Monthly review

Macro

The Price is Right

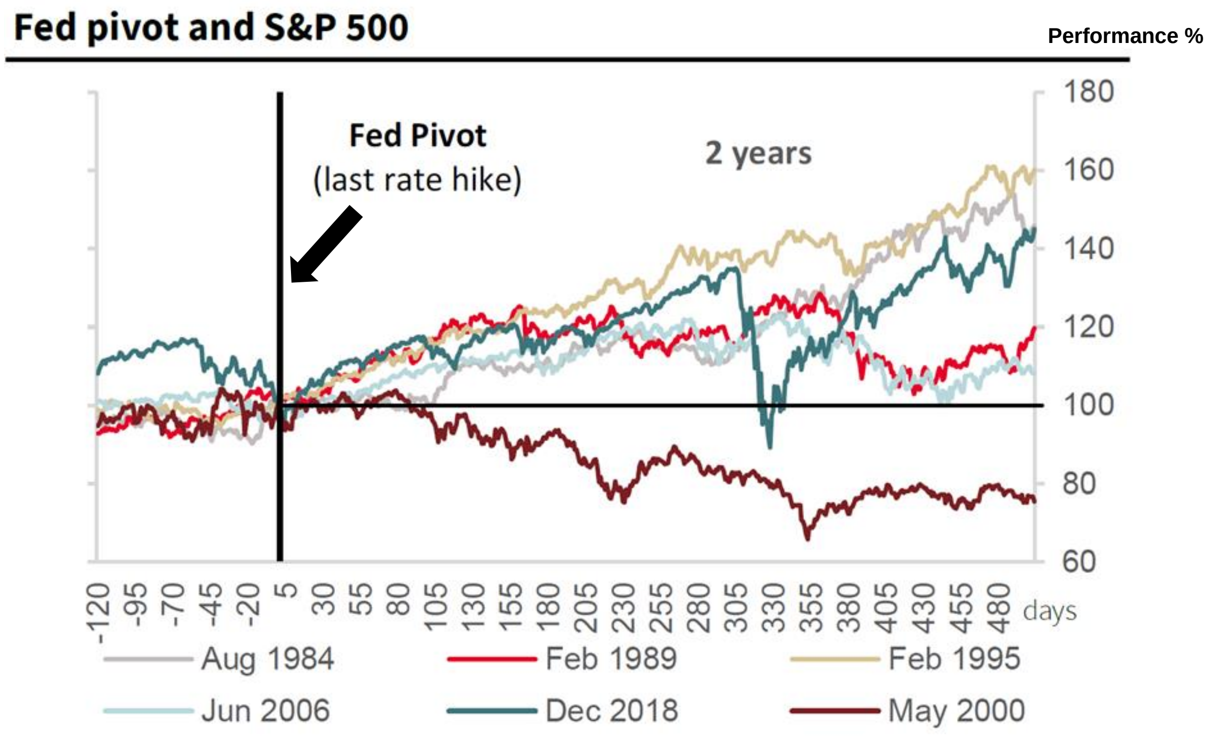
This game show has just celebrated its 50th anniversary this year with an international franchise in nearly 50 countries. The game was created in 1972 in the United States, the beginning of a period of very high inflation...

What would be the fair price of stock indices today?

As we wrote at the very beginning of the year, central banks are no longer friendly with investors because their objective is price stability. We have therefore suffered a strong correction on the two major assets and the traditional portfolios (60% stocks - 40% bonds) have suffered a deterioration not seen since the 1930s! (around -20%).

Where and when does this fall end?

First of all, we need to analyse when markets have rebounded in the past during periods of monetary tightening (leading to a more or less strong recession).



We can see that the low point of the equity markets coincides perfectly (except for the bursting of the internet bubble in 2000) with the last central bank rate hike. The central bank pivot is the moment when the central bank becomes neutral and therefore potentially accommodative. That is the first indicator we need to watch for.

The second possibility remains a capitulation of the equity markets (a strong decline with high volumes) taking the indices to very attractive levels. At this point, the main strategists have come down from their clouds and place the low level of the SP500 index around 3000 - 3200, i.e. still between 12% and 18% down. At these levels we consider that expectations of rate hikes and recession would be broadly taken into account.

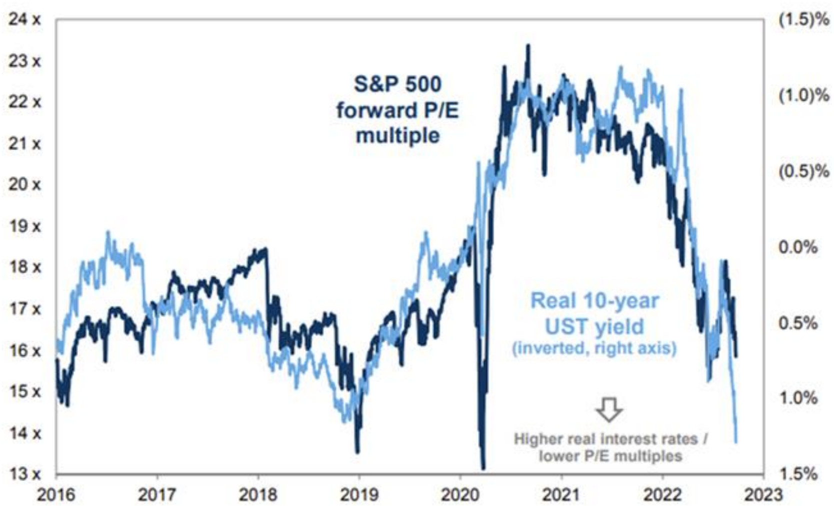
The price of real rates and expectations of a sharp slowdown would bring the P/E of the index down to around 14/15x, which seems to us a good opportunity for high-quality purchases at reasonable prices. We have been extremely cautious this year and have avoided the pitfalls. However, our sentiment remains cautious as there is still downside potential, especially in the US where retail investors still have a high exposure to the equity markets, which is strange as the general sentiment is bearish (retail investors on average still hold 63% of their portfolios in equities while it should be around 45% (see graph below).

Asset Allocation When Bears Growl*

	Bears	Stocks	Cash
Aug 1990	61.0%	46%	34%
Oct 1990	67.0%	45%	37%
Oct 2008	*60.8%*	*45%*	*36%*
Mar 2009	70.3%	41%	45%
Average		*44%*	*38%*
Sep 2022	60.9%	63%	22%

*table shows stock and cash allocations from monthly AAII Asset Allocation Survey when bears in weekly AAII Sentiment Survey have exceeded 60% in the past.

US consumption is positive and the job unemployment remains low (which the Fed does not want). These indicators are still at risk and the Fed must remain firm, which is still a risk for the markets. The valuation of stocks must return to levels closer to 15x to finally take into account the strong economic slowdown that is coming.



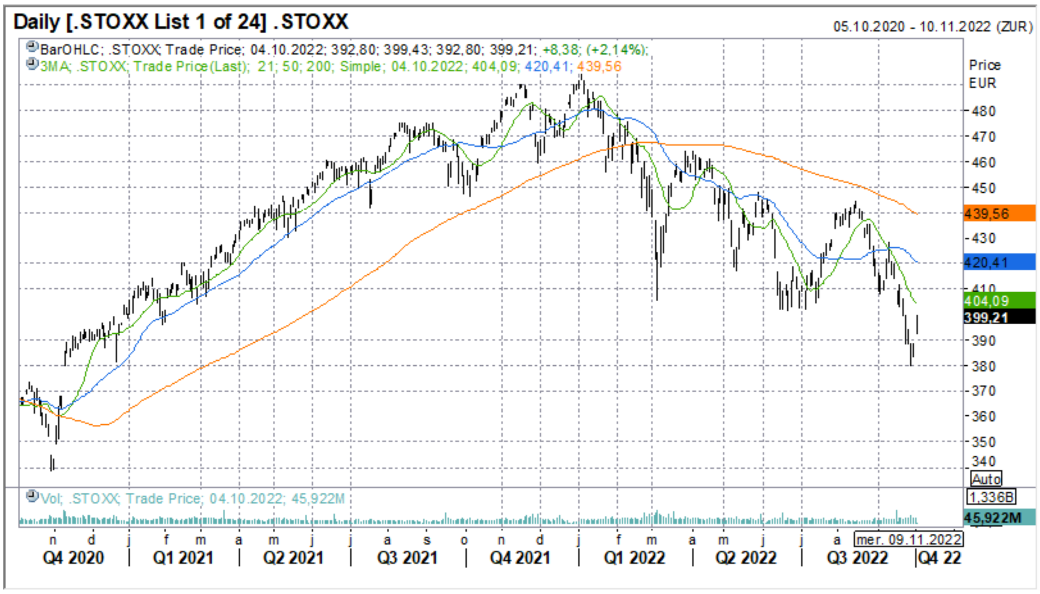
Outlook

We believe that we are close to a final downward movement that will allow us to strengthen our equity portfolio. To date, given the macroeconomic and geopolitical environment, we have not arrived at the right price.

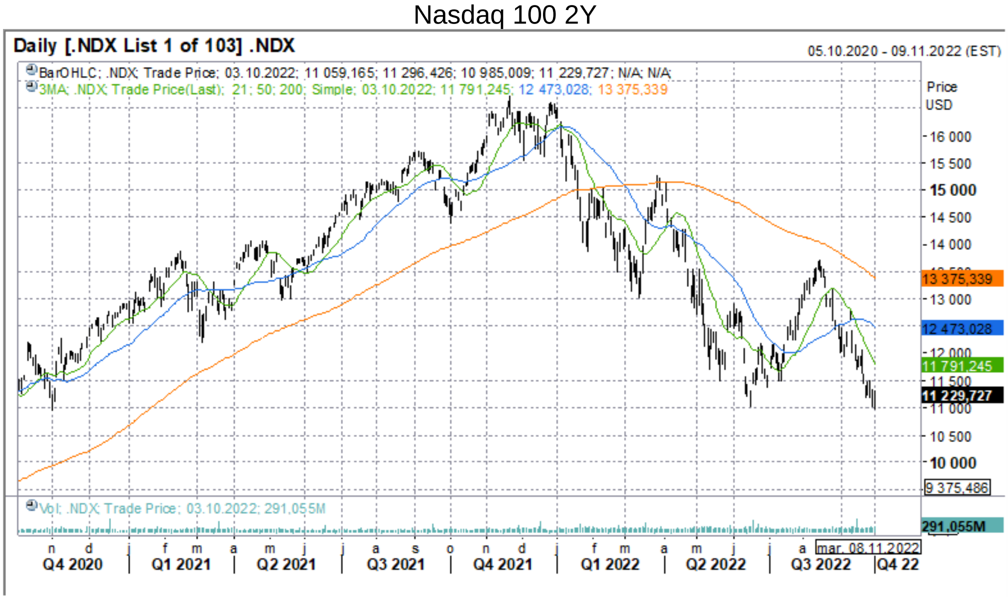
Equity markets

The third quarter thus ends on a clear decline and since the beginning of the year 36'000 billion dollars have gone up in smoke at the globaly in what constitutes the largest destruction of value in history on the stock and bond markets. This is the 3rd consecutive quarter of decline, which has not happened since 2009. Finally, we had the worst month since March 2020, with the Dow losing 8.8%, while the S&P 500 (93% of the index components finished in the red) fell by 9.3% and the Nasdaq fell by 10.5%. In Europe, the Stoxx600 fell by -6.37%.

Stoxx600 2Y



Nasdaq 100 2Y



Foreign exchange market

In Q3 2022, the euro was facing a litany of issues that seemed to prevent any sort of meaningful rebound: slowing economic growth; the war in Ukraine; questions about energy inventories; and concerns around possible fragmentation of European bond markets. There was a lull at the end of September when the pair hit 0.9734 on September 28! There are no positive signs to help the euro except perhaps that the market is too negative. Winter is approaching and energy issues may weigh on the euro in the medium term. Direction 0.95 against the dollar and 0.90 against the Swiss franc?

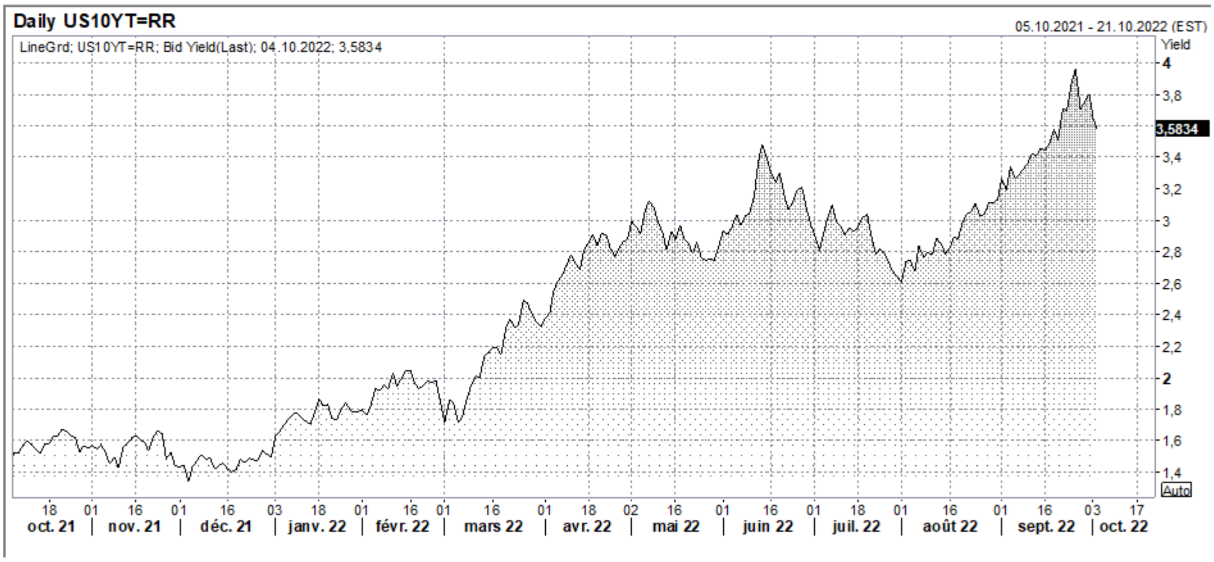
EUR USD YTD

EUR CHF YTD

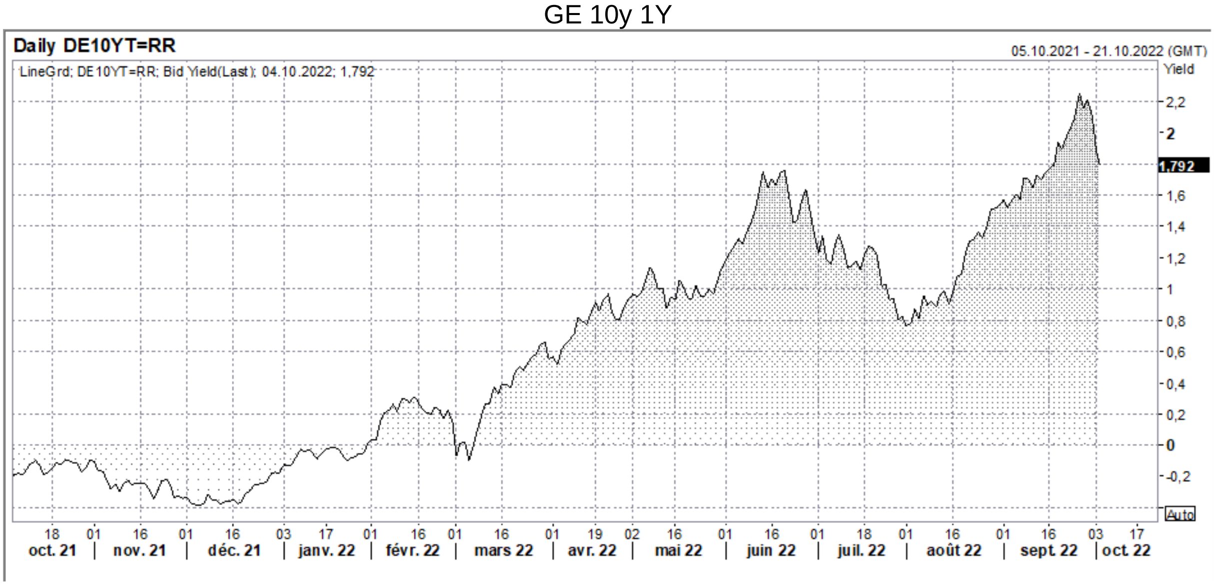
Bond market

On the yield side, after a frenzy to rise since early August and the September 10 inflation numbers, the U.S. 10-year fell to nearly 3.80% after the rumored Fed pivot, moving further away from the September 27 high of 4%. Investors are skeptical that central banks will be able to tighten monetary policy aggressively as signs of slowing economic activity mounts. Note that the ISM Manufacturing PMI unexpectedly fell to 50.9 in September, the lowest since May 2020 and below market expectations of 52.2.

US 10y 1Y



GE 10y 1Y



Commodities

Gold prices have also been under pressure since bond yields rose as a result of the greater than expected acceleration in core inflation in the US last month. Gold prices and other precious metals are suffering the consequences of central bank policies. In addition, the rise of the dollar is not helping, as emerging markets, which have a high demand for gold, are seeing the cost of an ounce explode against their currencies. The ounce has fallen by more than 8% since the beginning of the third quarter, dropping to its lowest level since April 2020 at 1,613 dollars.

Gold 2Y

WTI crude futures were trading around $80, down for the fourth straight month and on track for their first quarterly loss since the first quarter of 2020, down more than 20 percent since late June. Oil markets have sold off since June due to tightening monetary conditions that have raised concerns about a global recession and weaker energy demand. On top of that, the surging dollar has added to the bearish sentiment. Meanwhile, investors are looking forward to the OPEC+ meeting in October, as low oil prices have led to speculation that the cartel may announce a further supply cut, with Russia pressuring the group to reduce production by around 1 million barrels per day.

Brent 2Y