Investment letter

Monthly review of global financial markets

SWISS CAPITAL IB

April 2023

MACROECONOMICS

The month of March 2023 will certainly be one to remember with the failing of a few US mid-size banks, and turmoil around Credit Suisse (CS) triggered by a statement of one of its largest shareholders, the Saudi National Bank, ruling out further investment.

Those events have been addressed by swift official reactions.

In the US, the Fed, the FDIC (Federal Deposit Insurance Corporation) and the Treasury announced a solid backstop for banks (lending facility) to prevent broader runs on deposits. And for CS, the FINMA (Swiss financial market's supervisor) and the Swiss National Bank reacted quickly, eventually leading to an organised historic merger with UBS.

In this uncertain context, the ECB sticked to its pre-announced 50bps hike on March 16th, from 2.5% to 3% on the depo rate, reassuring markets that there was no reason to panic, while confirming their determination to fight inflation. They also dropped all forward guidance, linking future decisions to economic data and monetary policy transmission.

> JEROME POWELL'S (FED CHAIR) PRESS CONFERENCE WAS DOVISH AND RESEMBLED THE FAMOUS PIVOT MARKETS HAD BEEN EXPECTING FOR SO LONG

By not pre-committing to future hikes, they now have full optionality in case tail risks materialise. Their strong – and legitimate – statement on the soundness of the financial system in Europe and availability of ECB tools to react was aimed at preserving confidence and being able to continue hiking until inflation drops more.

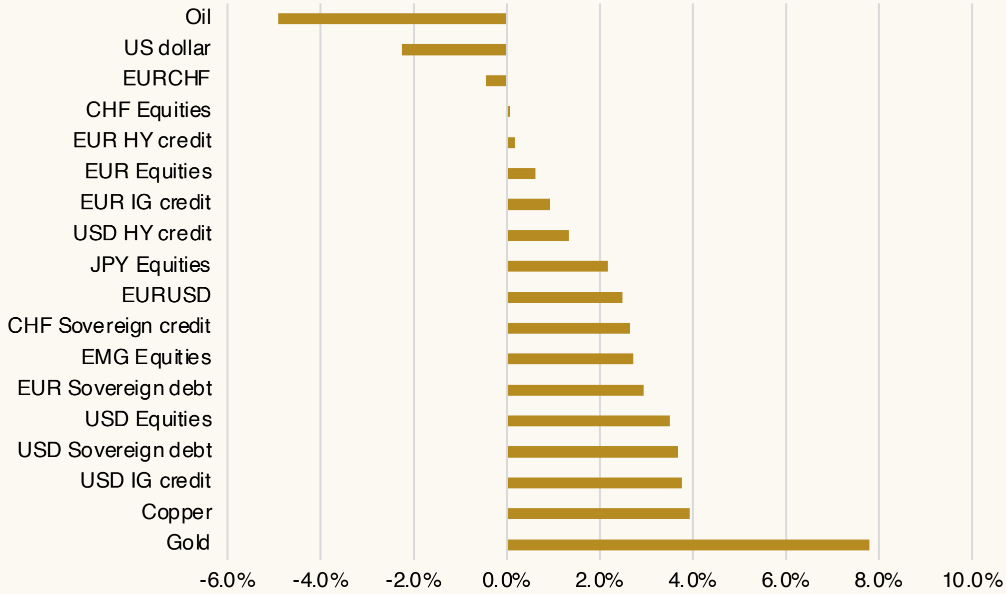
The Fed met a week later, and delivered a 25bps hike, as mostly expected. That said, Powell's press conference was dovish and resembled the famous pivot markets had been expecting for so long, with three key messages.

First, recent events are a game-changer for the Fed, as they tighten monetary conditions to a "difficult-to-assess" extent and should be considered as substitutes for hikes. With the Fed 2023 median "dot" staying at 5.1%, this hike was likely the last one, or prior to last.

A soft landing has officially become an extremely improbable prospect, with Powell acknowledging that the impact of the banking turmoil on credit tightening is likely to be "quite real", while saying that it is too early to say whether a soft landing can still be achieved. He will now likely try to calibrate policy to limit the depth of recession.

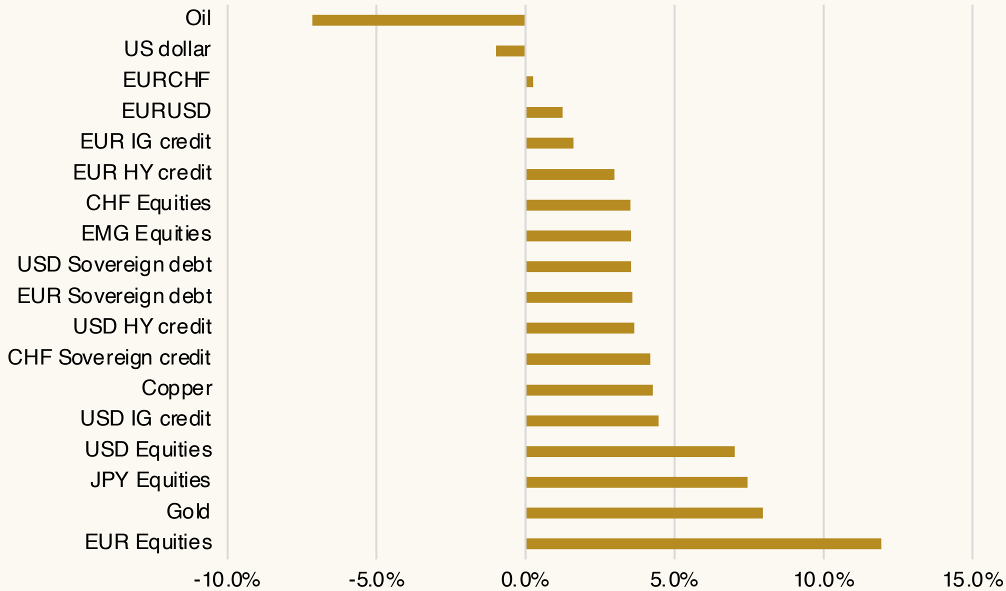
OVERVIEW

MAIN ASSET CLASSES
MONTHLY PERFORMANCE



Source: Bloomberg, 31/03/2023

MAIN ASSET CLASSES
PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 31/03/2023
Past performance is not indicative of future performance

MACROECONOMICS (CONTINUED)

The end of the tightening cycle is around the corner. The question is now shifting to the timing of the first rate cut. A wide gap has opened between markets, which expect cuts as soon as this summer, and the Fed, which insists it is not their base case. The reality will likely be data-dependent, with recession and/or financial instability triggering the first cut.

Meanwhile, March PMIs surprisingly comfortably beat expectation, with the Composite at 53.3, well in expansion. However, the uptick is uneven, largely driven by Services. The small rise in Manufacturing (still in contraction) came mainly thanks to improved supply chains, but new orders, the best leading indicator, has fallen for 6 straight months.

In all, we keep our long-held view that this inflationary cycle will end with a recession, like all traditional "boom-bust" economic cycles.

EQUITY MARKETS

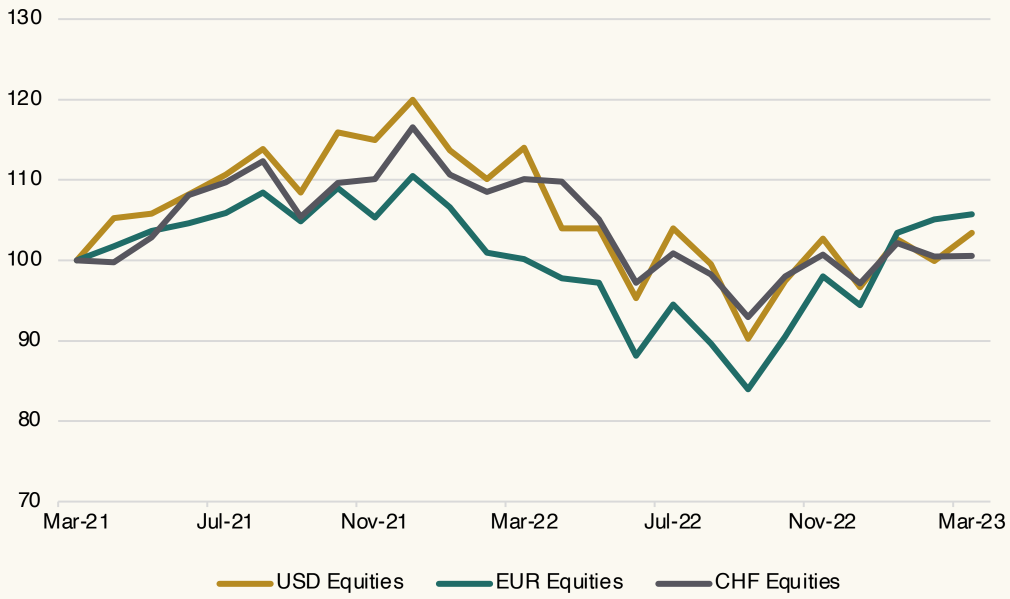
Cross-asset dynamics reversed sharply in March initially with the collapse of SVB in the US and the subsequent issues with Credit Suisse in Europe. Equities, especially in Europe, bore the brunt of the pain. Still, risk assets reversed direction again towards the end of the quarter as the crisis came under control.

In March, global equity returns were marginally positive…

In March, global equity returns were marginally positive, with emerging markets just managing to outperform developed markets. Long-duration US equities led the way as rates expectations fell notably. Europe, particularly the financials-heavy peripheral markets, suffered declines as banks woes dominated the market narrative. Duration and defensive trades performed better in March as risk assets were shaken, leading to Tech and Communication Services finishing at the top. Financials, Real Estate and Energy got hurt the most, given their high tilt to credit/real economy. Return profiles in March were a bit different with value enduring much pain from Bank/Energy underperformance and recession concerns. Low Vol and Quality were in high demand along with Growth as safety concerns came to the forefront amid declining rates. High beta small caps were down sharply while Momentum continued to underperform.

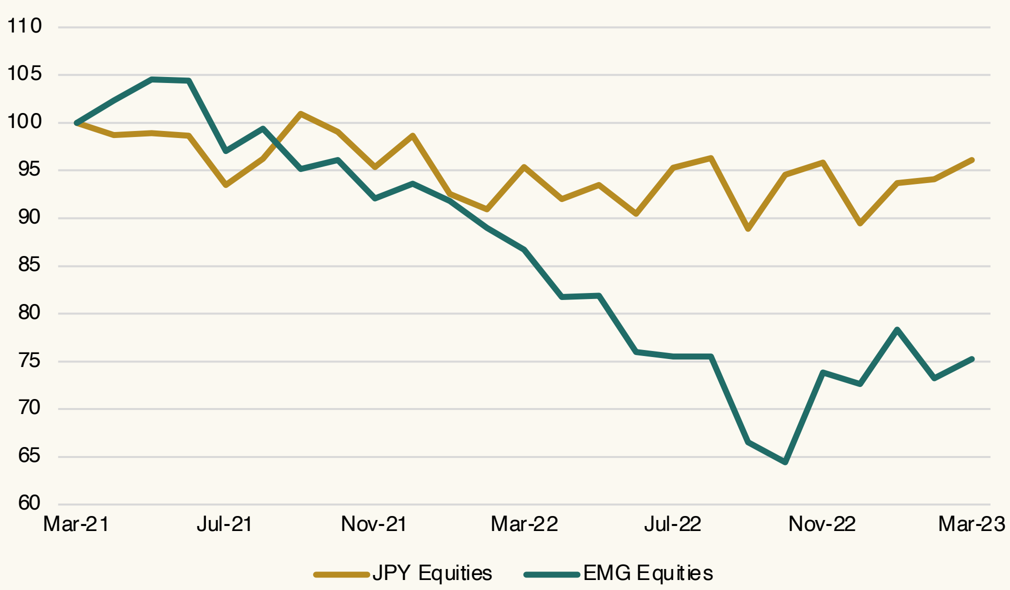
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 31/03/2023

EQUITY MARKETS JAPAN – EMERGING MARKETS
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 31/03/2023
Past performance is not indicative of future performance

BOND MARKETS

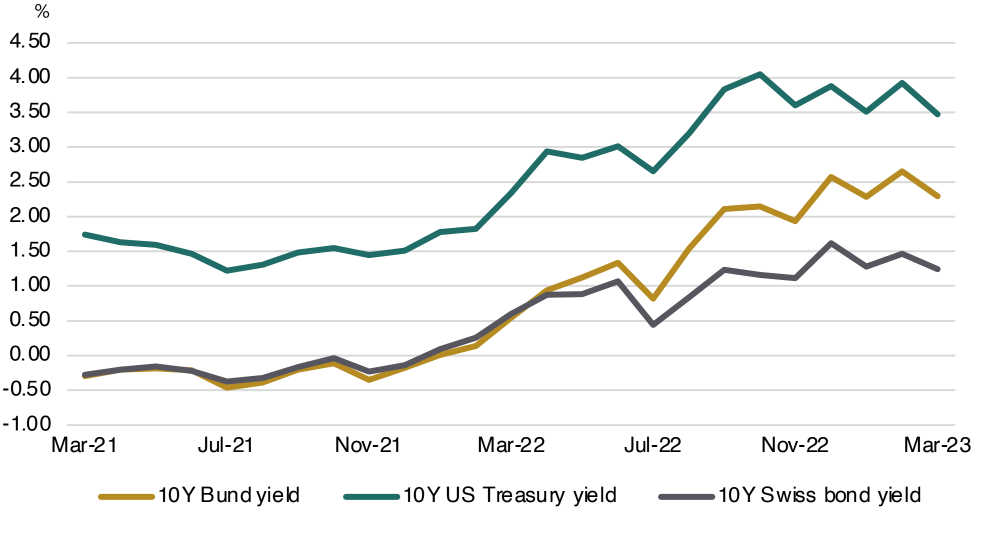
Government bond yield curves bull steepened as concerns around the lasting impact of the US regional banking stress on lending standards and wider financial conditions imply a lower terminal rate. Importantly, correlation between core government bonds and risk assets dropped materially, and we expect this correlation breakdown to extend in coming quarters.

Banking risk dominated financial markets' narratives in March, and recent events reminded the market of the importance of a bank's liability structure and its profitability. This was a crisis of confidence and liquidity and is highly unlikely to morph into a repeat of the Great Financial Crisis.

Bank credit logically underperformed, with AT1s exhibiting heightened volatility following the permanent write-down of the Credit Suisse. Beyond the loss associated with Credit Suisse AT1s within the financial credit space, the hierarchy of claims wasn't respected with an emergency ordinance providing the legal basis. This amplified the selloff, with significant outflows from large funds and forced sellers met by deep demand from hedge funds, distressed funds and flexible bond funds. With US regional banks and Credit Suisse considered as specific and not systemic issues and with EU bank fundamentals in as good a shape as one can remember, this created one of the most compelling buy opportunities in a very long time.

> WITH MONETARY POLICY AT VERY RESTRICTIVE LEVELS, CORRELATION BETWEEN GOVERNMENT BONDS AND RISK ASSETS HAS DROPPED MATERIALLY

10Y SOVEREIGN BOND YIELDS
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 31/03/2023
Past performance is not indicative of future performance

CURRENCIES

The USD weakened in March as banking turmoil led to a significant repricing of the Fed's terminal rate on the downside. Whilst the terminal rate should indeed be reached soon, markets' pricing of rate cuts in the summer 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.

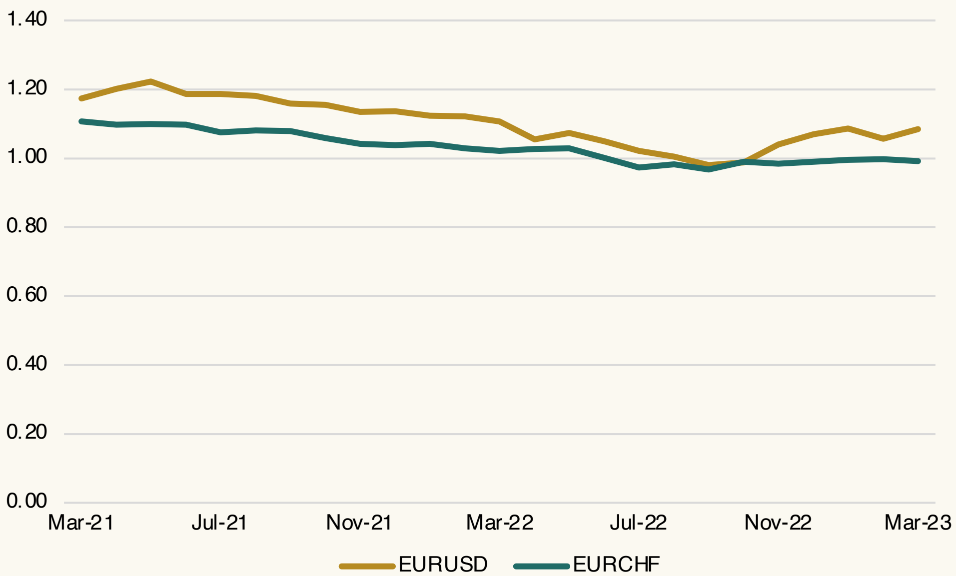
We believe the EUR-USD fair value to be around 1.10-1.15. If the ECB follows up on its relatively hawkish message, the EUR could remain supported against the USD. However, a recession would likely weigh on the pair.

EUR-CHF might remain range-bound as it is still unknown how much confidence could/has been affected by recent issues with Credit Suisse. On the other hand, Swiss headline inflation close to a 30-year high 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-USD pair. The driver of the yen's decline in 2022 has been exclusively monetary policy divergence between Japan and the US, which will eventually to fade. The yen would also benefit from any further 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



Source: Bloomberg, 31/03/2023

Past performance is not indicative of future performance

COMMODITIES

OIL

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

While the swift reopening of China may add some demand, this should not suffice to lift energy prices to new highs.

We continue to believe that a significant economic slowdown in the latter part of the year will limit the upside potential to energy prices.

We continue to believe that a significant economic slowdown in the latter part of the year will limit the upside potential to energy prices

OIL
EVOLUTION OF BRENT PRICES OVER 2 YEARS

Source: Bloomberg, 31/03/2023
Past performance is not indicative of future performance

COMMODITIES

GOLD

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

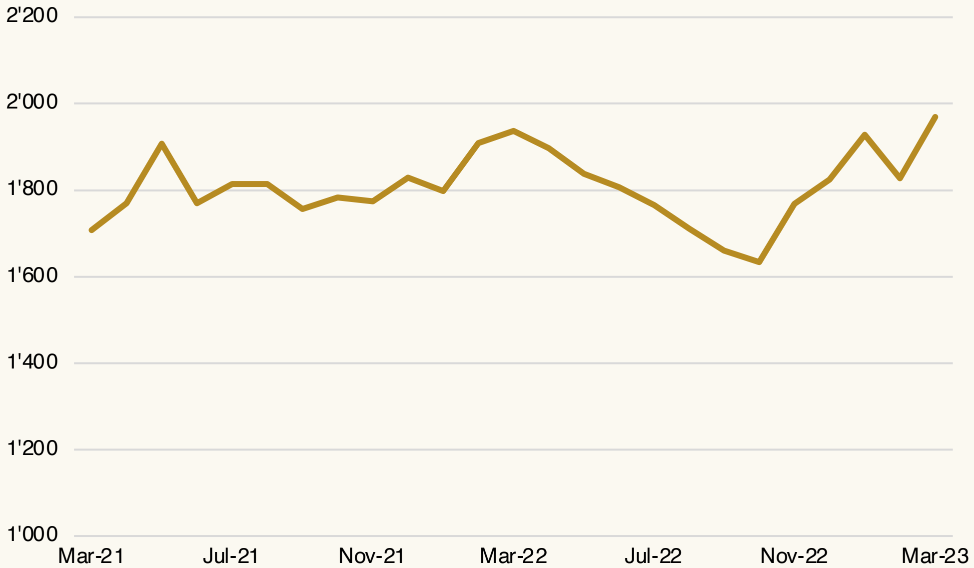
In terms of sequence, we might have a stabilisation in banking woes in the short-term, leading to a pull-back in Gold from close to 2000, where the upside potential seems very limited.

A better setting to add Gold might open in the next few months, at lower price levels and peak central banks' rates.

A better setting to add Gold might open in the next few months

GOLD

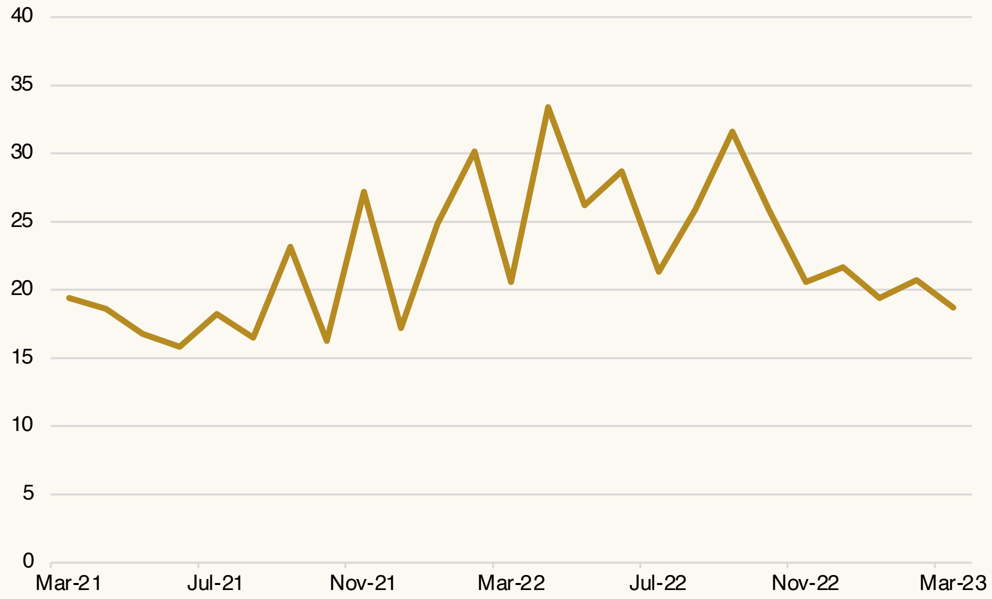
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 31/03/2023
Past performance is not indicative of future performance

VOLATILITY

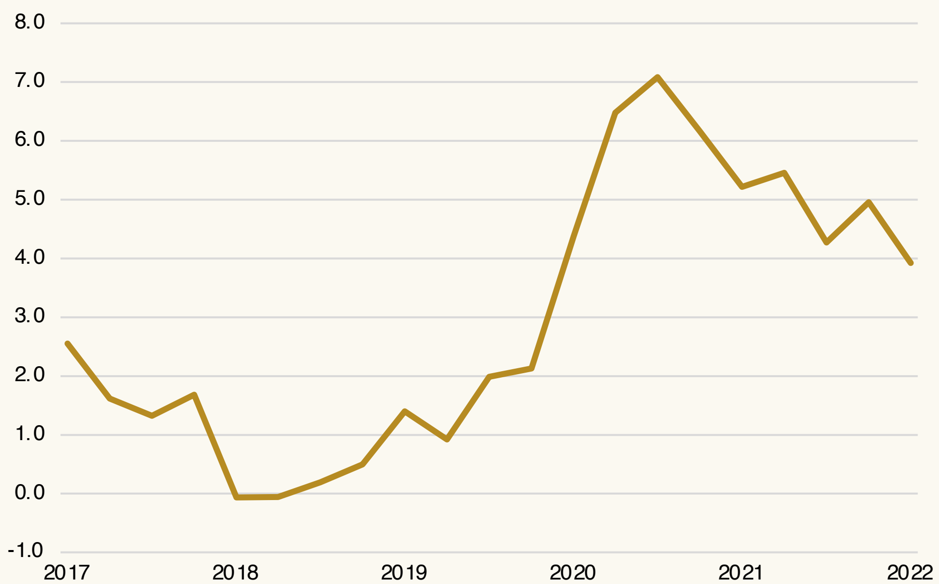
VOLATILITY – VIX INDEX
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 31/03/2023
Past performance is not indicative of future performance

REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE
ANNUAL PRICE CHANGE



Source: Bloomberg, 31/03/2023
Past performance is not indicative of future performance

CALENDAR

Date	Country	Economic Data	Period	Previous
05 April	US	ISM Non-Manufacturing Index	Mar-23	55,1
	Eurozone	Markit Services PMI	Apr-23	55,0
	UK	Markit Services PMI	Apr-23	52,9
06 April	Germany	Industrial Production (MoM)	Feb-23	3,5
	Switzerland	Unemployment Rate (%)	Mar-23	1,9
07 April	US	Employment (000s)	Mar-23	311,0
	US	Unemployment Rate (%)	Mar-23	3,6
11 April	China	Inflation (YoY)	Mar-23	1,0
12 April	US	Inflation (YoY)	Mar-23	6,0
	US	Fed minutes	Mar-24	
13 April	China	Exports (YoY)	Mar-23	-1,3
	Eurozone	Industrial Production (MoM)	Feb-23	0,7
14 April	US	Consumer Confidence	Apr-23	62,0
	US	Industrial Production (MoM)	Mar-23	0,0
18 April	China	Retail Sales (YoY)	Jan-23	-1,8
	China	Real GDP (YoY)	Mar-23	2,9
	China	Industrial production (YoY)	Mar-23	2,4
	UK	Unemployment Rate (%)	Feb-23	3,7
19 April	UK	Inflation (YoY)	Mar-23	10,4
	Japan	Industrial Production (MoM)	Mar-23	4,5
20 April	US	Philadelphia Fed Business Survey	Apr-23	-23,2
21 April	Eurozone	Markit Manufacturing PMI	Apr-23	47,3
	UK	Markit Manufacturing PMI	Apr-23	47,9
	Japan	Nikkei Manufacturing PMI	Apr-23	49,2
24 April	Germany	Ifo Business Climate	Apr-23	93,3
27 April	US	Real GDP (QoQ)	Mar-23	2,6
28 April	Eurozone	Real GDP (QoQ)	Mar-23	0,0
	France	Real GDP (QoQ)	Mar-23	0,1
	Germany	Real GDP (QoQ)	Mar-23	-0,4
	Italy	Real GDP (QoQ)	Mar-23	-0,1
	Japan	Bank of Japan Interest Rate (%)	Apr-23	-0,1
	Switzerland	KOF Leading Indicator	Apr-23	98,2

LET'S TALK ABOUT IT.

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

This article was finalised on 31st March 2023.

DISCLAIMER