Investment letter

Monthly review of global financial markets

SWISS CAPITAL IB

DECEMBER 2022

MACROECONOMICS

November started with the Fed potentially signalling its last 75bps interest rate hike. With the upper bound at 4%, and after a historically rapid cumulative tightening so far this year, the statement introduced the notion that monetary policy affects activity and inflation with a lag, and that it will become "appropriate", "at some point", "to slow the pace of increases" to determine whether the stance is sufficiently restrictive.

And most data in November seemed to confirm that the double process of disinflation and slowdown is indeed in motion. October inflation finally brought some good news with headline inflation decisively down from 8.2% to 7.7%, while core inflation also softened from 6.6% to 6.3%. Meanwhile, the November NAHB index of homebuilder activity and sentiment confirmed that the US real estate market is in recession, plunging from 38 to 33 for an 11th straight month to its lowest level since April 2020. Finally, November flash PMIs pointed to a solid contraction across the US private sector business activity, with both manufacturing and services well below 50, new orders falling at the fastest pace since May 2020, and private sector input cost inflation softening.

Remaining pockets of resiliency come from the consumer and the labour market, with retail sales still robust in October, while the pace of October jobs creation remained solid – albeit on a gradual downward trend since Dec. 2020.

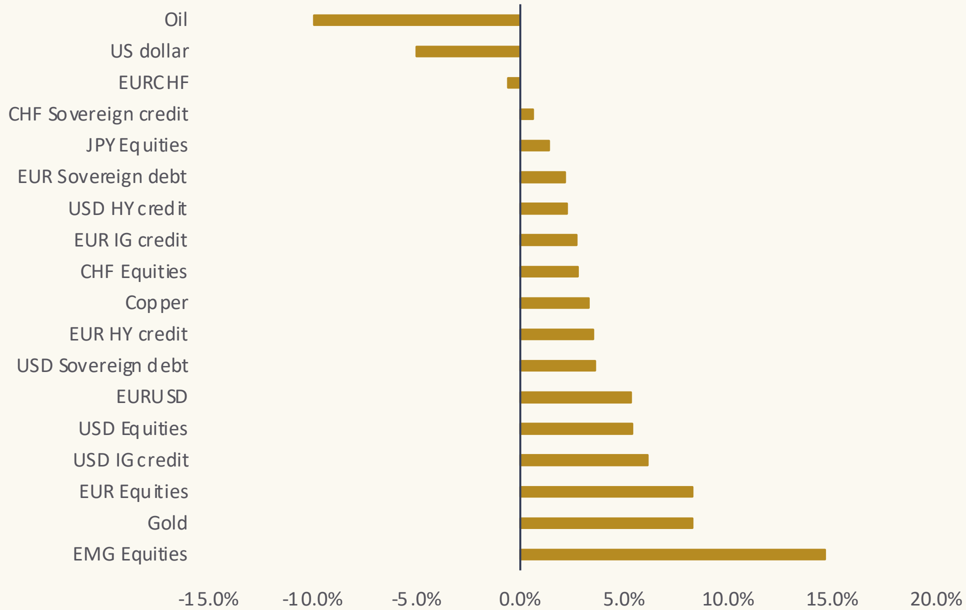
"Most data seem to confirm that the double process of disinflation and slowdown is in motion"

In all, markets' expectations of a 5% terminal rate around the end of Q1 2023 seems about right at this stage.

In the Eurozone, flash PMIs showed a fall in business activity for a 5th consecutive month, but the intensity of the downturn moderated and surprised positively, likely thanks to fewer supply constraints and warm weather allaying fears over energy shortages in the winter. While this is welcome news that worst case scenarios may be averted, the manufacturing sector remains in a severe downturn and service activity under pressure. Meanwhile November CPI showed encouraging signs of softening, at 10.0% YoY at the headline level (from 10.6% last month), while the core print remained at 5%. The ECB remains nonetheless in a difficult place, with its fight against inflation at odds with recessions risks.

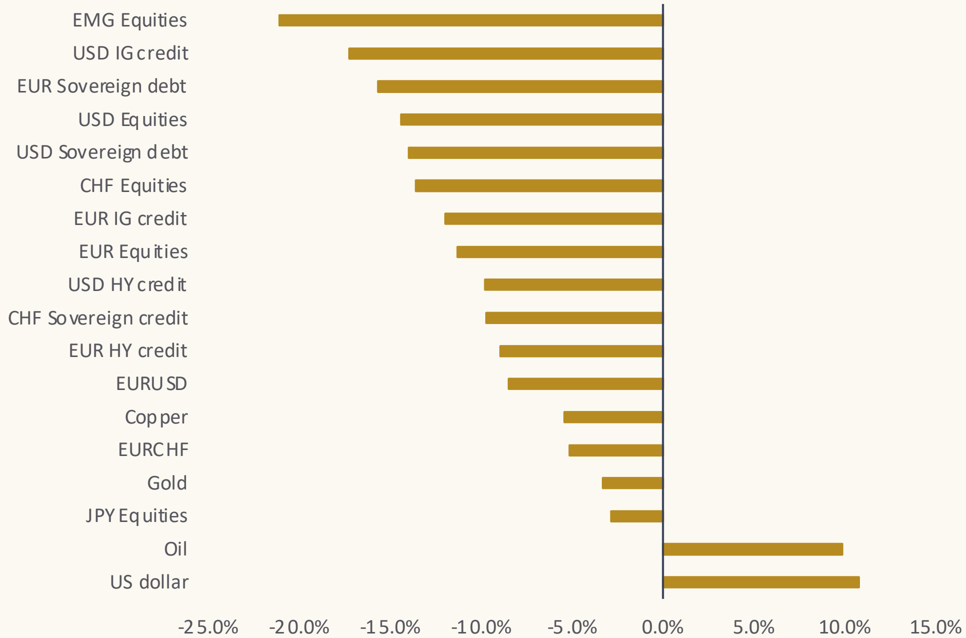
OVERVIEW

MAIN ASSET CLASSES
MONTHLY PERFORMANCE



Source: Bloomberg, from 31/10/2022 to 30/11/2022

MAIN ASSET CLASSES
PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 30/11/2022

MACROECONOMICS (continued)

In **China**, markets have been on a roller coaster last month, with growing clarity on relaxation of "Zero Covid" policies. If sustained, this will, positively, lead to a near-term Chinese growth rebound, and benefit global trade, European exporters, and supply chains.

Yet, **Chinese policymaking remains unpredictable**, with key risks. (1) A turnaround if they lose control over Covid cannot be ruled out. (2) Strategic US-China tensions mean that the risk of Chinese stocks being delisted from US exchanges is structural. (3) Under Xi, the Communist Party has become more ideologically than economically driven. The geopolitical premium required when owning Chinese assets should be greater. Tensions around Taiwan are a real possibility in 2023. (4) The **longer-term Chinese story remains one of structural decline**, with lower potential growth given rapidly ageing demographics, whilst the years when authorities could stimulate unproductive sectors of the economy to lift growth are gone. The transition to high-income status with a strong consumer is not completed and domestic drivers of growth are weak.

We would treat the Chinese "reopening trade" per se as tactical and avoid putting too much structural weight on this bet.

EQUITY MARKETS

Favour quality and low vol as we approach the end of the bear-market rally

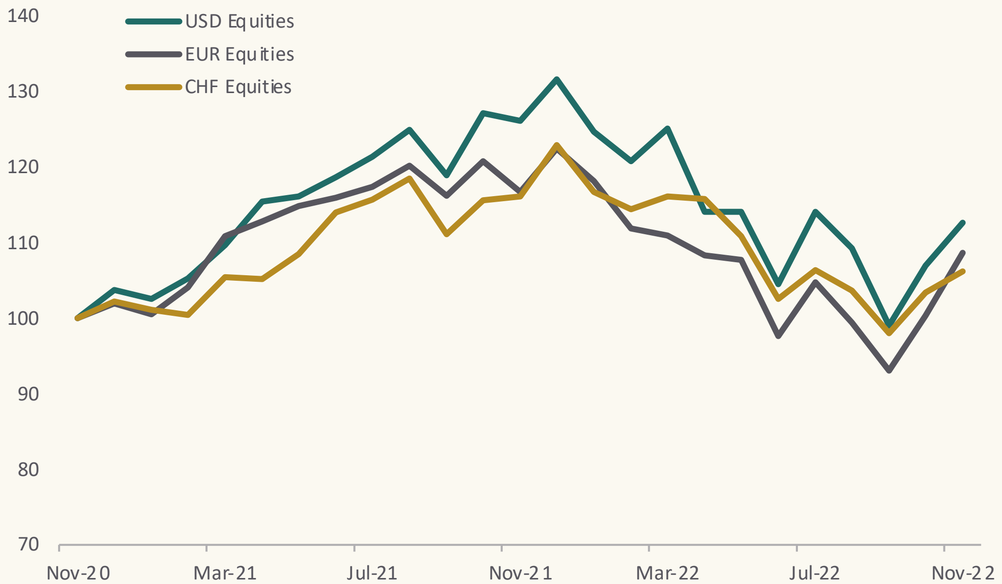
With the Stoxx600 and the S&P up by ~10-15% since the October lows, the bear-market rally is already well advanced. The path of least resistance for markets might still be higher as systematic flows remain supportive and positioning light, and equities could continue to follow the traditional bullish seasonal year-end pattern, helped by falling bond yields.

However, we caution against extrapolating the recent risk-on trend into the new year, amid a still unfavourable growth-policy trade-off and toppish market technical. We continue to favour quality, which is partly composed of GARP stocks (Growth At Reasonable Price), and low volatility strategies, as we approach slowly but surely the end of this bear-market rally.

Meanwhile, the current backdrop is favourable to large size utility & energy companies who are stockpiling large amount of cash. Product manufacturers with high operating leverage, who are highly reliable on green capex, are seeing healthy order growth, and we expect the more positive price/cost environment in FY23 to translate into higher volume and pricing.

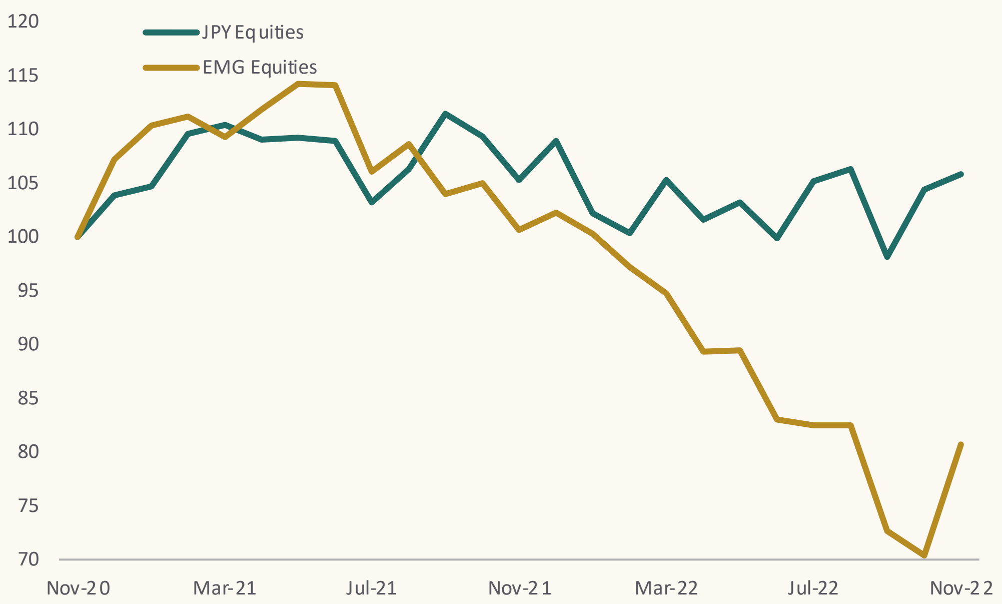
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 30/11/2022

EQUITY MARKETS JAPAN – EMERGING MARKETS
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 30/11/2022

BOND MARKETS

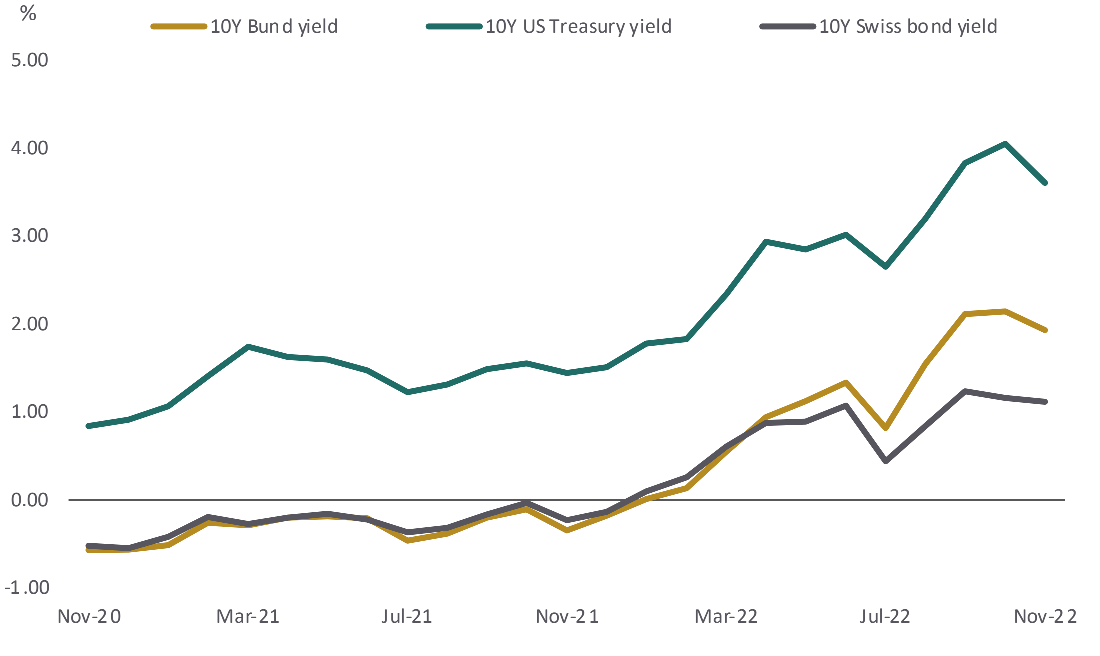
Even after the rally, **corporate credit remains very cheap on all measures**, but especially so for the higher quality segments. However, earnings and credit risks are set to rise materially from here and warrant a more cautious stance on the more levered (High Yield) and cyclical parts of the market.

Financial credit should perform strongly in 2023 as financial institutions are in robust shape, with earnings risk much lower than in previous economic slowdowns thanks to rising margins. Yields and spreads have reached very elevated levels, translating into extremely attractive risk-reward. More specifically, opportunities abound in the more defensive parts of the capital structure (senior and T2) in all major currencies.

Rapid Fed tightening, rise in UST yields and USD strength have contributed to **Emerging Markets**' poor relative performance for a year, but we now expect better performance ahead as markets start to price slower hikes from current implied levels.

"Overweight non-cyclical Investment Grade/BB bonds and financial credit"

10Y SOVEREIGN BOND YIELDS
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 30/11/2022

CURRENCIES

As the Fed signals a slower pace of rate hikes, and the end of the tightening cycle becomes clearer, the USD weakened in November. While a decisive downtrend might not materialise for another few months, the USD's peak may have been already seen.

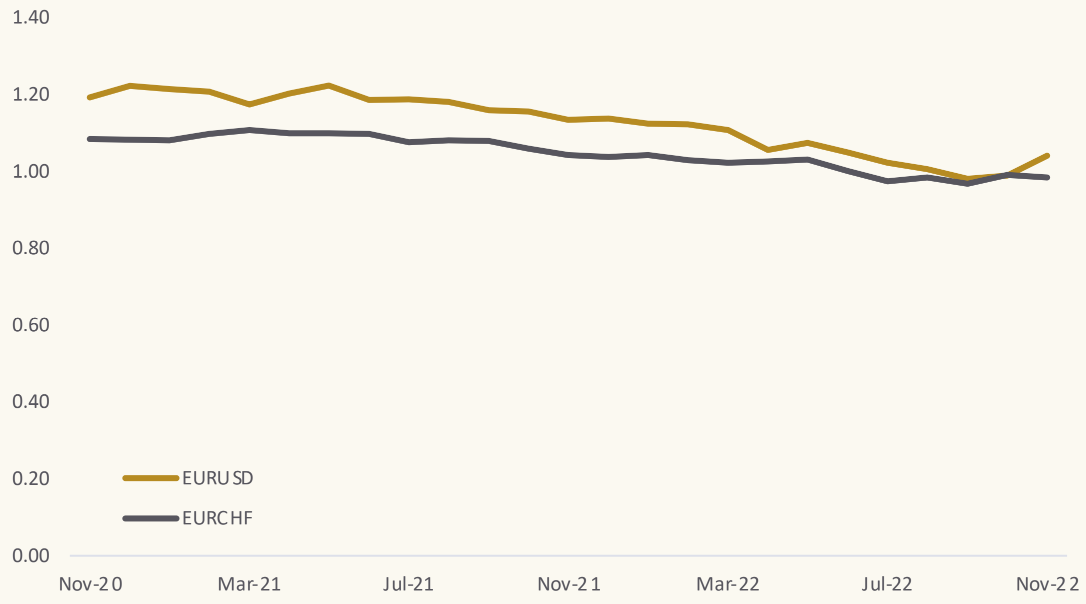
We would expect EUR-USD to remain range-bound a little longer, before likely gradually repricing to around 1.05-1.10 when the timing of the first Fed's rate cut becomes clearer.

We favour EUR versus CHF, as the pair should benefit from monetary policy differential. The ECB is still battling high inflation, while the Swiss National Bank has no reason to hike aggressively given low inflation, and reasons to remain cautious as growth will suffer from a Eurozone recession.

Finally, JPY-USD has started to strengthen with an upcoming Fed's slowdown. As the monetary cycle peaks and approaches a reversal in the US, the JPY may retrace significantly more to the upside.

USD & CHF

EVOLUTION OVER 2 YEARS AGAINST THE EUR



Source: Bloomberg, 30/11/2022

COMMODITIES

OIL

Oil was under downward pressure throughout November as a looming global economic slowdown weighs on demand.

That said, some tightness in energy markets may carry over into 2023 with Russian oil embargoes and low LNG supply growth. In addition, OPEC+ may continue to regularly cut output while the White House said it would refill the SPR at USD72/bbl (WTI).

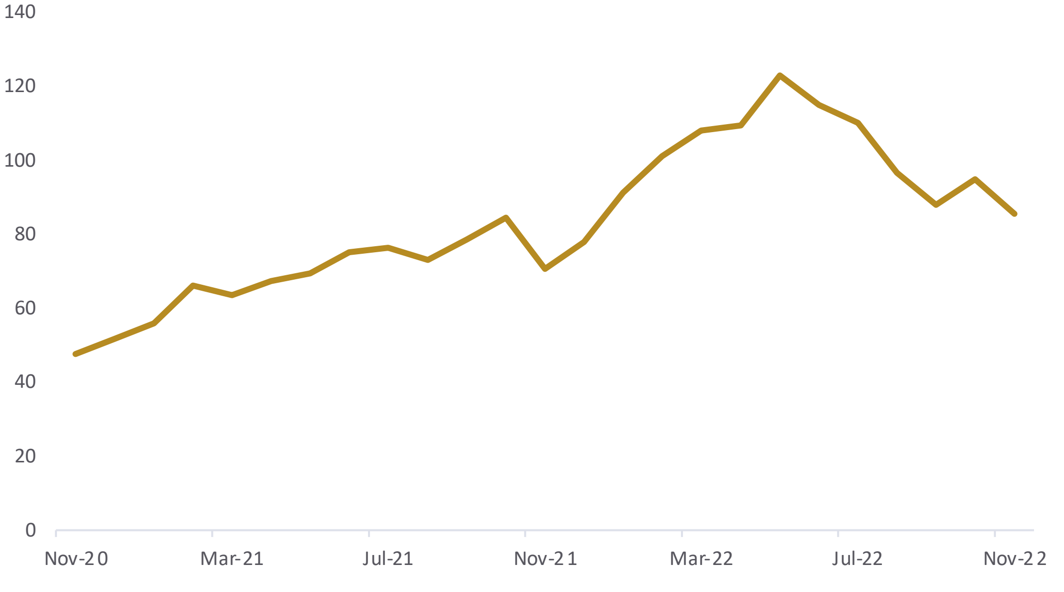
In all, oil prices may remain stuck between competing forces of constrained supply and muted demand into 2023, although the Chinese reopening may provide some support to the demand profile.

In all, we would expect downward pressure with a floor, and still elevated volatility on oil prices.

Oil prices may remain stuck between competing forces of constrained supply and muted demand into 2023

OIL

EVOLUTION OF BRENT PRICES OVER 2 YEARS



Source: Bloomberg, 30/11/2022

COMMODITIES

GOLD

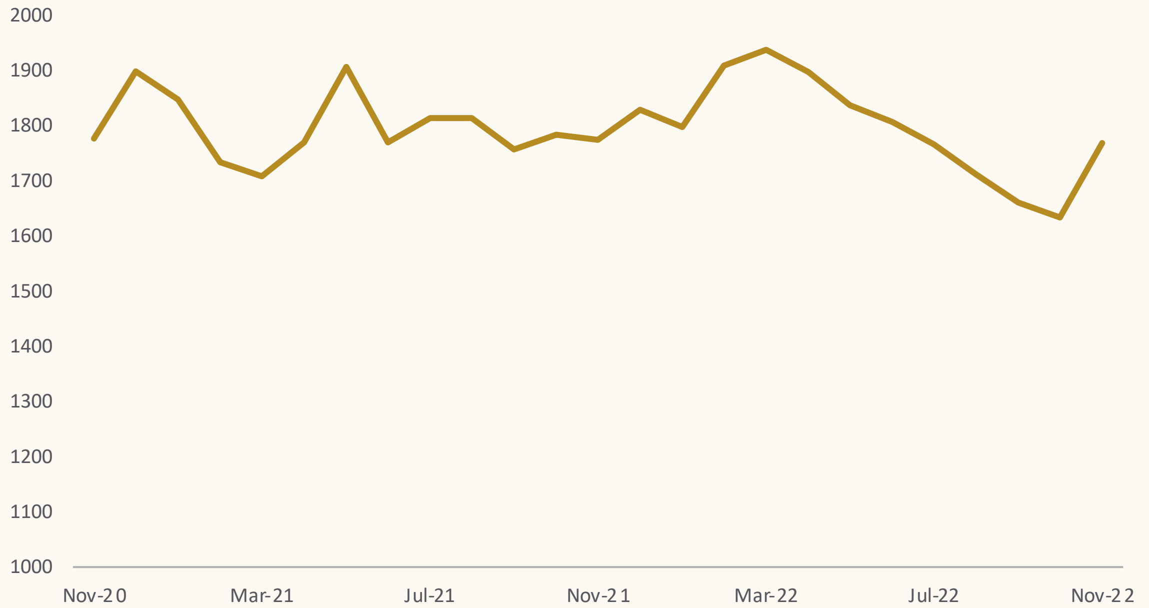
Gold benefitted in November from lower real rates as the Fed signals a slowdown in its hiking cycle pace.

Given still elevated real rates, it might be **a little early** to significantly increase gold exposure.

However, **as recessionary forces materialise and real rates start to compress more significantly, the relative benefit of owning gold will increase**, which might happen sometimes during the first half of 2023.

The relative benefit of owning gold might increase in the months to come, as real rates start to compress

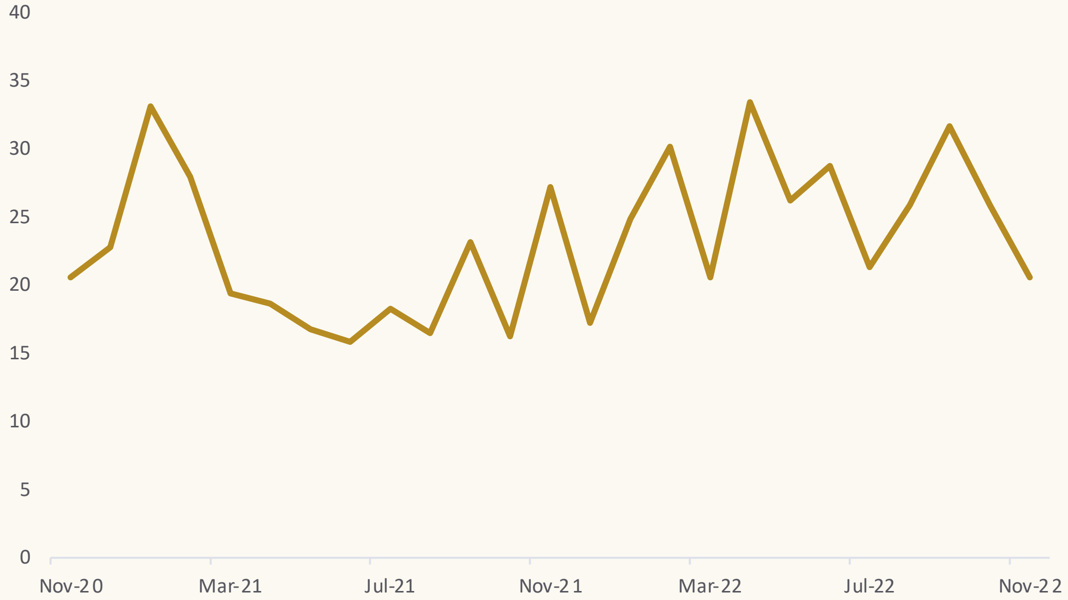
GOLD
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 30/11/2022

VOLATILITY

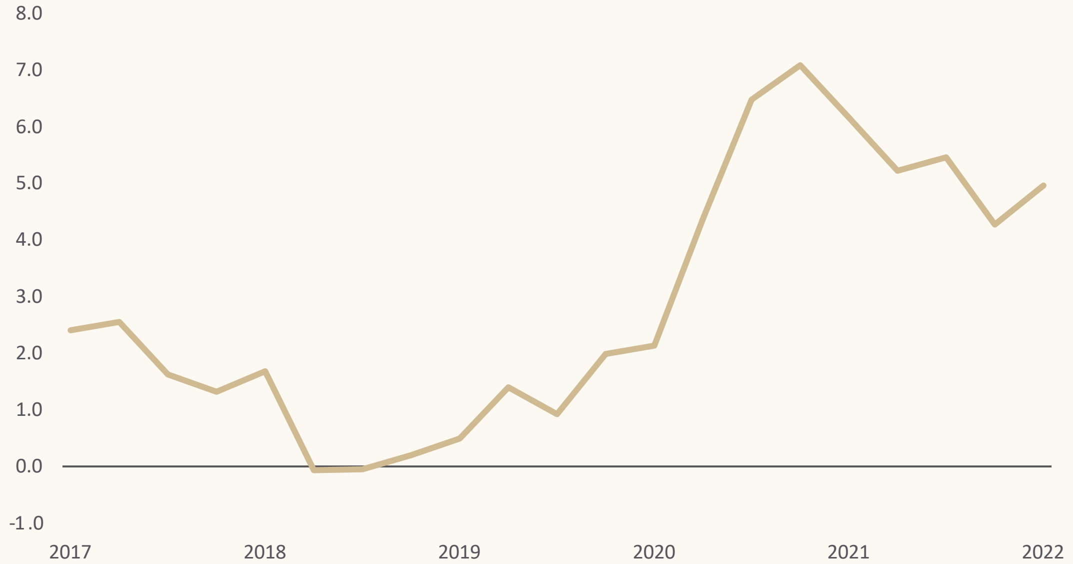
VOLATILITY – VIX INDEX
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 30/11/2022

REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE
ANNUAL PRICE CHANGE



Source: Bloomberg, 30/11/2022

CALENDAR

Date	Country	Economic Data	Period	Previous
02 December	US	Employment (000s)	Dec-22	263,0
	US	Unemployment Rate (%)	Dec-22	3,7
05 December	US	ISM Non-Manufacturing Index	Nov-22	54,4
	Eurozone	Markit Services PMI	Dec-22	48,6
	UK	Markit Services PMI	Dec-22	48,8
07 December	China	Exports (YoY)	Nov-22	-0,3
	Eurozone	Employment (QoQ)	Dec-22	0,2
	Eurozone	Real GDP (QoQ)	Dec-22	0,2
	Germany	Industrial Production (MoM)	Oct-22	0,6
	Switzerland	Unemployment Rate (%)	Nov-22	2,1
08 December	Japan	Real GDP (QoQ)	Dec-22	-1,2
09 December	US	Consumer Confidence	Dec-22	56,8
	China	Inflation (YoY)	Nov-22	2,1
13 December	US	Inflation (YoY)	Nov-22	7,7
	UK	Unemployment Rate (%)	Oct-22	3,6
14 December	US	Federal Reserve Interest Rate (%)	Dec-22	4,0
	Eurozone	Industrial Production (MoM)	Oct-22	0,9
	UK	Inflation (YoY)	Nov-22	11,1
	Japan	Industrial Production (MoM)	Nov-22	-2,6
15 December	US	Industrial Production (MoM)	Nov-22	-0,1
	US	Philadelphia Fed Business Survey	Dec-22	-19,4
	China	Retail Sales (YoY)	Nov-22	-0,5
	China	Industrial production (YoY)	Nov-22	4,0
	Eurozone	ECB Interest Rate (%)	Nov-22	1,5
15 December	UK	Bank of England Interest Rate (%)	Jan-23	3,0
16 December	Eurozone	Markit Manufacturing PMI	Dec-22	47,1
	UK	Markit Manufacturing PMI	Dec-22	46,5
	Japan	Nikkei Manufacturing PMI	Dec-22	49,0
19 December	Germany	Ifo Business Climate	Dec-22	86,3
20 December	Japan	Bank of Japan Interest Rate (%)	Nov-22	-0,1
22 December	US	Real GDP (QoQ)	Dec-22	2,9
	UK	Real GDP (QoQ)	Dec-22	-0,2
30 December	Switzerland	KOF Leading Indicator	Dec-22	89,5

LET'S TALK ABOUT IT.

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DISCLAIMER