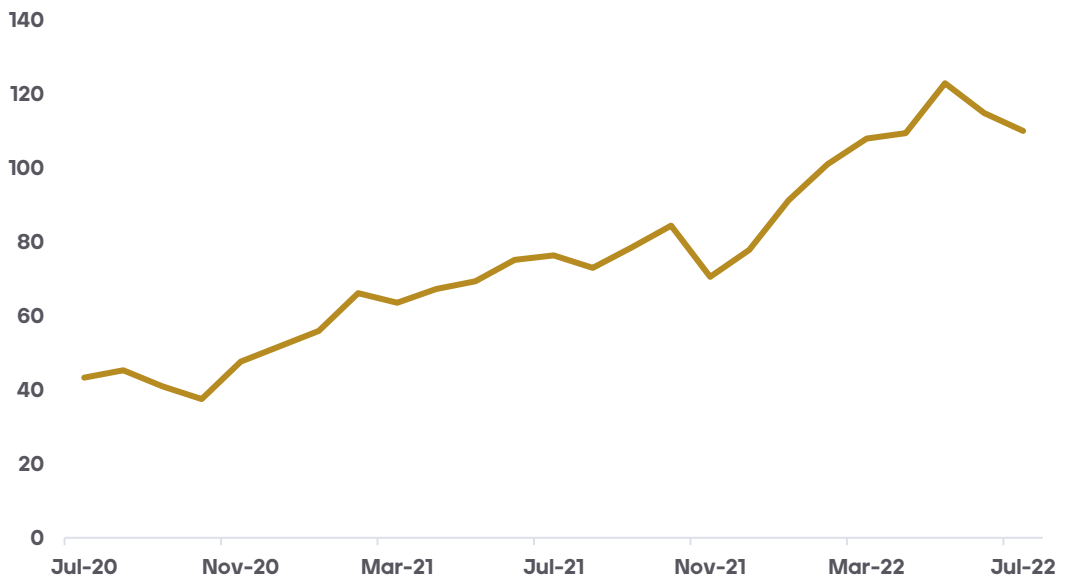
Oil remained under pressure as lower global growth expectations dent the demand outlook, with some evidence of shifting gasoline demand, possibly in response to higher prices at the pump. The medium-term outlook remains bearish.



The last bull is leaving the party

European gas and electricity prices have continued to rise as uncertainty around Russian gas flows remains high following the Nord Stream 1 maintenance. If prolonged, these price pressures are likely to impact European growth materially in coming quarters.

OIL EVOLUTION OF BRENT PRICES OVER 2 YEARS

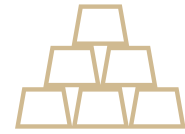


Source: Bloomberg, 31/07/2022

COMMODITIES

GOLD

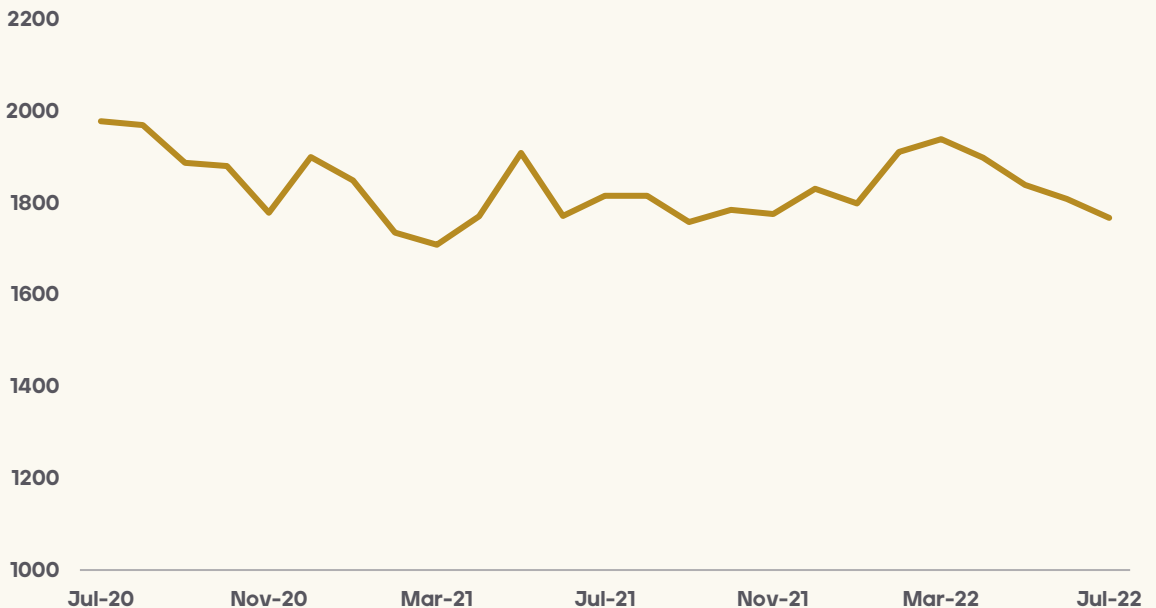
Gold staged a strong rally towards the end of the month, in line with the fall in real rates following the dovish take on Powell's post-FOMC press conference.



Weak RV

With a premature easing of financial conditions likely viewed as counterproductive by the Fed, the short-term risk to real rates is on the upside, posing a risk to the yellow metal's short-term performance. However, this episode suggests that gold is likely to be an attractive asset to own around a dovish Central Bank pivot in a recessionary backdrop.

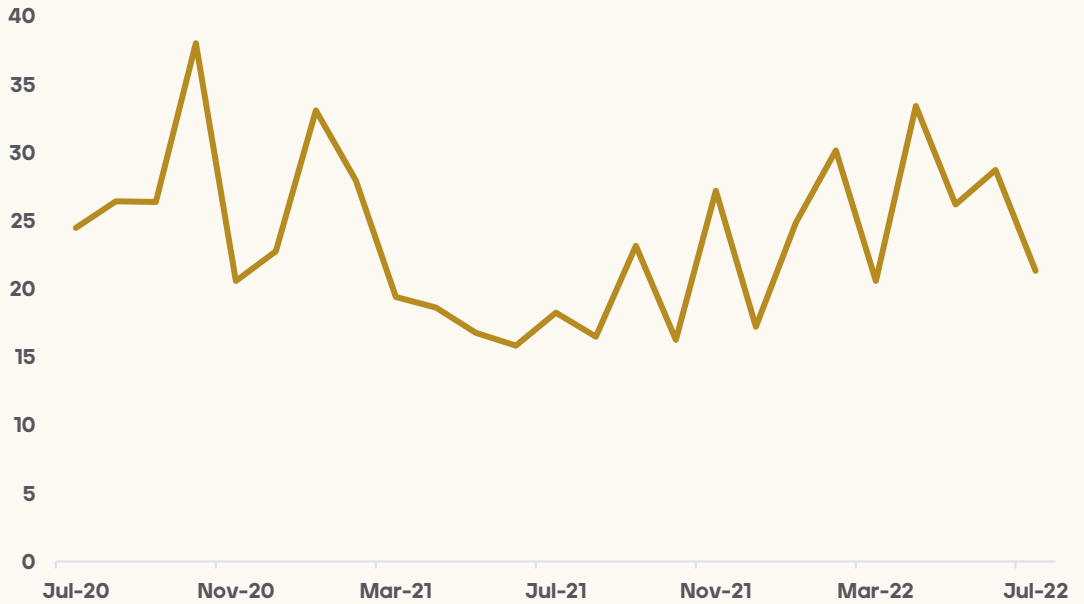
GOLD EVOLUTION OVER 2 YEARS



Source: Bloomberg, 31/07/2022

VOLATILITY

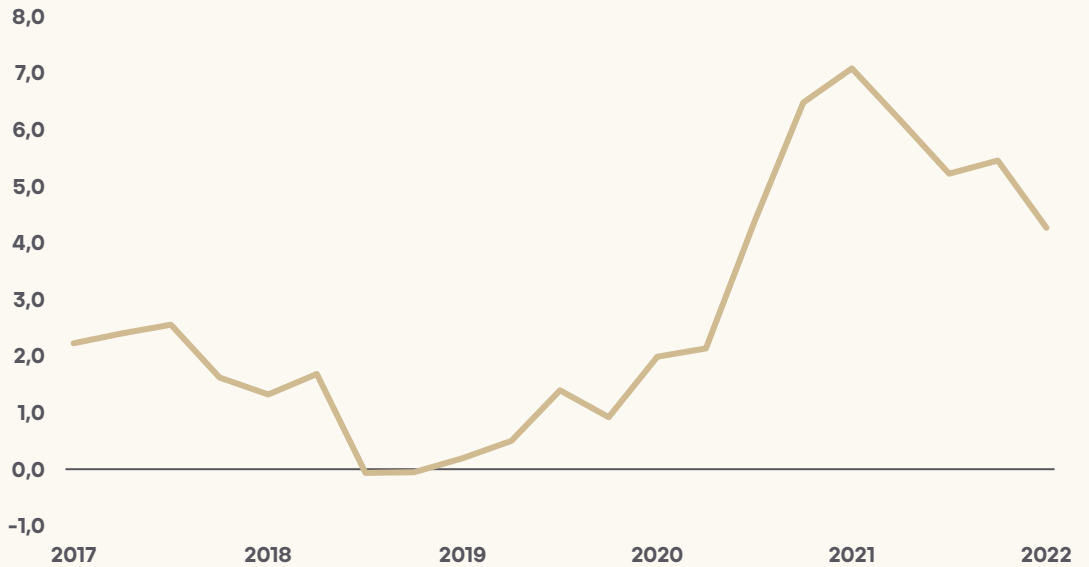
VOLATILITY - VIX INDEX EVOLUTION OVER 2 YEARS



Source: Bloomberg, 31/07/2022

REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE ANNUAL PRICE CHANGE



Source: Bloomberg, 31/07/2022

CALENDAR

Date	Country	Economic Data	Period	Previous	
01 August	US	Manufacturing PMI	Jul-22	56,1	
	China	Caixin Manufacturing PMI	Aug-22	51,7	
	Eurozone	Markit Manufacturing PMI	Aug-22	52,1	
	Eurozone	Unemployment Rate (%)	Jun-22	6,8	
	UK	Markit Manufacturing PMI	Aug-22	52,8	
	Japan	Nikkei Manufacturing PMI	Aug-22	52,7	
	02 August	Switzerland	Manufacturing PMI	Jul-22	59,1
03 August	US	ISM Non-Manufacturing Index	Jul-22	55,3	
	Eurozone	Markit Services PMI	Aug-22	50,6	
	UK	Markit Services PMI	Aug-22	53,3	
	Switzerland	Inflation (YoY)	Jul-22	3,4	
04 August	UK	Bank of England Interest Rate (%)	Sep-22	1,3	
05 August	US	Employment (000s)	Jul-22	372,0	
	US	Unemployment Rate (%)	Jul-22	3,6	
	Germany	Industrial Production (MoM)	Jun-22	0,2	
07 August	China	Exports (YoY)	Jul-22	17,9	
08 August	Switzerland	Unemployment Rate (%)	Jul-22	2,2	
10 August	US	Inflation (YoY)	Jul-22	9,1	
	China	Inflation (YoY)	Jul-22	2,5	
12 August	US	Consumer Confidence	Aug-22	51,5	
	Eurozone	Industrial Production (MoM)	Jun-22	0,8	
	France	Unemployment Rate (%)	Jun-22	7,3	
	UK	Real GDP (QoQ)	Jun-22	0,8	
	China	Retail Sales (YoY)	Jul-22	3,1	
	China	Industrial production (YoY)	Jul-22	3,4	
	Japan	Industrial Production (MoM)	Jul-22	8,9	
	Japan	Real GDP (QoQ)	Jun-22	-0,5	
	16 August	US	Industrial Production (MoM)	Jul-22	-0,2
		UK	Unemployment Rate (%)	Jun-22	3,8
17 August	US	Fed minutes	Mar-23		
	Eurozone	Employment (QoQ)	Jun-22	0,6	
	Eurozone	Real GDP (QoQ)	Sep-22	0,7	
	UK	Inflation (YoY)	Jul-22	9,4	
18 August	US	Philadelphia Fed Business Survey	Aug-22	-12,3	
25 August	US	Real GDP (QoQ)	Sep-22	-0,9	
	Germany	Ifo Business Climate	Aug-22	88,6	
	Germany	Real GDP (QoQ)	Sep-22	0,0	
	31 August	Eurozone	Inflation (YoY)	Aug-22	8,9
	France	Real GDP (QoQ)	Sep-22	0,5	
	Switzerland	KOF Leading Indicator	Aug-22	90,1	



LET'S TALK ABOUT IT.

T +41 (0)22 512 10 24
Place de l'Université 6
CH - 1205 Geneva
swisscapital-ib.com

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