Investment letter

Monthly review of global financial markets

SWISS CAPITAL IB

May 2023

MACROECONOMICS

April brought further evidence of a slowing, yet resilient US economy.

The labour market was still tight but softening in March, with 236k jobs created, a high number compared to pre-Covid norms, but less abnormal than has been the case in some recent instances. Importantly for the Fed, average hourly earnings dropped to 4.2% YoY from 4.6% in February and jobs opening fell below 10mn in February for the first time since May 2021.

March CPI came in a touch softer than expected with headline falling sharply from 6.0% YoY to 5.0% thanks to falling energy prices. The "core" measure remains sticky at 5.6%, with a tentative bright spot in the slower pace of rent gains but still pressures from goods and labour-sensitive services.

In all, this uneven deterioration in data will allow the Fed to hike early May, and probably keep options open for one possible last hike in June. Anyhow, the end of the hiking cycle is near, with tighter credit conditions on track to finish the Fed's job.

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In the Eurozone, headline inflation fell significantly YoY in March from 8.5% to 6.9%, thanks to firmly negative energy base effects, but core CPI remained sticky and elevated at 5.7%.

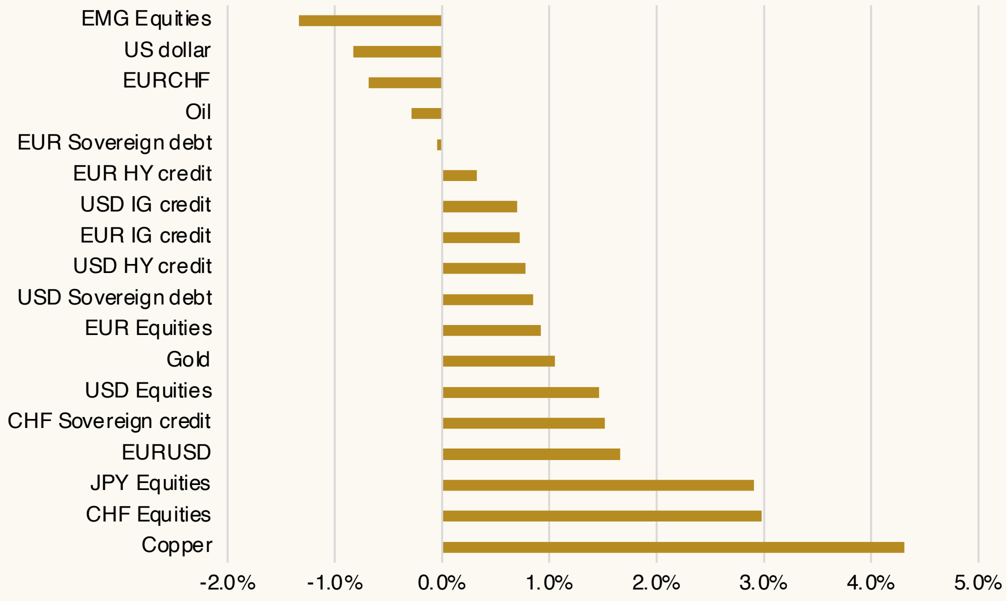
With the soundness of the European banking sector reaffirmed, this will likely keep the ECB hawkish. Yet, the cumulative tightening so far is significant and will likely affect inflation and activity more than commonly thought over the next 18 months, with the monetary base M1 now contracting from a year ago for the first time in history. The ECB only started to raise interest rates 9 months ago and the current level of monetary restraint – assuming a neutral rate around ~1.5% – has never been so high, making a recession in the next 12 months likely.

We also learnt in April that China grew 4.5% YoY in the first quarter, the fastest pace in a year, on track to meet its 5% growth objective for 2023 without the need for major stimulus.

Services unsurprisingly lead the recovery with a robust 5.4% YoY growth, as household spending increases amid a declining savings rate while the manufacturing sector lags with 3.3% YoY growth in Q1, a slower-than-expected pace of recovery.

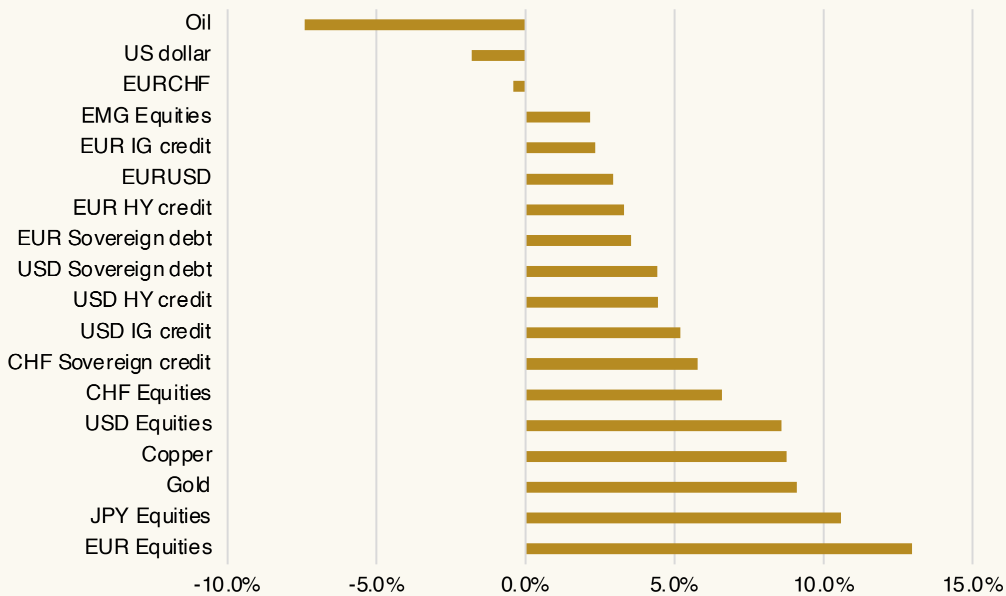
OVERVIEW

MAIN ASSET CLASSES
MONTHLY PERFORMANCE



Source: Bloomberg, 28/04/2023

MAIN ASSET CLASSES
PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 28/04/2023
Past performance is not indicative of future performance

MACROECONOMICS (CONTINUED)

Going forward, domestic demand will likely remain supported by better labour market conditions as the strong services' recovery should be labour-intensive (although the near record-high youth unemployment rate remains an issue) and by continued recovery in the property sector, with the number of cities with home prices up on a monthly basis (64 out of 70) at the highest level since May 2019.

However, we shouldn't expect this recovery to match previous construction-led and credit-fuelled business cycles in terms of global growth impact. Retail sales are mostly a domestic story, with a very small portion of purchases by retail firms being imported.

EQUITY MARKETS

Equities have continued to grind higher in April, as banking stress receded, activity held up and early Q1 earnings managed to beat the lowered expectations. Although Europe outperformed the US, sector leadership turned more defensive and cross-asset flows were tilted towards bonds and cash.

The banking-stress-induced sell-off and rotation back towards more safety-type assets of March largely reversed in April. Equities rebounded further, led by global ex-US developed markets, along with commodities.

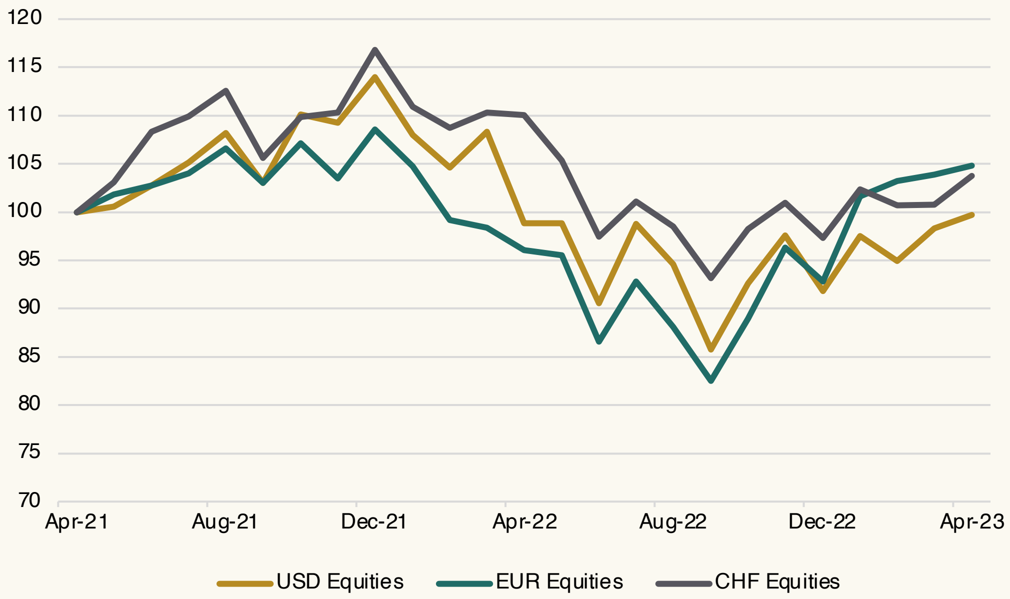
In April, developed markets equities comfortably outperformed emerging markets

Developed markets equities, led by Europe once again, comfortably outperformed emerging markets, which was flat overall. Within Europe, FTSE 100 and CAC 40 outperformed, while Dax and IBEX lagged.

Leadership was more defensive despite the higher equity market, although some cyclical sectors still managed to deliver positive returns. Globally, the Energy sector bounced the most on the unexpected output cuts from OPEC+. Luxury was strong, helped by China-related earnings beats, while some other consumer-related sectors such as Consumer Services/Leisure, and Retailing also outperformed. However, both Financials and many of the defensive sectors, such as Utilities, Healthcare and Staples, did well too. The only sectors to deliver negative performance in April were some of this year's leaders – Media, Semiconductors and Automotives, while Industrials and Materials also lagged.

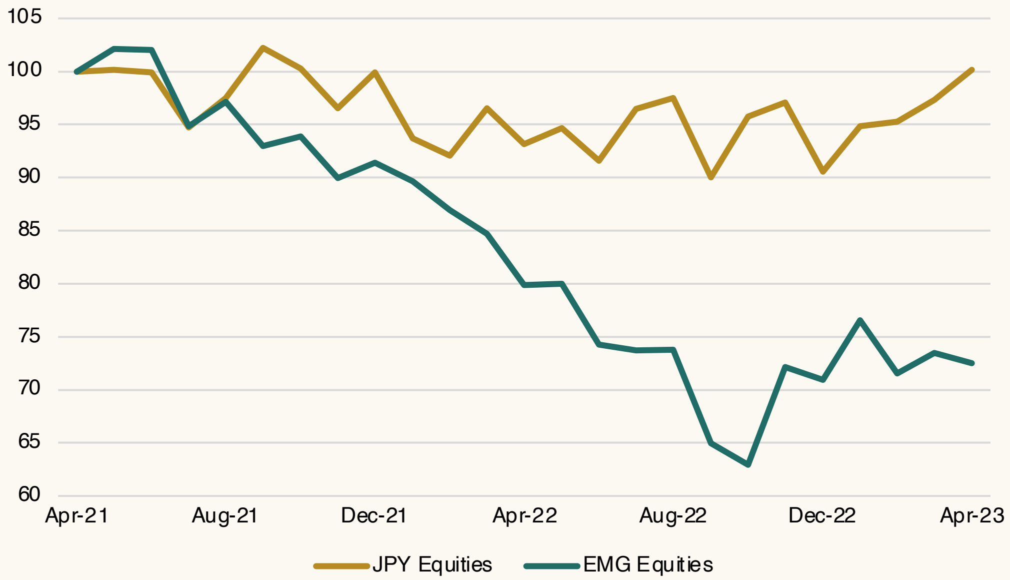
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 28/04/2023

EQUITY MARKETS JAPAN – EMERGING MARKETS
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 28/04/2023
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BOND MARKETS

The banking industry remained at the centre of attention following March's events, with various themes confirmed:

- Poorly managed US regional banks with ALM vulnerabilities continue to struggle as expected, with the FDIC taking over First Republic Bank before a sale to JPM;

- Large US financial institutions benefitted from US regional bank woes by attracting deposits and in some cases, participating in consolidation at attractive terms;

- No deposit contagion has been observed in Europe as banks' liquidity positions remain strong;

- CRE scrutiny has logically moved up investors' attention and while this will lead to higher levels and dispersion in US banks' cost of risk, it represents a much more negligible issue for European banks (lower exposure and much more compelling risk distribution);

- Finally, both Lloyds and Unicredit announced calls of AT1 securities, a sign of confidence in the strength of balance sheets.

Government bond yield curves moved sideways in April as relief from waning banking woes was offset by weakening inflation and economic leading indicators.

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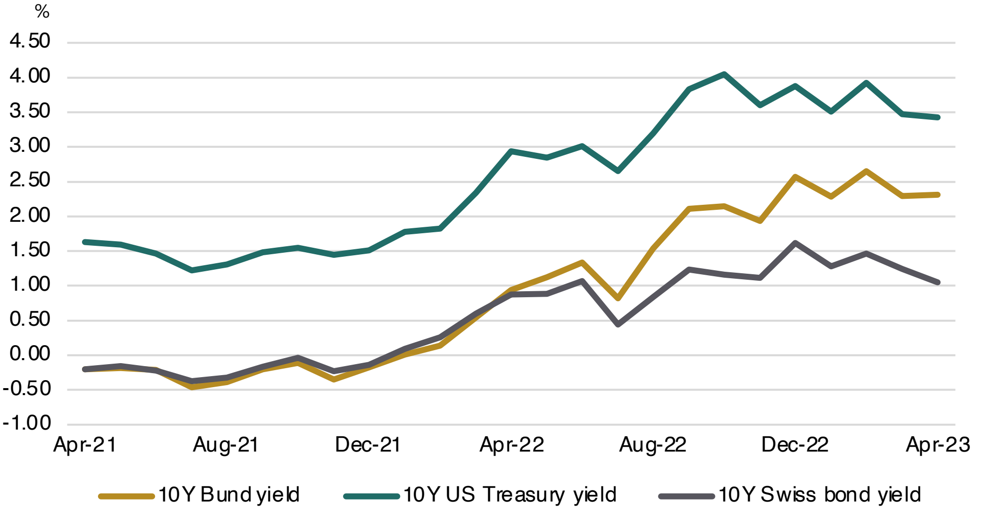
10Y SOVEREIGN BOND YIELDS
EVOLUTION OVER 2 YEARS



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CURRENCIES

After weakening in March as the banking turmoil led to a significant downward repricing of the Fed's terminal rate, the USD remained rangebound in April. Whilst the terminal rate should indeed be reached soon, markets' rate cuts' expectations may be a bit premature. A repricing of cuts later in time may support the USD somewhat in the short-term, although further banking instability would play in the other direction, potentially leading to volatility and a lack of direction for the currency.

In the medium-term, we believe the 2022 USD peak will not be revisited, but also recognize its safe-haven attribute, which could provide a support once recession starts in earnest.

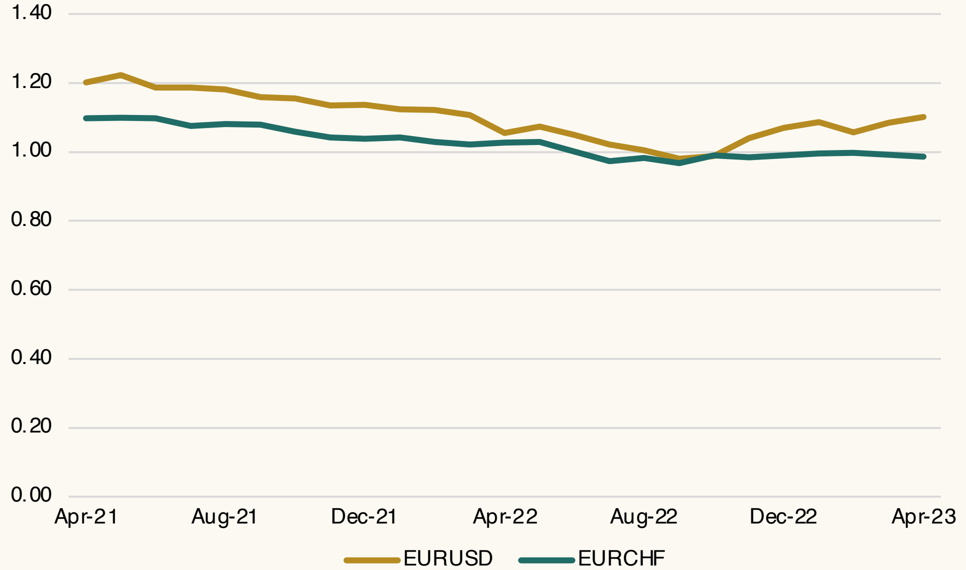
We believe the EUR-USD fair value to be around 1.10-1.15. If the ECB follows up on its relatively hawkish message, the EUR could remain supported against the USD. However, a recession would likely weigh on the pair.

EUR-CHF might remain range-bound as it is still unknown how much confidence has been affected by recent issues with Credit Suisse. On the other hand, high Swiss headline inflation has led to a hawkish message from the SNB, a potential support for the CHF. In addition, the CHF tends to outperform in global downturns.

There is also significant upside to the JPY. The driver of the yen's decline in 2022 has been exclusively monetary policies' divergence between Japan and the rest of the world, which will eventually fade. The yen would also benefit from any tweaks to the Bank of Japan's policy settings, and it tends to outperform during global slowdowns.

USD & CHF

EVOLUTION OVER 2 YEARS AGAINST THE EUR



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COMMODITIES

OIL

The oil market remains stuck between competing forces of constrained supply and slower global growth.

On the supply side, OPEC's unexpected production cuts' announcement early April will likely put a floor under oil prices, probably around 80$.

On the demand side, China alone will not suffice to lift energy prices to new highs in the face of an upcoming significant global economic slowdown, which will likely trigger selling pressures whenever oil prices surpass 90$ for too long.

As such, we expect oil prices to trade in a ~80-90 range over the next few quarters.

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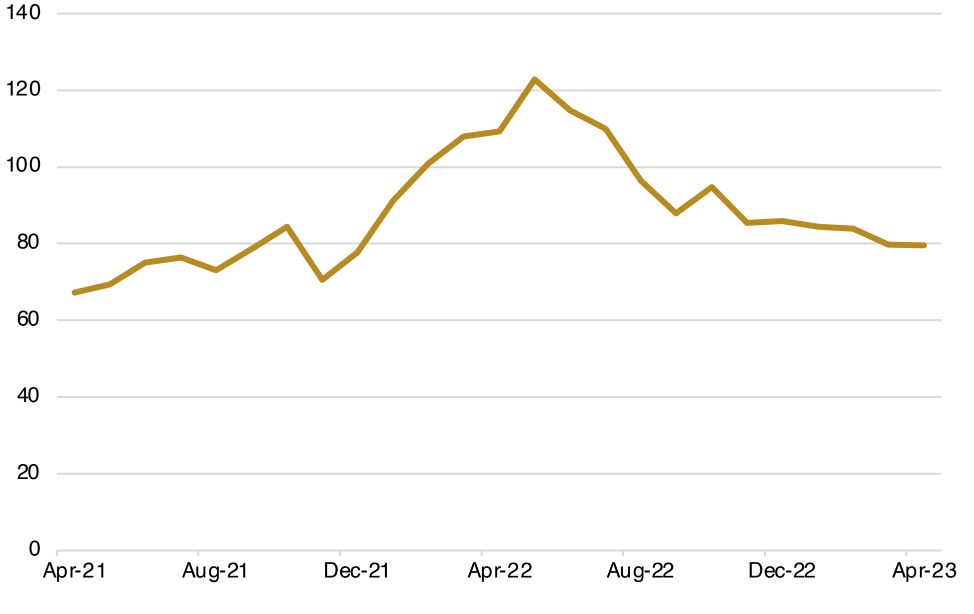
OIL
EVOLUTION OF BRENT PRICES OVER 2 YEARS



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COMMODITIES

GOLD

Gold has been volatile so far this year, hesitating between pricing a recession and the eventual rate cuts that will accompany it, or pricing continued monetary pressure from central banks in the face of a still resilient economy.

In terms of sequence, banking turmoil's stabilisation could lead to a short-term pull-back in Gold from close to 2000, where the upside potential seems limited.

A better setting to add Gold might open in the next few months, at lower price levels.

Anyhow, with central banks' strong demand and an upcoming recession, Gold should remain supported over the next 12 months.

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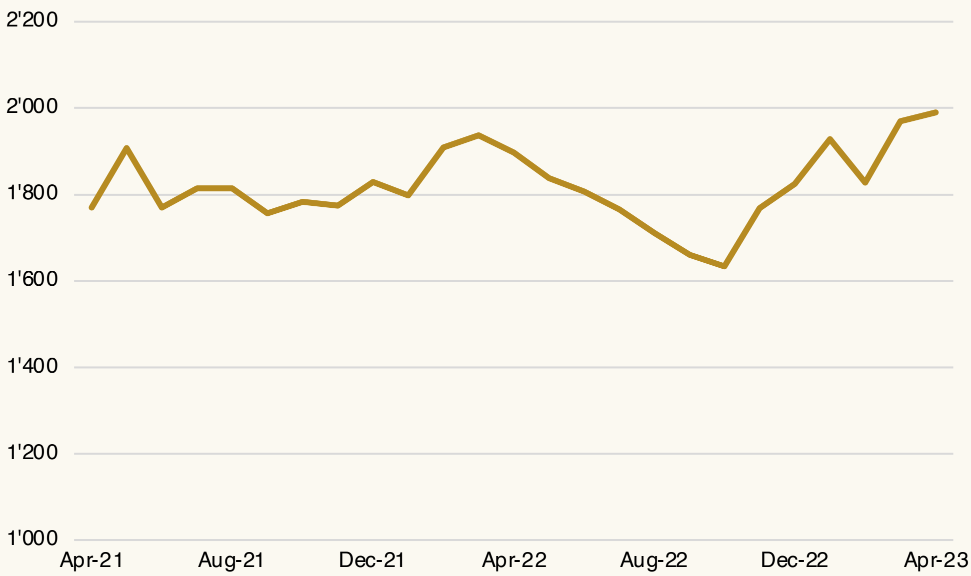
GOLD
EVOLUTION OVER 2 YEARS



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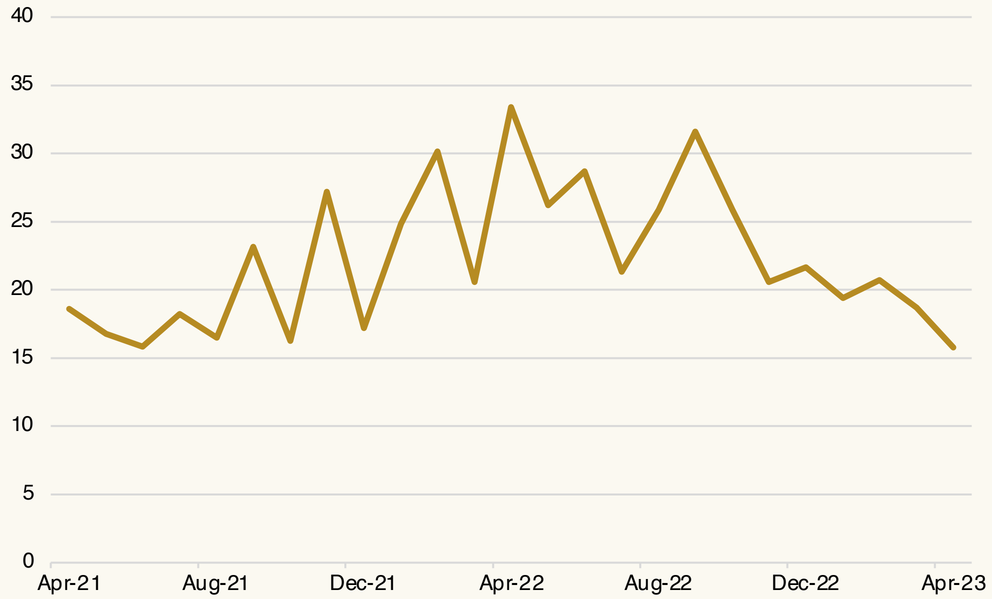
VOLATILITY

VOLATILITY – VIX INDEX
EVOLUTION OVER 2 YEARS



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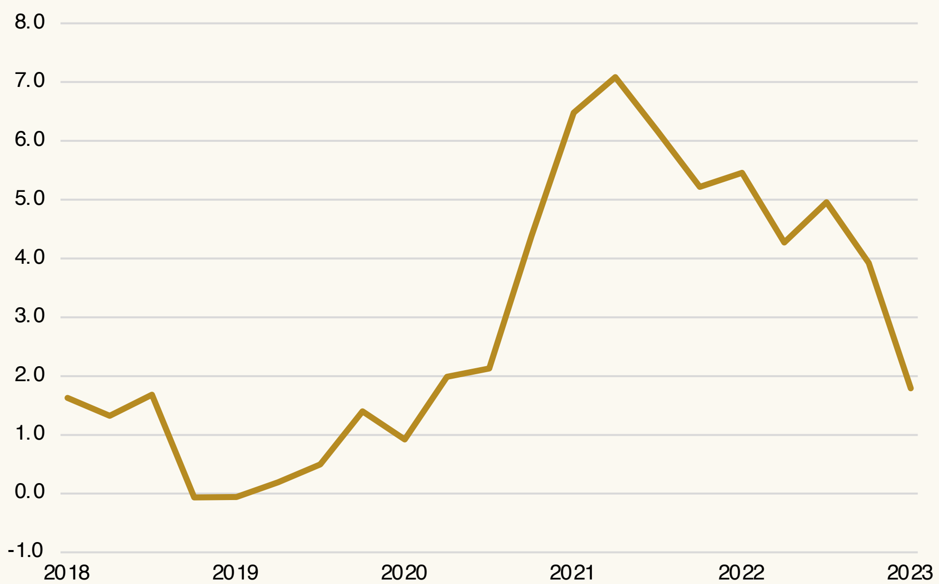
REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE
ANNUAL PRICE CHANGE



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CALENDAR

Date	Country	Economic Data	Period	Previous
02 May	Eurozone	Inflation (YoY)	May-23	7,0
02 May	Eurozone	Markit Manufacturing PMI	May-23	45,8
02 May	UK	Markit Manufacturing PMI	May-23	47,8
02 May	Switzerland	Manufacturing PMI	May-23	45,3
03 May	US	Federal Reserve Interest Rate (%)	Apr-23	5,0
03 May	US	ISM Non-Manufacturing Index	Apr-23	51,2
03 May	Eurozone	Unemployment Rate (%)	Mar-23	6,6
04 May	China	Caixin Manufacturing PMI	Apr-23	50,0
04 May	Eurozone	Markit Services PMI	May-23	56,6
04 May	Eurozone	ECB Interest Rate (%)	Apr-23	3,0
04 May	UK	Markit Services PMI	May-23	54,9
05 May	US	Employment (000s)	Apr-23	236,0
05 May	US	Unemployment Rate (%)	Apr-23	3,5
05 May	Switzerland	Unemployment Rate (%)	Apr-23	1,9
05 May	Switzerland	Inflation (YoY)	Apr-23	2,9
08 May	Germany	Industrial Production (MoM)	Mar-23	2,0
09 May	China	Exports (YoY)	Apr-23	14,8
10 May	US	Inflation (YoY)	Apr-23	5,0
11 May	China	Inflation (YoY)	Apr-23	0,7
11 May	UK	Bank of England Interest Rate (%)	Jun-23	4,3
12 May	US	Consumer Confidence	May-23	63,5
12 May	UK	Real GDP (QoQ)	Mar-23	0,1
15 May	Eurozone	Industrial Production (MoM)	Mar-23	1,5
16 May	US	Industrial Production (MoM)	Apr-23	0,4
16 May	China	Retail Sales (YoY)	Apr-23	10,6
16 May	China	Industrial production (YoY)	Apr-23	3,0
16 May	Eurozone	Employment (QoQ)	Mar-23	0
16 May	Eurozone	Real GDP (QoQ)	Jun-23	0,1
16 May	UK	Unemployment Rate (%)	Mar-23	3,8
17 May	France	Unemployment Rate (%)	Mar-23	7,2
17 May	Japan	Industrial Production (MoM)	Apr-23	0,8
17 May	Japan	Real GDP (QoQ)	Mar-23	0,1
18 May	US	Philadelphia Fed Business Survey	May-23	-31,3
23 May	Japan	Nikkei Manufacturing PMI	May-23	49,5
24 May	US	Fed minutes	Mar-24	
24 May	UK	Inflation (YoY)	Apr-23	10,1
24 May	Germany	Ifo Business Climate	May-23	93,6
25 May	US	Real GDP (QoQ)	Jun-23	1,1
25 May	Germany	Real GDP (QoQ)	Jun-23	0,0
30 May	Switzerland	Real GDP (QoQ)	Mar-23	0,0
30 May	Switzerland	KOF Leading Indicator	May-23	96,4
31 May	France	Real GDP (QoQ)	Jun-23	0,2
31 May	Italy	Real GDP (QoQ)	Jun-23	0,5

LET'S TALK ABOUT IT.

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DISCLAIMER