Investment letter

Monthly review of global financial markets

SWISS CAPITAL IB

MARCH 2023

MACROECONOMICS

February started with the Fed slowing its pace of monetary tightening to 25bps, taking Fed fund rates to 4.5%-4.75%.

While Jerome Powell sounded fairly dovish at the time, the January labour market report the same week started a string of resilient US macro-economic data, which lasted over the month. Indeed, the economy created a surprisingly high 517k jobs, taking the unemployment rate to a historically low 3.4%, and leading Fed speakers to reiterate the need for more rate hikes, with the "higher for longer" mantra coming back to fore.

Similarly, inflation data remained elevated, with January headline CPI at 6.4% YoY, and Core CPI at 5.6%, while Core PCE, the Fed's preferred inflation gauge, came out materially above expectations, and at a still well-above target 4.7% YoY. Finally, the significant beat in retail sales, which jumped 3% on the month, did not assuage concerns that the Fed will have no other choice but to maintain significant monetary pressure if it is serious in reaching its 2% inflation target.

"The European outlook has undoubtedly brightened at the turn of the year, but perspectives remain weak and vulnerable, and we caution against too much complacency"

Markets now price a 5.4% terminal rate (27th Feb.) and have pushed back in time their anticipation of first rate cuts from Q3 to Q4 2023.

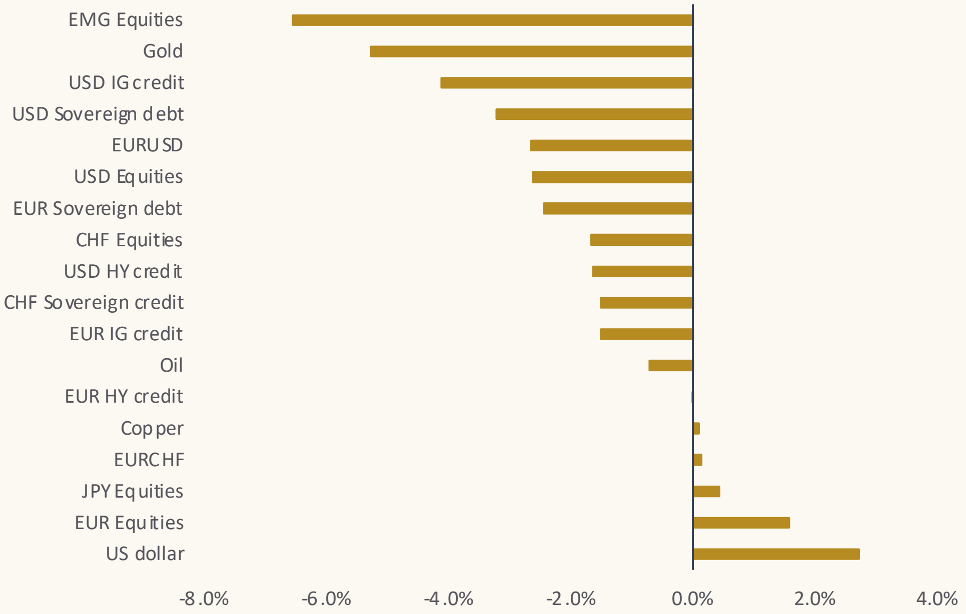
In this context, we continue to believe that a significant economic deceleration in the US is in the cards sometimes between the end of 2023 and mid-2024.

In the Eurozone, brighter economic prospects thanks to collapsing energy prices were confirmed by rebounding PMIs in February, with the Services component, and Composite, back in expansion territory. The same story is told by stronger consumer confidence. However, perspectives remain muted. Annual growth in retail sales is in negative territory, there is no wage-price spiral so far, inflation expectations remain anchored, and there is no demand-led overheating like is the case in the US.

Still, risks have now shifted to monetary tightening. With inflation elevated in January (8.6% at the headline level, 5.3% for the core), some members of the ECB governing council have been communicating hawkish intents this month. As a result, markets are now pricing a 3.75% terminal rate, which, if realized, would amount to the most restrictive stance ever applied by the ECB since the creation of the Eurozone, according to our assessment.

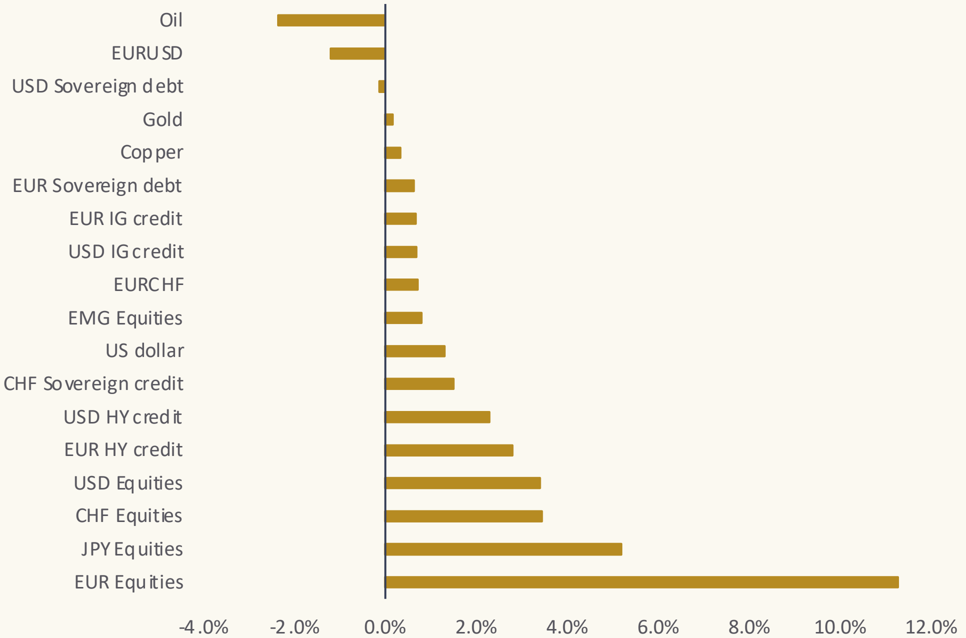
OVERVIEW

MAIN ASSET CLASSES
MONTHLY PERFORMANCE



Source: Bloomberg, 28/02/2023

MAIN ASSET CLASSES
PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 28/02/2023
Past performance is not indicative of future performance

MACROECONOMICS (continued)

The European outlook has undoubtedly brightened at the turn of the year, but perspectives remain weak and vulnerable, and we caution against too much complacency.

Allocation-wise, we remain prudent with US equities' valuation looking stretched, and more importantly, anticipated earnings not sufficiently reflecting slowdown risks.

Hence, we prefer to position ourselves during the first part of the year with relative value calls. We believe for example that it is a very good time to increase defensives over cyclicals, and we like the quality thematic. Regionally, we are starting to neutralize our preference for Europe over the U.S., as the bet has already performed very well, and given growing risks in the Eurozone.

Finally, we continue to believe that quality fixed income offers very interesting entry points.

EQUITY MARKETS

Bear capitulation ongoing...

So far this year, "performance pain" is the biggest narrative, with heavily shorted stocks outperforming lightly shorted ones by 1.5-2.5 standard deviations in every single sector. Similarly, from a top-down perspective, European equities are up by more than 20% from their October trough.

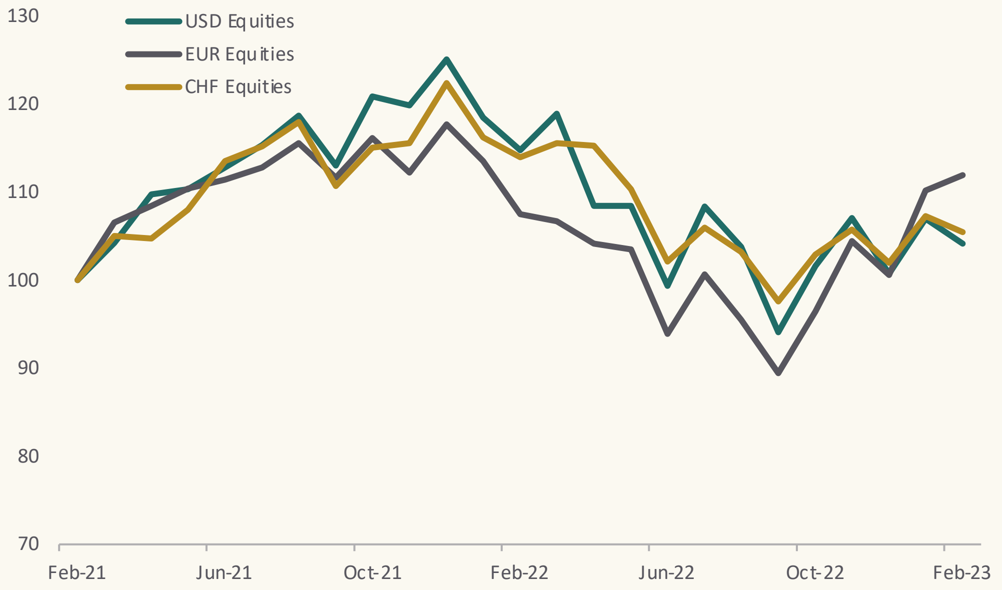
With valuations far from compelling, especially in the US, some warning signs sent by cross assets correlations' breakdown and the record move of Cyclicals vs. Defensives, all stars seem aligned for a reversal in Equity indices and in the Cyclical vs. Defensive pair.

If recession strikes as we expect, probably towards end-23/early-24, equities are unlikely to avoid a major drawdown, given the risk of sharp EPS downgrades and widening risk premia. In our scenario, we expect the final equity capitulation around mid-year.

For now, soft landing hopes are still supporting markets, translating into an ongoing "capitulation of the bears" that might continue into Q2. Fading the soft-landing story will become appropriate when it becomes widespread, and that point is nearing.

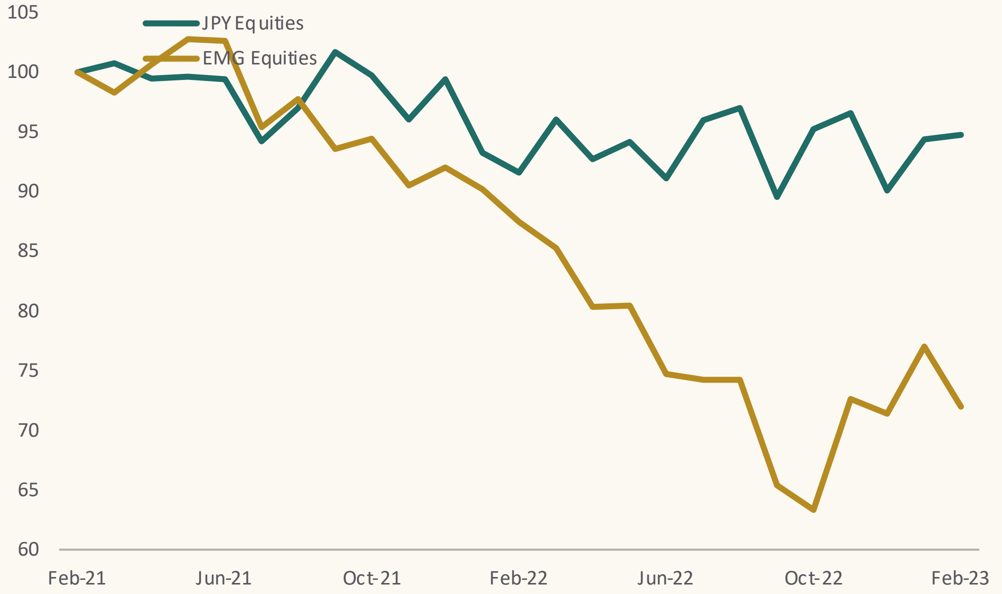
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 28/02/2023

EQUITY MARKETS JAPAN – EMERGING MARKETS
PERFORMANCE OVER 2 YEARS



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BOND MARKETS

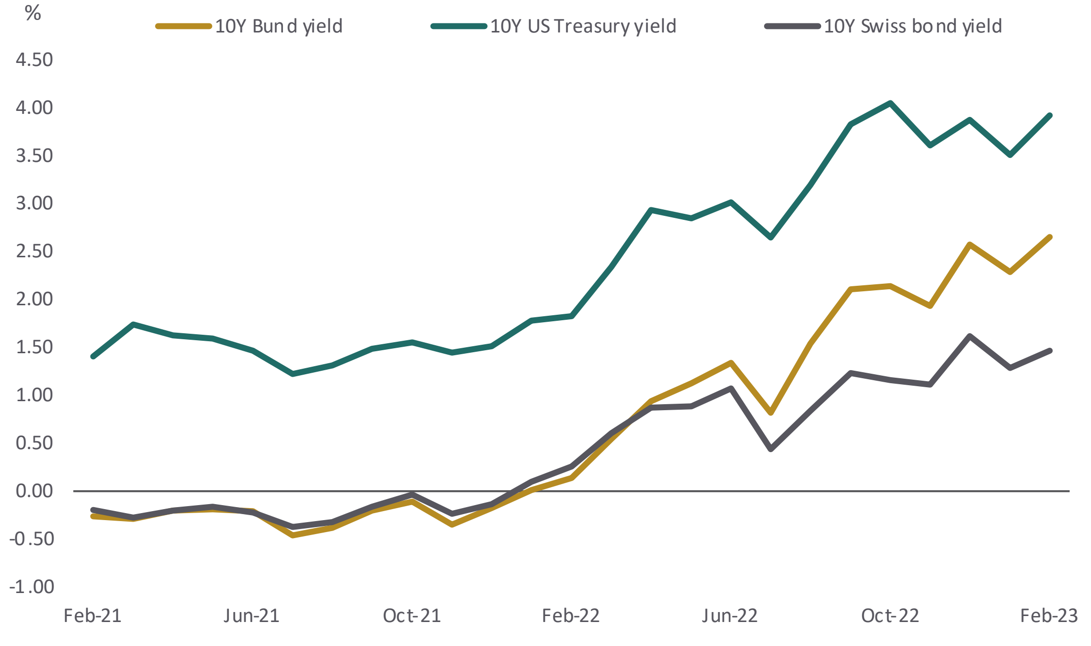
Government bonds' curves bear flattened as firmer economic data prompted a repricing of terminal rate expectations higher by about 50bps in major developed market regions. Expectations for rate cuts were also pushed back in time and reduced in magnitude as markets priced higher rates for longer. The additional tightening of monetary conditions, both in real rates terms and time spent in restrictive territory, is highly likely to deepen the economic contraction and reduces the risk of a second inflation wave.

While UST implied volatility increased somewhat, Bund volatility stayed relatively unchanged. Equity volatility, while higher, failed to rise meaningfully. As such, credit spreads widened only marginally and remain tighter since the beginning of the year on most corporate credit segments. European credit continues to outperform US credit.

Q4 earnings and companies' guidance are starting to show diverging fortunes across sectors. In turn, European financial institutions continue to release and guide to very strong earnings momentum.

"High quality bonds are back at very attractive valuations levels, translating into an elevated expected return"

10Y SOVEREIGN BOND YIELDS
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 28/02/2023
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CURRENCIES

The USD strengthened in February as resilient macroeconomic data led to a material upward repricing of the Fed terminal rate, from 4.9% to 5.4%. The USD could remain supported as the Fed continues to battle inflation. Once the terminal rate is reached, growth concerns might take over and limit the USD downside.

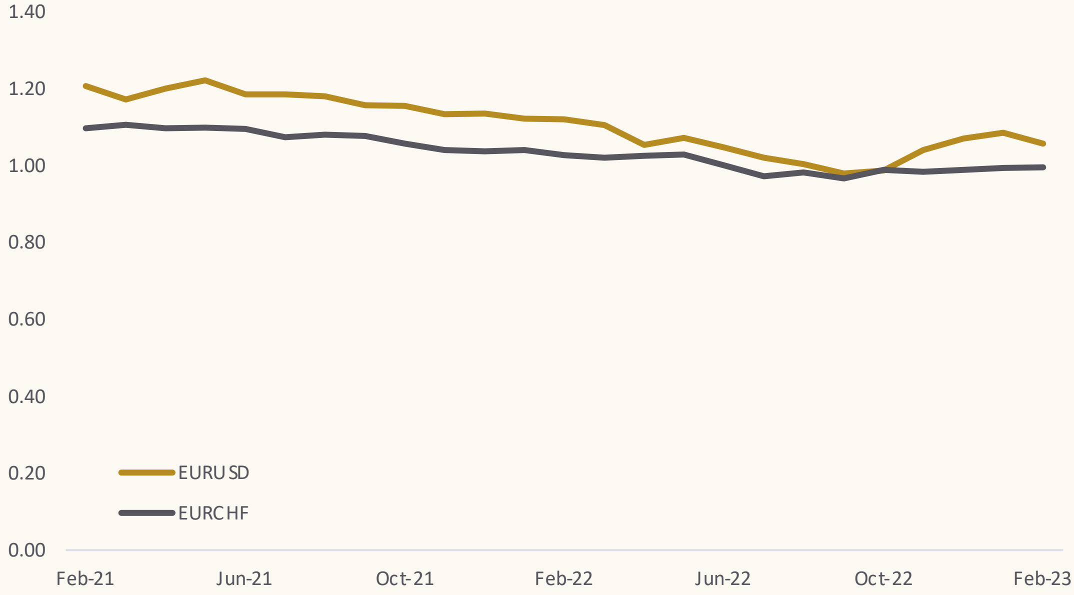
In all, we don't expect the USD to revisit last year's peaks, but it should nonetheless remain supported by a higher-than-expected peak in the hiking cycle, and recessionary forces thereafter.

We believe the EUR-USD fair value to be around 1.10-1.15. If the ECB turns out as hawkish as markets expect, the EUR could rebound against the USD in the short-term. However, a recession would likely weigh on the pair.

The EUR-CHF pair should benefit from monetary policy differential. The ECB is still battling high inflation, while the Swiss National Bank has less reason to hike aggressively given low inflation.

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, 28/02/2023
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COMMODITIES

OIL

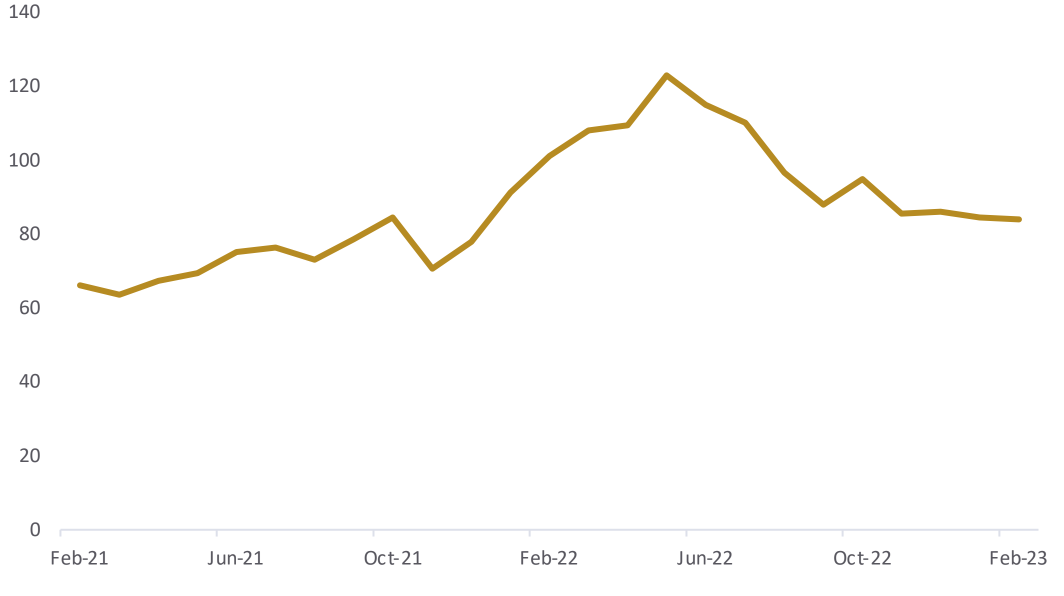
The oil market remains stuck between competing forces of constrained supply and slower global growth.

While the swift reopening of China may add some demand, this should not suffice to lift energy prices to new highs, especially with recent strength in the USD playing in the other direction.

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

A significant economic slowdown in the latter part of the year would limit the upside potential to energy prices

OIL
EVOLUTION OF BRENT PRICES OVER 2 YEARS



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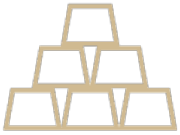
COMMODITIES

GOLD

After a surge to 1950 early February, which did not seem justified by an environment of still elevated real rates, a stronger USD and higher Fed terminal rates' repricing has materially weighed on the yellow metal in February, currently trading at 1810, over 7% below its 2023 peak.

We continue to believe that the right time to add Gold will be when the Fed indeed reach the end of its hiking cycle, and recession nears, as real rates compression should support Gold.



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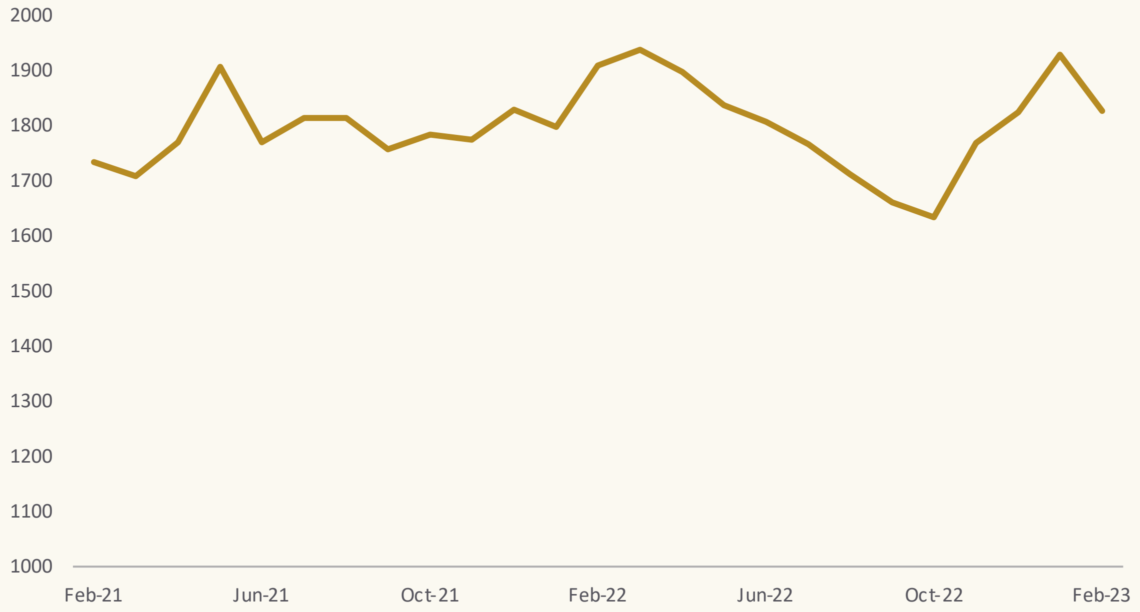
GOLD
EVOLUTION OVER 2 YEARS



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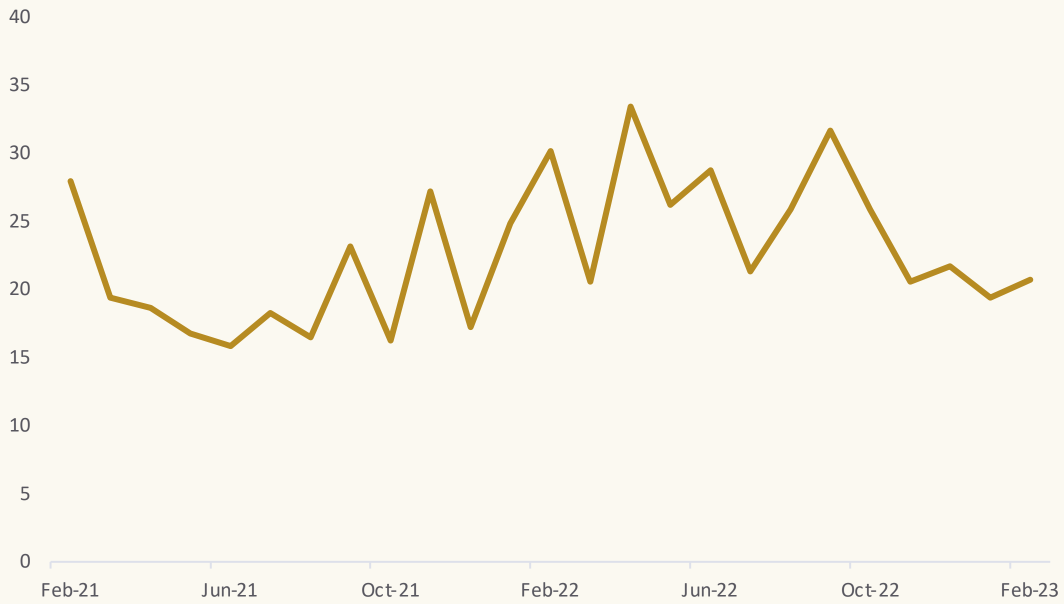
VOLATILITY

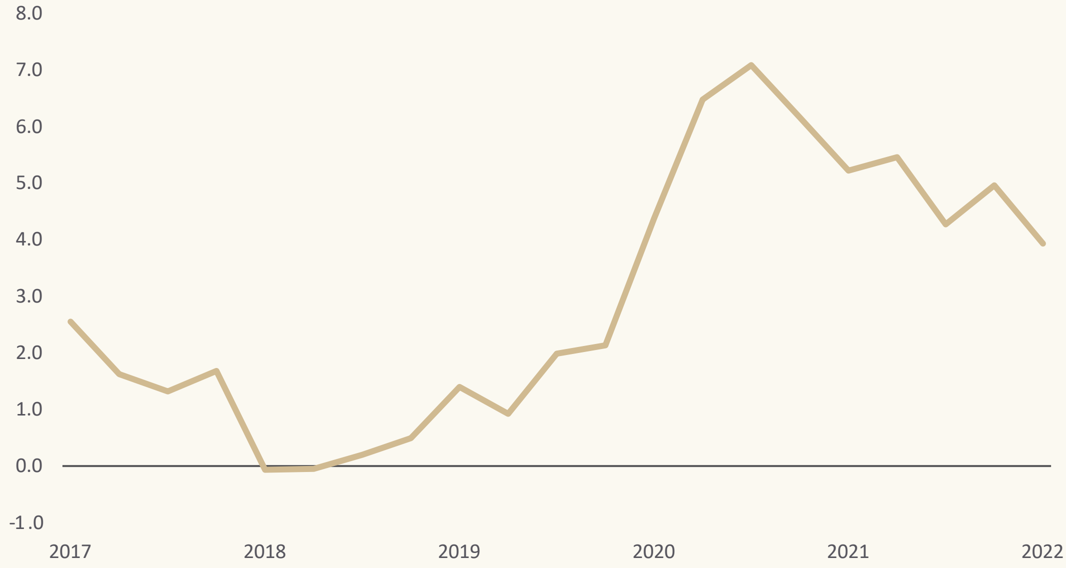
VOLATILITY – VIX INDEX
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 28/02/2023

REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE
ANNUAL PRICE CHANGE



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CALENDAR

Date	Country	Economic Data	Period	Previous
01 March	US	Manufacturing PMI	Mar-23	47,4
	Eurozone	Markit Manufacturing PMI	Mar-23	48,8
	UK	Markit Manufacturing PMI	Mar-23	47,0
	Switzerland	Manufacturing PMI	Mar-23	49,3
02 March	Eurozone	Inflation (YoY)	Feb-23	8,5
	Eurozone	Unemployment Rate (%)	Jan-23	6,6
03 March	US	ISM Non-Manufacturing Index	Feb-23	55,2
	Eurozone	Markit Services PMI	Mar-23	53,0
	UK	Markit Services PMI	Mar-23	53,3
	Italy	Real GDP (QoQ)	Mar-23	-0,1
06 March	Switzerland	Inflation (YoY)	Feb-23	3,3
07 March	Switzerland	Unemployment Rate (%)	Feb-23	1,9
08 March	Eurozone	Employment (QoQ)	Mar-23	0,4
	Eurozone	Real GDP (QoQ)	Mar-23	0,1
	Germany	Industrial Production (MoM)	Jan-23	-3,1
09 March	China	Inflation (YoY)	Feb-23	2,1
	Japan	Real GDP (QoQ)	Mar-23	0,6
10 March	US	Employment (000s)	Feb-23	517,0
	US	Unemployment Rate (%)	Feb-23	3,4
	Japan	Bank of Japan Interest Rate (%)	Feb-23	-0,1
14 March	US	Inflation (YoY)	Feb-23	6,4
	UK	Unemployment Rate (%)	Jan-23	3,7
15 March	China	Retail Sales (YoY)	Jan-23	-1,8
	China	Industrial production (YoY)	Jan-23	3,6
15 March	Eurozone	Industrial Production (MoM)	Jan-23	-1,1
16 March	US	Philadelphia Fed Business Survey	Mar-23	-24,3
	Eurozone	ECB Interest Rate (%)	Mar-23	2,5
	Japan	Industrial Production (MoM)	Feb-23	-4,6
17 March	US	Consumer Confidence	Mar-23	67,0
	US	Industrial Production (MoM)	Feb-23	0,0
22 March	US	Federal Reserve Interest Rate (%)	Mar-23	4,8
	UK	Inflation (YoY)	Feb-23	10,1
23 March	UK	Bank of England Interest Rate (%)	Apr-23	4,0
24 March	Japan	Nikkei Manufacturing PMI	Mar-23	47,7
27 March	Germany	Ifo Business Climate	Mar-23	91,1
30 March	US	Real GDP (QoQ)	Mar-23	2,7
31 March	UK	Real GDP (QoQ)	Mar-23	0,0
	Switzerland	KOF Leading Indicator	Mar-23	100,0

LET'S TALK ABOUT IT.

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