MONTHLY REVIEW

MACRO

SANTA CLAUS IS COMING, BUT THE RECESSION IS RIGHT BEHIND HIM

The markets want a year-end rally, so we have a third bear market rally this year that is particularly powerful (+13% in Europe, +16% on the Dow Jones +9% on the SMI since mid-October).

The cause: the publication of inflation figures in the United States were lower than expected and raised hopes of a smaller rate hike by the Fed. With inflation falling, investors were hoping that the Fed would welcome the first signs of easing and send reassuring signals to the markets. But the Fed prefers to make sure that everything is under control before taking actions to reassure the financial markets.

The central bank will therefore be able to become neutral and wait passively for the data. But on the one hand, neutral does not mean pivot (talking about a rate cut) nor does it mean putting liquidity back into the market as inflation never disappears overnight (on average it takes 16 months for a return to below 2%).

OUTLOOK

2023 RECESSION, STAGFLATION, PIVOT, CHINA, UKRAINE?

We are not getting carried away with the year-end rally, we still think the markets are not taking several things into account:

- Macroeconomic indicators are pointing to a recession in the US and a slowdown in Europe in a more scattered fashion.
- Analysts are still not taking into account the lower earnings expectations.
- Central banks are massively withdrawing liquidity (Quantitative tightening) from the markets (which was the main driver of the rally).
- The US central bank will not move in 2023, barring a miracle (several representatives reminded us again yesterday that rates could move between 5 and 7%!). The pivot seems unlikely in 2023
- The ECB will also remain hawkish with inflation being even higher due to energy prices
- China will reopen one day! What effect will this have on commodities and therefore on global inflation?
- The war in Ukraine will unfortunately remain a reality

We are convinced that interesting levels will be found for stocks during the coming months!

EQUITY MARKETS

BEAR MARKET RALLY

Strong reaction of the markets following the publication of the American inflation on 10.11.22. The US markets recovered between 5 and 7%, in a single session, proof of the extreme volatility that reigns in the financial markets. In addition, the market reacted positively to the news that China has reopened to the Covid. The Hang Seng has recovered 27% since the lows in early November! These two events allowed the market to rebound from the lows seen in mid-October. And finally to conclude the month of November Jerome Powell reassured the markets about rate hikes. The performance of equity indices in November: Stoxx600 +6.13%, EuroStoxx50 +8.50%, SMI 3.19%, S&P500 +5.81%, Nasdaq +5.30%, Hang Seng +20.33%!

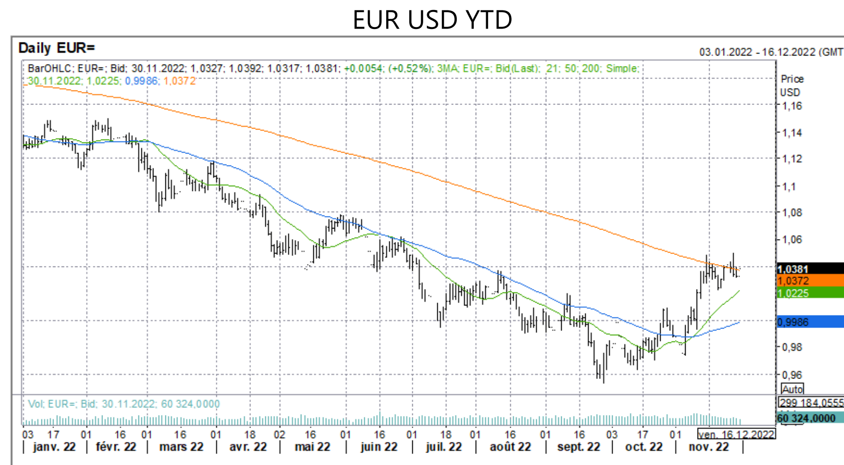
Stoxx600 2Y

Nasdaq 100 2Y

FOREIGN EXCHANGE MARKET

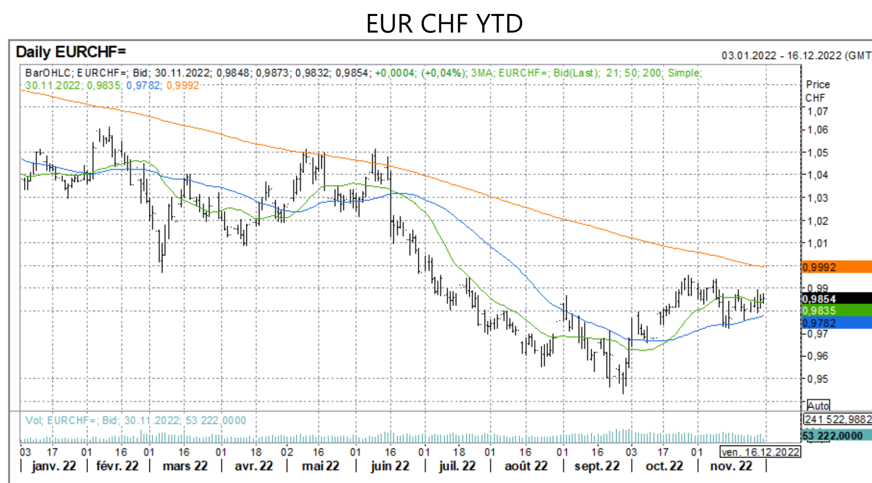
Dovish reading Fed minutes combined with increasingly hawkish ECB communication mean that EURUSD remains close to recent multi-month highs. The fundamental picture, however, does not point to further potential upside yet: China's mobility restrictions are deepening, gas prices are off their lows, the verdict is still out regarding US inflation moderation and EURUSD short-term is closer to parity. In brief, the Euro area still faces stiff headwinds from energy shortages, and many smaller economies are more sensitive to changes in the policy rate due in part to a proliferation of variable rate mortgages. In comparison, the US economy has a brighter outlook, and may be less sensitive to higher rates.

EUR USD YTD



The Euro is deeply undervalued by most conventional standards, but we see good reason to be sceptical about those valuation estimates at this time. The Euro area's current account has deteriorated significantly in recent months, driven by higher prices for energy, and it could swing even lower, generating a material impact on prospective returns for the Euro. Our commodity analysis expect that Europe will continue to face gas shortages and elevated prices to rebuild storage levels again next year. On the other hand, the Swiss economy is doing better and is facing lower inflation. This background strengthens the Swiss franc against the euro, which could remain below 0.98 during 2023.

EUR CHF YTD

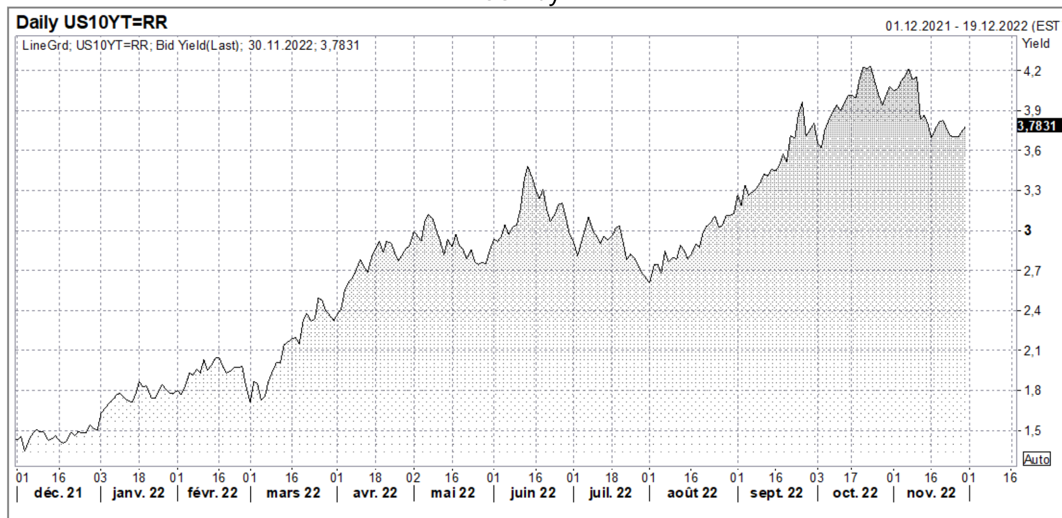


BOND MARKET

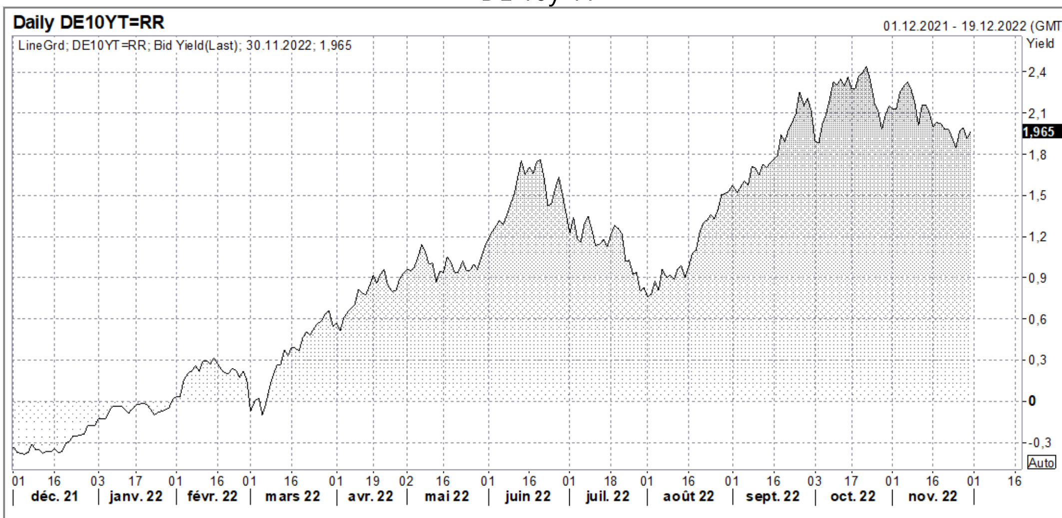
After the slowdown in inflation in October, yields have contracted on most bonds, both European and American. We expect 10-year U.S. Treasuries and German Bunds to peak at 4.5% and 2.75% respectively in the first half of the year. Although we are at the peak of the flattening yield curve in Europe and the US, a significant steepening is far ahead. Inflation prices seem overly optimistic on the normalization of inflation in Europe and the US.

Smaller hikes in interest rates are indeed better and helps to settle bond market volatility. This is still a more significant tightening as we await the impact of four consecutive 75 bp hikes and as the market gradually shifts its mindset from pricing Inflation to pricing Recession.

US 10y 1Y



DE 10y 1Y

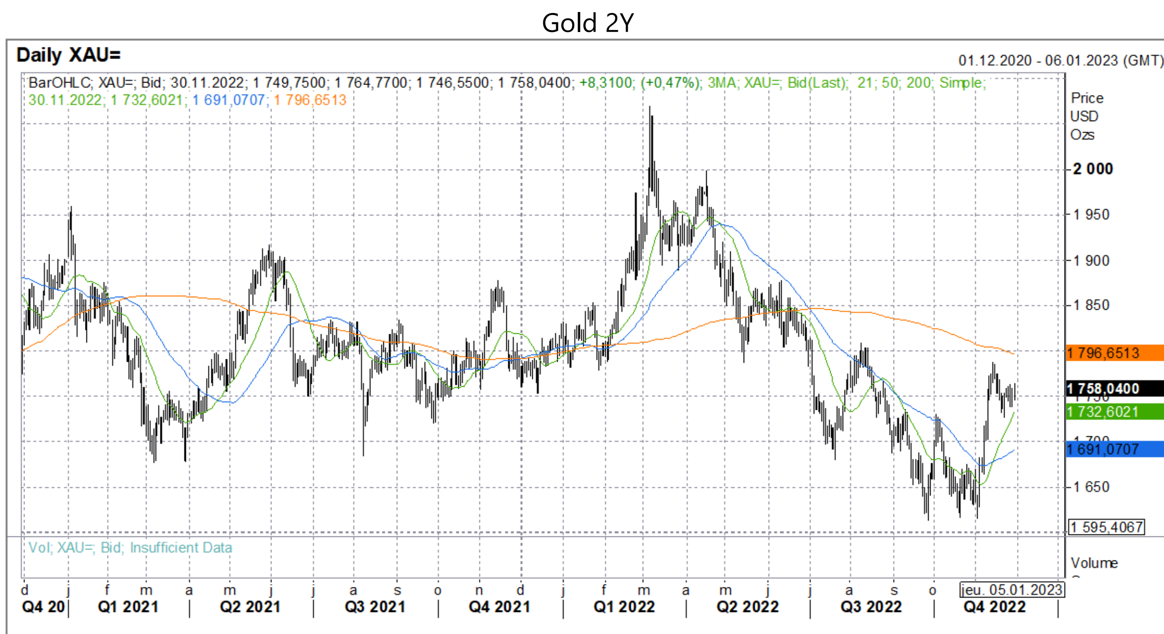


COMMODITIES

Gold has been volatile in 2022. It rallied in Q1 when growth and inflation concerns emerged and it remained unclear how central banks would respond to them. When it became clear that central banks had decided to prioritise inflation fighting over growth support, gold fell in line with the rally in the USD and increase in US real rates. In our view, the reason for gold's relative outperformance is due to the limited scale of physical investor liquidation as a result of to elevated recession risks and support from physical EM consumers.

Looking towards 2023, we believe gold offers an asymmetric payoff. It would likely continue to be under pressure in the event of further hawkish Fed surprises or a US soft landing but the scope of this downside would be limited by cause of already depressed investor positioning. But in the event that a US recession leads to the Fed cutting rates, we believe gold could rally.

Gold 2Y



In recent weeks, oil prices have once again succumbed to growing concerns about future growth and fundamentals. Mainly driven by a significant surge in China's Covid cases, along with a strong dollar and falling demand expectations creating strong headwinds for prices.

With the structural bullish oil supply pattern - due to lack of investment, low spare capacity and inventories - has only strengthened, in our view, the case for higher prices. Furthermore, we expect seasonal rise in the coming months as a result of heating demand in winter.

As a result, from the current depressed level of positioning and prices, we reiterate a bullish price view and expect Brent crude oil prices to average $100/bbl in 2023. At our updated assumptions, it would take an economic hard landing in the US to justify sustained lower prices.

Brent