Marketing Material

MONTHLY HOUSE VIEW

May 2023

China: a pick up in the “Long March” rocket

Architects of Wealth

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STARTING OUR DESCENT

Alexandre
DRABOWICZ
Chief Investment Officer

Dear Reader,

On a recent flight to Madrid to visit our teams, the captain's words "starting our descent" resonated with me just as the US inflation print had a few days before, confirming its descent from 9% year-on-year (YoY) to 5% in nine months. Captain Powell must take some comfort from the latest figures: for the first time since January 2021, energy was a negative contributor to headline inflation. The bears tend to look more at the sticky part of inflation – services – but a closer look at the shelter subcomponent is also showing signs of rolling over. Captain Powell is indeed trying to land several airplanes at once: inflation, the economy and financial stability. Inflation is unlikely to return to the target of 2% in the near future, but the current decline is encouraging. The economy is slowing, we see this slowdown happening in H2 2023, but not a hard landing outright. The big question mark remains how tight lending conditions will become: small companies in the US represent 35% of the workforce, they get 70% of their loans from regional banks. The Federal Reserve (Fed) is therefore close to completing its tightening path (for now): one more hike in May and it's done for the year. To echo the Chicago Fed's Austan Goolsbee this calls for "prudence and patience".

Back on financial markets, investors still expect 50 basis points (bps) of rate cuts this year, we disagree and think the Fed will pause for the year. Volatility of interest rates, which surpassed the level recorded in the Great Financial Crisis of 2008, is a very unwelcome visitor to portfolio construction and banks' balance sheets. This is why we also favour in our fixed income portfolios lower duration assets and high quality credit as we are able to take advantage of attractive yields while suppressing duration risk. Liquidity in the market remains ample: money market funds in the US stand at USD 5.2 trillion, an increase of USD 500 billion this year as investors take advantage of strong yields and shy away from bank deposits.

Equities in the meantime have shown remarkable resilience. If you had been lucky enough to lock yourself away on an island without Wi-Fi for a month and upon your return heard that three US banks had failed, that Credit Suisse was swallowed by UBS in one weekend while both the European Central Bank (ECB) and the Fed were able to continue to raise interest rates... asides from the horrific shock of this news, you would have expected equities to be down sharply this year. Wrong. The descent that we were expecting on earnings is indeed not coming as brutally as expected, but why? Put simply, nominal matters more than real in the equity world. Companies have been able to grow their revenues thanks to the positive economic *momentum*. This has been offset by some margin contraction, but we are very far away from the collapse of expected earnings. This in turn explains the equity market's performance. But not only. Investor sentiment remains cautious, and positioning on equities - particularly in institutional portfolios - at defensive levels.

The pain trade is clearly on the upside, particularly as European equities power on: US investors have been buyers of European equity Exchange Traded Fund's (ETF) listed in the US every week this year except one. The China reopening trade has greatly benefited European companies, as reflected by the strong results of luxury names. This is the frustrating part for us this year: Chinese equities are not taking off despite a strong domestic reopening. We continue to believe however that going east makes sense. This month we focus on the state of the Chinese economy, where we have revised our growth forecasts up, and continue to believe that risks are on the upside. While we acknowledge that many investors have decided to buy Europe as a proxy for the Chinese reopening, as they shy away from Chinese names, particularly for US investors, China is too large to ignore. If China's A-shares inclusion factor[1] in the MSCI Emerging Markets was revised from the current 20% to 100%, its weight in the MSCI Emerging Markets would ramp up from 5 to 22%. Global investors are poised to allocate more to China as the A-share market dynamics will benefit from increased institutional (foreign and domestic) participation.

Finally, on a last personal note, as this is my first editorial as CIO for Indosuez Wealth Management, I would like to share with you that I am delighted to join the firm and feel fortunate to work in an organisation with such a high level of professionalism, client focus and integrity.

Enjoy the reading.

1 - Investors can access the Chinese equity market through several share classes, the largest being A-shares – those that trade in mainland China on domestic exchanges. Since 2018, MSCI has started to partially include China large-cap A-shares in the MSCI Emerging Markets Index.

CHINA: A PICK UP IN THE "LONG MARCH" ROCKET

Gautier VENERATI, CFA
Senior Equity
Portfolio Manager

Lucas MERIC
Investment
Strategist

While it had been a strong driver of the Chinese market rebound between November and January, the China reopening theme has since appeared to lose steam. Chinese macro data shows a strong rebound in the Chinese economy in Q1 2023, but Chinese markets have disappointed global investors since then: a dichotomy that we do not expect to persist in the coming months.

THE REOPENING IS NOW IN THE MACRO FIGURES

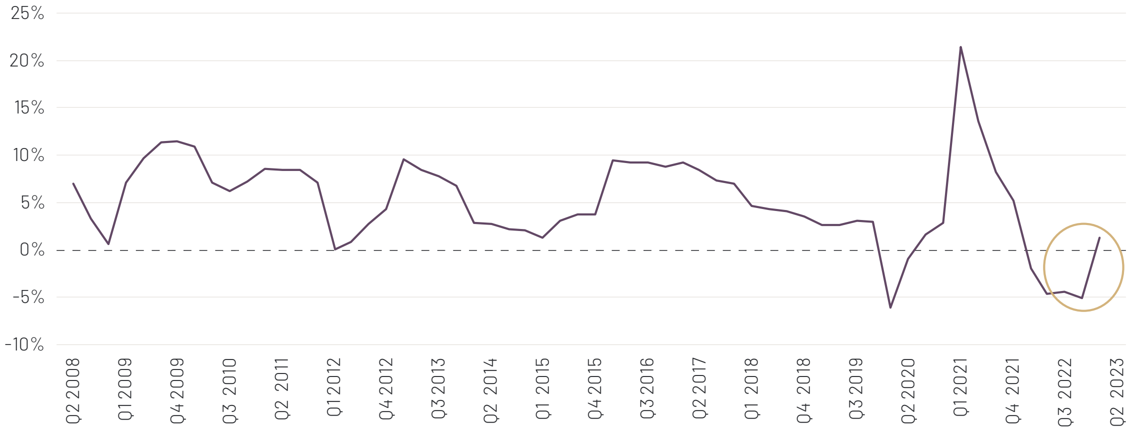
In early 2023, one of the big questions was the impact of the reopening on the Chinese economy. In the figures, Chinese GDP rose by 4.5% in Q1 2023 in year-on-year (YoY) (against 2.9% in Q4 2022) driven by domestic consumption while retail sales rose by 10.6% YoY in March. These figures confirm the potential for a recovery in consumption, as Chinese consumer sentiment remains subdued for the time being, albeit having increased in March. As we wrote in our March 2023 issue, the reopening is mainly driven by services as the services PMI reached 58.2 in March (highest level since 2012), with the manufacturing sector being more contained (but expanding) at 51.9. Industrial production grew by 3.9% YoY in March, below the consensus and its long-term average. Real estate has begun to show signs of stabilisation with property sales rising in value and volume by 8.8% and 0.2% YoY respectively in March, although property investment continued to decline by 7.2% YoY.

China's
RECOVERY
should be driven by
pent-up domestic
demand

AND SHOULD PICK UP

The encouraging figures for Q1 2023 reinforce our scenario of a solid 5.6% GDP growth in 2023, above the 5% target set by the National People's Congress (NPC) in early March, driven by the recovery of Chinese domestic consumption and services. In the coming months, the strength of the recovery will depend on the improvement in Chinese consumer sentiment after three years of drastic anti-COVID-19 measures without benefiting from exceptional government support similar to that seen in the west. The improvement in the labour market (the unemployment rate dropped to 5.3% in March), the current weakness in real income, which grew by only 3.8% YoY in March (despite low inflation), and the normalisation of real estate should support the essential recovery in sentiment (Chart 1).

CHART 1: THE CHINESE PROPERTY MARKET IS BOTTOMING OUT?
GROWTH OF VALUE ADDED, REAL ESTATE, YOY, %



Source: Datastream, Indosuez Wealth Management.

While major economies are struggling with high inflation, China indeed appears to be a haven from rising prices and supply-chain issues with its annual inflation at 0.7% YoY in March. This more than justifies accommodative monetary and fiscal policies to support its growth targets as private sector credit growth remained strong in March (9.6% YoY). The risks to our scenario are more on the upside for China. The global economic slowdown and the geopolitical situation regarding Taiwan and the US constitute downside risks, but for now exports remain robust (up 14.1% YoY in March).

WE MAINTAIN OUR STRONG CONVICTION IN CHINESE EQUITIES

Initially driving a strong 50% rebound in Chinese equities between November and the end of January, the reopening theme has materialised in strong macroeconomic data, as evidenced by the increase in positive economic surprises in China since January. Nevertheless, despite these excellent figures, Chinese markets have underperformed the main global equity indices (-6% vs. MSCI World since 1 February). In our view, this dichotomy between a strong macro in China and mixed performance lies in three notable aspects:

- Despite the rebound in macro figures, international investors are not yet convinced about the Chinese economic rebound, especially given the low level of Chinese consumer sentiment at the moment.
- Geopolitical episodes in 2023 (Chinese balloon in February and tensions with Taiwan) are weighing on Chinese assets.
- Investor sentiment is currently mainly driven by US interest rate movements and expectations of a hypothetical Fed pivot.

However, our conviction in Chinese equities remains intact. Bottom-up analysis showed strong outperformance year-to-date (YTD) from "blue chip" companies in sectors like consumption, communication services, IT, energy and materials, in line with our view of a domestic-demand driven recovery. Looking ahead, China will account for a third of global growth in 2023 and 2024.

The expected recovery in sentiment and the low point in the property market should support Chinese markets. Moreover, China is one of the few major economies where economic policy remains pro-growth while most advanced economies are beginning to feel the effects of the extremely aggressive monetary policies initiated in 2022. In particular, from an equity market perspective, China offers diversification to global equities at a time when the market environment is encouraging risk reduction, particularly in the US and European markets:

- Chinese equity earnings growth is expected to reach 17.8% in 2023 and 14.9% in 2024 (compared to 1.1% and 11.3% respectively for the MSCI World); we believe that earnings estimates bottomed out in November 2022 and expect a second wave of positive revisions after the one in late 2022.
- Chinese equities remain attractive in terms of valuation relative to the 10-year average price/earnings level (displaying a discount of 18% for H-shares and 30% for A-shares).
- Sentiment from global investors is improving; flows into global emerging markets (EM) and Asia ex-Japan funds have been positive YTD, with inflows of respectively USD 37 billion and USD 18 billion compared to outflows of USD 4 billion and inflows USD 7 billion in 2022. In the longer term, a potential increase in the inclusion factor for Chinese A-shares in the MSCI Emerging Markets index could attract sustainable long-term inflows on Chinese equity markets.

Finally, US/China tensions continue to make the front pages, but the strong economic interconnection between the two giants (US deficit trade with China, Chinese dominance in many value and production chains, in the renewables sector and the significant increase in Chinese technology in the country's exports over the last 15 years) makes China for the moment unavoidable.

03 • Macro economics

WHERE AND WHEN WILL THE US ECONOMY LAND?

Bénédicte KUKLA
Senior Investment Strategist

Although the degree to which credit conditions will tighten in the coming months remains uncertain, we see a partial landing of the US economy in the second half of 2023, as the correction in the jobs market is only just getting started. The slowdown in the US economy will show a limited impact on Europe, thanks in particular to the reopening of the Chinese economy.

UNITED STATES: A MODERATE AND TEMPORARY CONTRACTION IN GROWTH H2

US job openings:
9.9 MILLION VS. 7 MILLION
pre-pandemic

We started our investment committee with a sigh of relief: the recent US banking sector turmoil seems a far cry from the 2008 financial crisis. Hard data suggests a normalisation in deposits and tightening in financial conditions back to pre-March levels. Consumer confidence (University of Michigan) has weakened, but does not appear to be impacted by the shock (63.5 compared to 62 in March). Nevertheless, Small Business survey data (NFIB[2]) indicates that financing was the most important problem they are currently facing. This uncertainty has nourished fears of a credit crunch and explains the divergence in growth forecasts for the US economy in 2023. Our take is the following: better than expected growth performance in the first half of the year (as supported by the Atlanta Federal Reserve's latest GDPNow forecast for Q1 2023 at 2.5% SAAR[3]) and then a temporary contraction in GDP in H2, with a more significant drop in Q4 than in Q3 (implying a negative carry over impact on the average annual 2024 GDP growth).

This delayed weakening in growth is derived from a progressive pullback in consumption in the coming months as the jobs market becomes less supportive and credit is no longer a supportive factor for households as banks become more selective on loans in the current context of growing pessimism on the US economy. We could be wrong on the timing, with services remaining resilient (the ISM non-manufacturing survey was at 51.2[4] in March), job openings weakening, but still high (at 9.9 million currently vs. 7 million pre-pandemic) and the debt burden low on historical standards; this could push back the contraction in GDP to early 2024. However, although uncertainty is high, we do not give way to the ongoing pessimism that recession is imminent in the US, we speak only of a temporary contraction in growth. Furthermore, in 2024 the recovery could be less modest than previously expected, notably with the end in the housing sector investment purge that has shaved off about half a percentage point of quarterly GDP growth on average since Q2 2021.

2 - National Federation of Independent Business.
3 - Seasonally Adjusted Annual Rate.
4 - Reminder : PMI and ISM surveys above 50 points indicate an expansion in activity, below 50 a contraction in activity.

The Spanish services **PMI HITS 59 POINTS** in March

In this context, where domestic demand is beginning to moderate, we see positive signs for cyclical disinflation in the US, as contrary to the Euro Area, inflation was originally triggered by excess demand post-pandemic. Energy prices are now falling in the US (-6% YoY). Supply tensions have eased, as witnessed by the slowdown in goods prices (to 1.5% YoY in March from 12% in early 2022). Services prices, however, continue to remain strong (7.1% YoY) and the main source of concern for the Fed. Encouragingly, the shelter component, encompassed in services prices, began to fall on a monthly basis in March, although still rising in annual terms (8.2% YoY). Given the weight of the latter in the inflation index (>30% of total inflation and 45% of core inflation), it could help bring core inflation down faster than previously expected. This may not have a huge impact on the Fed's rate trajectory as the institution is less concerned by this housing component, but it can make a difference for the recovery in household income in 2024. All in all, we expect inflation to moderate in the coming months, thanks notably to strong base effects on energy and food prices, with core inflation surpassing headline inflation as of Q2 2023.

RISKS TO THE UPSIDE FOR THE EURO AREA

With Chinese growth accelerating (see Focus, page 4) and US growth moderating towards the end of the year, we have left our GDP growth scenario unchanged for the Euro Area in 2023 (Table 1). We do not expect a recession in the Euro Area and would say that risks are titled to the upside, notably with the recovery in industry after the significant 2022 energy shock (German production has rebounded +5.8% since December 2022). Spanish GDP growth is also projected to be stronger with the robustness in services (the Euro Area services PMI remained at 55 points in March and rose to 59 in Spain). On the inflation front, the increase in labour costs is similar to the US (around 6% YoY) and is currently approaching the rate of inflation, a positive for purchasing power. However, in Europe we believe that wages are less sensitive to changes in the jobs market and therefore will have a more lasting impact on inflation. In this context, ECB monetary tightening is to continue, even if the impact on GDP growth will be felt later down the road than in the US.

TABLE 1: MACROECONOMIC FORECAST 2023 - 2024, %

● Revised down since last month ● Revised up

	GDP		INFLATION	
	2023	2024	2023	2024
United States	1.3%	0.4%	3.9%	2.4%
Euro Area	0.5%	1.0%	5.9%	3.1%
China	5.6%	4.7%	1.5%	2.5%
Japan	1.1%	1.3%	2.7%	2.2%
India	5.3%	6.0%	6.0%	6.0%
Brazil	0.9%	1.7%	5.0%	5.0%
World	2.6%	2.8%	-	-

Source: Indosuez Wealth Management.

IT'S THE NATURAL RATE, WHAT ELSE?

Thomas GIQUEL
Head of Fixed Income

With the contribution
of the Fixed Income Team

The International Monetary Fund (IMF) joined in April the cohort of theoretical research on the "natural" rate of policy[5]. This resembles the quest for the Holy Grail of economic prosperity, in a world without shocks, high predictability and accurate forecasts. What a boring world! In reality fixed income markets are currently reminding investors how volatile they can be, even more so than equities. Sometimes at the expense of investors in the need for safety.

THE GREAT RETURN of the price of money

CENTRAL BANKS

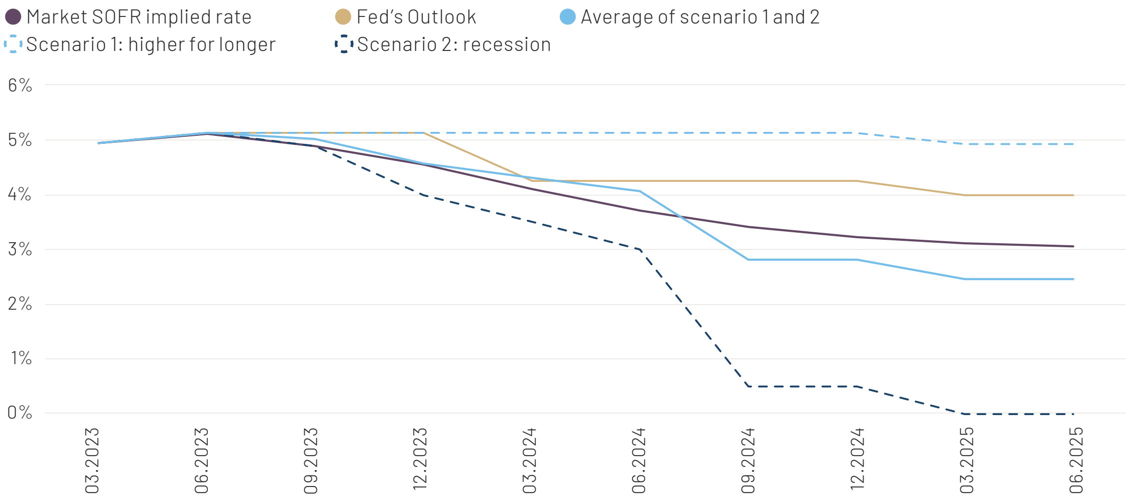
What has happened since the March bumpy ride? Foreign institutions in the need for dollars activated the swap lines with the Fed, and then the stress disappeared. US banks that needed liquidity used the Fed's facilities and already started paying them back. On the economic front, surveys look weak while other macro publications still look relatively bright. As a consequence, yields slowly but surely grinded higher, starting with the short part of the curve, as FOMC speakers leaned towards a 25 bps hike at the next May meeting, at the time of writing. All in all, as a central scenario, we see rates remaining high for longer.

In the Euro Area, core inflation dynamics are still too far from the ECB's comfort zone to be ignored. Rate hikes are a given until the summer, accompanied with smooth quantitative tightening.

The next question mark will be on the possibly more aggressive balance sheet reduction, not officially in the playbook yet.

Regarding rates and curves, the term premia in the US is back into negative territory, this comforts us in our view to keep a low modified duration within portfolios. The Fed Funds Futures are currently pricing in rate cuts as early as end 2023, which is consistent with an immediate severe recession and sharp downwards path for inflation (Chart 2). This is far from our central macro scenario: a two quarter mild recession starting in the third quarter of 2023. As a consequence, we stick with our underweight or short positioning on this part of the curve.

CHART 2: HOW TO PRICE 2 YEAR RATES? MARKET PRICING STILL LOOKS AGGRESSIVE, % (RATES ASSUMPTIONS UNDER DIFFERENT SCENARII)



SOFR: Secured Overnight Financing Rate.
Dotted lines represent in house hypotheses.
Source: Bloomberg, Indosuez Wealth Management. Past performance does not guarantee future performance.

5 - IMF: https://www.imf.org/-/media/Files/Publications/WEO/2023/April/English/ch2.ashx
ECB: https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op217.en.pdf
Fed: https://www.newyorkfed.org/research/policy/rstar

CREDIT MARKETS

Mid-April, credit markets have already retraced their underperformance in March (-90 bps according to Bloomberg Barclays Indices, in Europe) in terms of spreads. This counterbalances the risks of credit crunch caused by banking stress, at least initially. We will closely monitor the transmission to the real economy in the coming weeks or months. As in the past, the key question will rely on the willingness of banks to lend, or on the lack of demand from corporates and households. Qualitatively, corporate balance sheets remain strong, at least for the largest companies. Financing markets are always open for big names. In terms of sectors, there is value on banks, on the senior part of the capital structure, and selectively on deeply subordinated debt. In Europe, markets have sharply repriced risk premia on real estate issuers, pushing them to refinance via the banking system.

We still favour highly rated short-dated investments. The latter provide investors with a nice carry, alongside a strong breakeven in case of rising yields.

In China, property sector issuers defaulted en masse in 2022, as a consequence this part of the market has been washed out. Other sectors were relatively immune to defaults in 2022 and so far this year.

What we have witnessed in recent months, at the macro level, is that institutions in the need for cash have an access to it (Bank of England in late September, Fed with the Bank Term Funding (BTF) program) but with a price definitively above zero in both nominal and real terms. This is consistent with quantitative tightening measures in both areas, and probably shows the way for the ECB.

WHAT ARE THE RISKS GOING FORWARD?

- The US Debt ceiling. Tax collection is the new data set scrutinised by market participants. Janet Yellen forecasts the Treasury will run short of cash in late June, while markets are discounting a risk on bills mid-August, with a spike on rates at this period.
- A hit to Japanese central bank policy: the new Governor Kazuo Ueda sticks with his predecessor's ultra-loose monetary policy. Will the current policy survive the long-awaited recovery in Japanese inflation?
- On credit markets, the high market performance remains strongly correlated to global risk appetite, i.e. stock market performances with low volatility. We remain cautious on the lower-rated part of the market, subject to refinancing issues in 2024.

STEPPING CLOSER TO EUPHORIA?

Laura CORRIERAS
Equity Portfolio Manager

With the contribution
of the Equity Team

Markets have already erased the correction following the Silicon Valley Bank crisis. However, caution is still required in the banking sector especially with credit conditions and resulting impact on residential real estate. Along with the Fed pivot, the slowdown remains the central issue for markets, whether it be for economic or earnings growth.

EPS
revisions remain
STABLE

EARNINGS SEASON

The new earnings season is going to be an important driver for market performance in the coming weeks. The pre-announcement ratio is more negative than previous earnings releases, even above the long-term average and at its highest level since Q3 2019 (Chart 3). However, analysts' earnings-per-share (EPS) revisions for all regions remain quite stable for now.

UNITED STATES

The recent turmoil in the financial sphere seems to have normalised and the first publications of the US banks for the first quarter of 2023 seem to confirm the risk decrease. However, the rebound of these companies remains modest at this stage. Moreover, we note that investor sentiment has changed very quickly, showing now a certain euphoria, as evidenced by the VIX, which is at lows not seen for over a year.

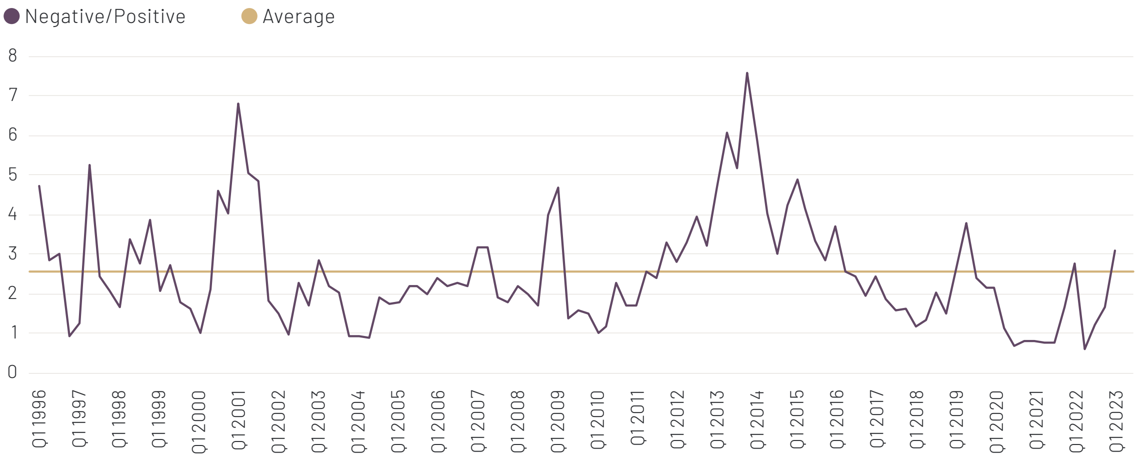
The slowdown remains a central issue, whether it be for economic or earnings growth. At the beginning of the earnings season, we are seeing a certain caution, both from financial analysts and from companies, with more than usual reductions in their outlooks. The evolution of monetary policy and the earnings season will be the main catalysts to follow to determine the future evolution of markets.

EUROPE

European equities bounced back sharply since 15 March, and are now even above the levels where they were before the correction following the fall of the Silicon Valley Bank.

Regarding the macro *momentum*, economic data are still quite solid in the Euro Area, and the Chinese reopening which has been a positive catalyst for European stocks since the beginning of the year, should continue to be a driver.

CHART 3: S&P 500 NEGATIVE-TO-POSITIVE PRE-ANNOUNCEMENTS, RATIO



Source: Citigroup, Indosuez Wealth Management.
Note: The number of companies having announced a negative earnings release for Q1 2023 has increased compared to previous earnings seasons and above the long-term average. The upcoming earnings season could therefore be more mixed.

EPS revisions are stabilising after being revised up from the beginning of the year and valuations for European equities still remain quite attractive (slightly below the 20 year median), especially when compared to the US.

EMERGING MARKETS

As explained in further detail in our Focus this month (page 4), Chinese equities staged a strong rebound in March following some profit taking in February. Global investor sentiment toward China has been improving over the last few months on the back of China's ongoing economic recovery. Improvement has been particularly substantial on the services front as well as retail sales. An ongoing recovery in the property market was also apparent in March (home prices and sales volume). Another support came from a strong credit cycle as well as accommodative monetary and fiscal policies. Chinese authorities have reiterated their support to the platform economy (i.e. the internet sector) and private-sector firms. Chinese equities remain one of our preferred markets for 2023 on the back of still substantial valuation discounts and EPS revisions that have likely bottomed in late 2022. The main risks to monitor still are China/US tensions and ongoing uncertainties as to peak US interest rates and actual Fed pivot timing.

INVESTMENT STYLE

Driven in particular by the rebound in interest rates and the OPEC oil restriction announcement, we saw a recent bounce back in Value stocks. In the medium-term, we continue to wait for a short-term normalisation in long-term yield and a continuation of the current tactical bounce in Value to take some profits and increase our exposure to Growth.

We remain constructive on Growth stocks, especially on profitable growth companies with subscription models and strong balance sheets that could benefit from weaker long-term interest rates.

In addition, some themes are now driving flows back on technology such as Artificial Intelligence.

Finally, we are still positive on the quality style which can be the best approach in a scenario of slowing growth, widening credit spreads and fading bond yields. However, we remain selective and prefer quality stocks at reasonable prices.

USD NO LONGER DEFYING GRAVITY

Bénédicte KUKLA
Senior Investment Strategist

Increased pessimism for the US economy and a Fed approaching its terminal rate, is making the USD lose some of its shine, while other currencies wait for their return to glory. The EUR looks the likely candidate, but the CHF has also remained resilient, with some ground still to recover. Gold has been the main winner of 2023, and is expected to hold its ground.

A WEAKER MACRO environment further dulls THE USD SHINE

USD

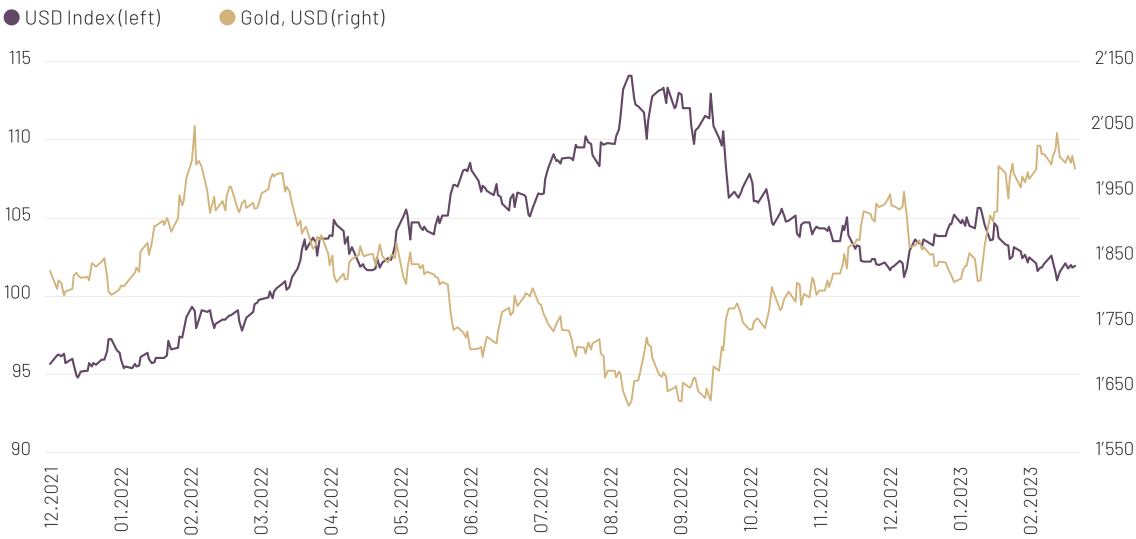
Losing its lustre

The US Dollar Index (DXY), a measure of the currency's strength against a basket of competing currencies, stood at the 102 mark as of 19 April, down 2% since mid-March, but still remains up 1% compared to the same period last year. After the uptick early March, the USD is resuming its downward trend on the back of weaker macro data and Fed rate expectations.

The Fed outlook will remain a key USD driver. According to our colleagues in CACIB, historic analysis suggests that the USD tended to appreciate by 2% on average in the three months leading to the final Fed rate hike before losing some ground once the Fed paused but mainly vs. the JPY, CHF and EUR.

This suggests that while the USD could recover some ground in Q2 2023, as the Fed delivers its final rate hike. Thereafter, the USD could remain a sell-on rallies versus other safe-haven currencies (EUR, YEN and CHF notably), notably in H2 as the weaker US macro environment further dulls the USD shine (Chart 4). Other key short-term drivers for the USD, could be the regain of banking sector tensions that would benefit the USD from a flight to quality. However, and probably more importantly, in a 6 to 9 month horizon, the slower pace of Fed tightening, China's reopening and abating energy crisis in Europe as well as continued tightening by other G10 central banks should make the USD lose some of its lustre in the year end. The upcoming June-July debt ceiling debates and looming political uncertainty is also negative for the USD.

CHART 4: EVOLUTION OF USD AND GOLD



Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

A EUR/USD upper-bound target range of 1.08 to 1.12

EUR

Pushing for rate hikes

The EUR/USD had a solid month, recovering 3% since mid-March, remaining nevertheless still 2% below its pre-Ukraine war outbreak level. Slowing economic *momentum* in the US and a hawkish ECB could push the EUR/USD higher, with our upper bound at a target range of 1.08 to 1.12. With wages and core inflation sticky to the upside in the Euro Area, the ECB is still focused on prices rather than concerns on financial stability. The latter also seems confident on the Euro Area banking system not facing risks as seen in the US or Switzerland, with sufficient tools to reinforce financial stability if needed.

Furthermore, the recent improvement in terms of trade due to lower energy prices have contributed to the euro's appreciation both by indirectly reducing the demand for dollar-denominated commodities and indirectly by supporting the growth outlook.

CHF

Back to macro

The performance of the CHF has been relatively neutral against the EUR over the past month and progressed 2% against the weakening USD. The Credit Suisse event has abated and the market has now regained its focus back on inflation. Although Swiss inflation is enviably low on global standards (at 2.9% YoY in March down from 3.4% in the prior month), it remains uncomfortably high for the central bank. The Swiss National Bank (SNB) has hinted to another tightening move at its meeting in June 2023.

Furthermore, at 1.5%, the SNB reference rate is significantly lower than its European counterparts and probably not high enough to abate inflation leading markets to anticipate rates over 2% by year end. Therefore, we see the CHF having still room to improve against the USD and EUR in the coming months.

JPY

Disappointing

The new Bank of Japan (BoJ) Governor Kazuo Ueda began his 5-year term on 9 April. His short-term focus is the risk that inflation falls back below the 2% target. Japanese inflation stood proudly at 3.3% YoY in February, but fell unexpectedly for the first time October 2021. The new governor has vowed to keep a dovish stance on inflation, linking any change in yield curve control to the underlying trend in inflation. This rhetoric has put downward pressure on the JPY. With US recession fears growing stronger and increased pressure on Japanese inflation leading to a potential review of BoJ monetary policy later in the year, we maintain our current positive view on the JPY which should in time regain its safe-haven appeal, but as the old proverb goes: haste is waste.

GOLD

Still in demand

Demand for gold has been strong as a risk-aversion and inflation hedge. Market expectations of a Fed pivot for year-end keeps gold supported. Lower real interest rates in the US have helped to support the XAU around the USD 2'000 mark, a level we believe the yellow metal could hold in the medium term, especially in a still delicate geopolitical environment with structurally higher central bank gold demand.

07 • Asset Allocation

INVESTMENT SCENARIO AND ALLOCATION CONVICTIONS

Grégory STEINER
Global Head of Multi Asset

Adrien ROURE
Portfolio Manager

US GDP GROWTH,
slightly stronger H2 contraction

INVESTMENT SCENARIO

- **Growth:** no major change in annual US GDP growth figures, with a temporary, but slightly stronger contraction in H2 2023 and a less modest recovery in 2024, pulled by rising real household income and the end in the real estate purge. Emerging markets will lead global growth, with China economic activity gaining strength from a more broad-based recovery. No changes in the Euro Area with upside risks on the strength of China's reopening and tourism flows.
- **Inflation:** square-root shaped scenario maintained with major based effects to pull inflation down, starting now. Euro Area inflation expected to be stickier due to wages dynamics. Cyclical disinflation in the US with uncertainty surrounding the pace of shelter prices disinflation later this year.
- **Central banks:** if the recent banking sector turmoil and subsequent tightening of lending conditions are likely to push central bankers moderating their restrictive policies, we do not buy however the markets scenario of Fed cutting their rates this summer. We still expect central bankers to remain focused on inflation by maintaining a high level of rates until year-end.
- **Earnings:** ongoing earnings season will be an important driver of markets direction in the coming weeks, as investors focus on margin strength and guidance insights, while macroeconomic uncertainty remains high. Earnings revisions appear to be stabilising in advanced economies. Sentiment remains positive in Q1 2023 for Europe in contrast to the rest of the world.
- **Risk environment:** after popping up on recent banking turmoil, fixed income volatility has erased its March spike while equity volatility has reached back to its one-year low. If stress has decreased and conversely investor sentiment has been improving, this does not reflect elevated macro risks (side effects of the banking crisis, financial stability, inflation stickiness, US debt ceiling) as well as external risks on the geopolitical front (US-China tensions around Taiwan, Ukraine-Russia war).

ALLOCATION CONVICTIONS

EQUITIES

- After redeploying our cash to risky assets in the previous months on opportunity, we maintain a neutral view on equities, whose risk/return asymmetry is lower after the recent rally and given the ongoing slowdown of the economic cycle. The increased dispersion between sectors and geographical areas could, however, offer new opportunities.
- In terms of geography, we maintain our positive view on Chinese equities, particularly domestic stocks, as stronger-than-expected growth and pent-up demand should translate into a better outlook for these companies. We remain close to neutrality on European and US markets, although we note the relative attractiveness of European equities to their US counterparts in terms of valuation.
- We continue to see opportunities for companies with strong fundamentals and high pricing power in the current context as the changing trend in yields and inflation risks should support the relative performance of Quality stocks. The Growth style has been outperforming the Value style YTD driven by the banking sector turmoil and declining yields. As this move has probably been exaggerated in the short-term, we prefer to wait for a further normalisation and keep our exposure to the Value style before looking at opportunities on the Growth segment.

FIXED INCOME

- Preference maintained for short-dated government bonds. The recent rally following US banking sector turmoil and markets expecting aggressive Fed cuts by H2 2023 is overly optimistic as core inflation dynamics are still too far out from central bankers' comfort zones while our macroeconomic scenario does not point towards a severe recession in advanced economies.
- The US yield curve steepening strategy is starting to offer good entry points on a strategic horizon, providing a good hedge against a more severe than expected economic downturn or disinflation cycle and generating carry.
- Within credit, we continue to favour short-term investment grade over high yield as funding conditions for issuers deteriorate. Meanwhile, we see value in financials in the senior segment and selectively in subordinated debt albeit being more cautious on name picking.
- A constructive view on emerging local currency debt as dollar weakness will help the asset class to outperform, although caution is merited given the recent rally.

FOREX MARKETS

- Differing inflation and macroeconomic dynamics (as well as different financial stability risk levels at some point) between the US and the Euro Area are giving the ECB more room to continue its hawkish stance relative to the Fed, which should push the EUR/USD higher by year-end.
- The Swiss franc remains an attractive hedge while the currency is expected to remain supported by robust Swiss macroeconomic data and the Swiss National Bank's monetary policy.
- If the new BoJ governor pledges for no policy changes in the near-term, increased pressure on inflation with rising wages could lead to a potential review of the central bank monetary policy later in the year, which explains our current positive view on the yen in addition to its macro hedge quality.
- Gold's rally has been strong since the beginning of the year. This rally could pause in line with a short-term rebound in real rates. We remain constructive in the medium term as lower yields expected by year-end and sustained demand from central banks should continue to drive gold's appreciation.

KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
EUR 2-Year (Germany)	=/-	=/-
EUR 10-Year (Germany)	=/-	=/-
EUR Periphery	=/-	=/-
US 2-Year	=/-	=/+
US 10-Year	=/-	=
EUR Breakevens Inflation	=/+	=/+
US Breakevens Inflation	=/+	=/+
CREDIT		
Investment grade EUR	=/+	+
High yield EUR/BB- and >	=/-	=
High yield EUR/B+ and <	-	=/-
Financials Bonds EUR	=	=
Investment grade USD	=/+	+
High yield USD/BB- and >	=/-	=
High yield USD/B+ and <	-	=/-
EMERGING DEBT		
Sovereign Debt Hard Currency	=/-	=/+
Sovereign Debt Local Currency	=/+	=/+
Latam Credit USD	=	=
Asia Credit USD	=	=
Chinese Bonds CNY	=	=
EQUITIES		
GEOGRAPHIES		
Europe	=	=/+
United States	=	=
Japan	=/-	=/-
Latin America	=/-	=
Asia ex-China	=/+	=/+
China	=/+	=
STYLES		
Growth	=/-	=/+
Value	=/+	=/-
Quality	=/+	=
Yield	+	=/+
Cyclical	=/-	=/+
Defensive	=	=/-
FOREX		
United States (USD)	=	=/-
Euro Area (EUR)	=/+	=
United Kingdom (GBP)	=/-	=
Switzerland (CHF)	=/+	=/+
Japan (JPY)	=/+	=/+
Brazil (BRL)	=/+	=
China (CNY)	=	=
Gold (XAU)	=/-	=/+

Source: Indosuez Wealth Management.

08 • Market Monitor (local currencies)

OVERVIEW OF SELECTED MARKETS

DATA AS OF 20 APRIL 2023

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10-year	3.53%	10.52	-34.30
France 10-year	3.00%	28.20	-10.60
Germany 10-year	2.44%	25.10	-12.20
Spain 10-year	3.48%	24.00	-16.80
Switzerland 10-year	1.10%	-6.90	-51.40
Japan 10-year	0.47%	16.60	5.20

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Government Bonds Emerging Markets	35.79	0.35%	3.11%
Euro Government Bonds	195.01	-1.02%	1.22%
Corporate EUR high yield	200.00	1.05%	3.35%
Corporate USD high yield	307.76	1.65%	3.72%
US Government Bonds	302.09	-0.55%	2.27%
Corporate Emerging Markets	43.63	0.51%	2.03%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	0.9790	-1.40%	-1.07%
GBP/USD	1.2443	1.27%	2.98%
USD/CHF	0.8923	-2.64%	-3.48%
EUR/USD	1.0970	1.28%	2.48%
USD/JPY	134.24	2.59%	2.38%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	17.17	-5.44	-4.50

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'129.79	4.59%	7.56%
FTSE 100 (United Kingdom)	7'902.61	5.37%	6.05%
STOXX 600	467.43	4.75%	10.01%
Topix	2'039.73	4.21%	7.82%
MSCI World	2'822.54	4.66%	8.45%
Shanghai SE Composite	4'113.02	1.83%	6.23%
MSCI Emerging Markets	989.79	1.23%	3.49%
MSCI Latam (Latin America)	2'242.31	8.47%	5.36%
MSCI EMEA (Europe, Middle East, Africa)	194.42	4.27%	1.27%
MSCI Asia Ex Japan	639.88	0.18%	3.33%
CAC 40 (France)	7'538.71	5.60%	16.45%
DAX (Germany)	15'795.97	3.85%	13.45%
MIB (Italy)	27'627.12	4.32%	16.54%
IBEX (Spain)	9'450.90	5.36%	14.85%
SMI (Switzerland)	11'390.64	6.27%	6.16%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	3'922.00	-4.71%	-4.22%
Gold (USD/Oz)	2'004.80	0.57%	9.91%
Crude Oil WTI (USD/Bbl)	77.29	10.48%	-3.70%
Silver (USD/Oz)	25.37	9.63%	5.54%
Copper (USD/Tonne)	8'881.00	-1.66%	6.08%
Natural Gas (USD/MMBtu)	2.25	4.41%	-49.74%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

MONTHLY INVESTMENT RETURNS, PRICE INDEX

FTSE 100 · Topix · MSCI World · MSCI EMEA · MSCI Emerging Markets
STOXX 600 · S&P 500 · Shanghai SE Composite · MSCI Latam · MSCI Asia Ex Japan

	JANUARY 2023	FEBRUARY 2023	MARCH 2023	4 WEEKS CHANGE	YTD (20.04.2023)
BEST PERFORMING +	9.69%	1.74%	3.51%	8.47%	10.01%
	8.18%	1.35%	3.29%	5.37%	8.45%
	7.85%	0.91%	2.83%	4.75%	7.82%
	7.37%	-2.10%	2.73%	4.66%	7.56%
	7.00%	-2.53%	0.51%	4.59%	6.23%
	6.67%	-2.61%	0.36%	4.27%	6.05%
	6.18%	-4.41%	0.04%	4.21%	5.36%
	4.42%	-6.36%	-0.46%	1.83%	3.49%
	4.29%	-6.54%	-0.71%	1.23%	3.33%
− WORST PERFORMING	2.27%	-6.86%	-3.10%	0.18%	1.27%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

09 • Glossary

Basis point (bps): 1 basis point = 0.01%.

Blockchain: A technology for storing and transmitting information. It takes the form of a database which has the particularity of being shared simultaneously with all its users and generally does not depend on any central body.

BLS: Bureau of Labor Statistics.

BNEF: Bloomberg New Energy Finance.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Cyclicals: Cyclicals refers to companies that are dependent on the changes in the overall economy. These stocks represent the companies whose profit is higher when the economy is prospering.

Defensives: Defensives refers to companies that are more or less immune to the changes in the economic conditions.

Deflation: Deflation is the opposite of inflation. Contrary to inflation, it is characterised by a sustained decrease in general price levels over an extended period.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates. This value is expressed in years. The longer the duration of a bond, the more sensitive its price is to interest rate changes.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to non-operating expenses.

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and Euro Area member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

Economies of scale: Decrease in a product's unit cost that a company obtains by increasing the quantity of its production.

EPS: Earnings per share.

ESG: Non-financial corporate rating system based on environmental, social and governance criteria. It is used to evaluate the sustainability and ethical impact of an investment in a company.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

Growth: Growth style refers to companies expected to grow sales and earnings at a faster rate than the market average. As such, growth stocks are generally characterised by a higher valuation than the market as a whole.

IEA: International Energy Agency.

IMF: The International Monetary Fund.

Inflation breakeven: Level of inflation where nominal bonds have the same return as inflation-linked bonds (of the same maturity and grade). In other words, it is the level of inflation at which it makes no difference if an investor owns a nominal bond or an inflation-linked bond. It therefore represents inflation expectations in a geographic region for a specific maturity.

Inflation swap rate 5-Year, 5-Year: A market measure of what 5-Year inflation expectations will be in five years' time. It provides a window into how inflation expectations may change in the future.

IPPC: The Intergovernmental Panel on Climate Change.

IRENA: International Renewable Energy Agency.

ISM: Institute for Supply Management.

Japanification of the economy: Refers to the stagnation the Japanese economy has faced in the last three decades, and is generally used to refer to economists' fears that other developed countries will follow suit.

Metaverse: A metaverse (portmanteau of meta and universe) is a fictional virtual world. The term is regularly used to describe a future version of the internet where virtual, persistent and shared spaces are accessible via 3D interaction.

OECD: Organisation for Economic Co-operation and Development.

Oligopoly: An oligopoly occurs when there is a small number of producers (supply) with a certain amount of market power and a large number of customers (demand) on a market.

OPEC: Organization of the Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

PMI: Purchasing Managers' Index.

Policy mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

Pricing power: Refers to the ability of a company or brand to increase its prices without affecting demand for its products.

Quality: Quality stocks refers to companies with higher and more reliable profits, low debt and other measures of stable earnings and strong governance. Common characteristics of Quality stocks are high return to equity, debt to equity and earnings variability.

Quantitative easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

Secular stagnation: Refers to an extended period of little or no economic growth.

SRI: Sustainable and Responsible Investments.

Stagflation: Stagflation refers to an economy that is experiencing simultaneously an increase in inflation and stagnation of economic output.

TPI : An addition to the Eurosystem's toolkit that can be activated by the ECB to counter unwarranted, disorderly market developments if these pose a serious threat to the smooth transmission of monetary policy across the euro area. The ECB Governing Council approved the instrument on the 21 July 2022.

Uberisation: Term derived from the name of US company Uber which develops and operates digital platforms that connect drivers and riders. It refers to a new business model that leverages new digital technologies and is part of the sharing economy, insofar as it puts customers in direct contact with service providers, at a reduced cost and with lower prices.

Value: Value style refers to companies that appear to trade at a lower price relative to its fundamentals. Common characteristics of value stocks include high dividend yield, low price-to-book ratio, and a low price-to-earnings ratio.

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: World Trade Organization.

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