Market review August 2023

There seems to be no stopping the upward trend. Despite a still unstable geopolitical context and restrictive central banks, equity markets were once again well oriented in July. Most Western indices rose by between 2% and 5%, allowing some of them to reach their highest levels of the year, and the highest since the end of 2022. The vast majority of indices have recovered between 90 and 95% of last year's losses, and are now just a few percent off their all-time highs. Others, such as the Eurostoxx50, have even had the luxury of breaking through this barrier. On the other hand, we can see that small and medium-sized companies are underperforming. The Russell 2000, for example, has recovered 80% of its 2022 losses and still needs to climb more than 20% to move above its November 2021 level. Quite a few brokerage houses have revised their forecasts for the economic cycle, while at the same time making their "mea cupla". Indeed, for most of them, such as Goldman Sachs and Morgan Stanley, the probability of the US economy (and, by extension, the global economy) falling into recession before the end of 2023, amid the most brutal monetary tightening in 40 years, was very high. In recent weeks, given the resilience of the US labor market and consumers, some economists have changed their tune and become more optimistic about the evolution of US GDP. While some are forecasting a recession in 2024, the consensus is now for a "soft landing".

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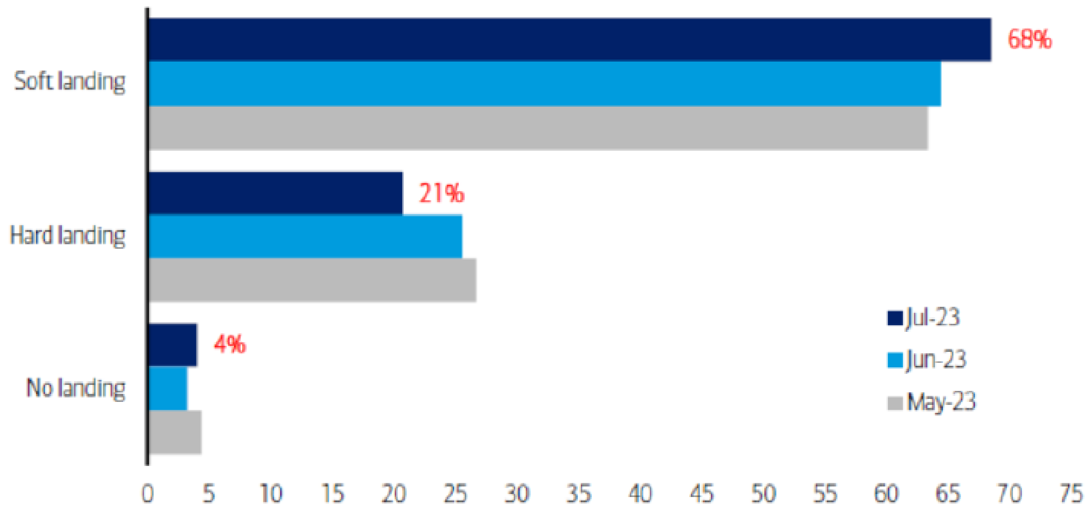
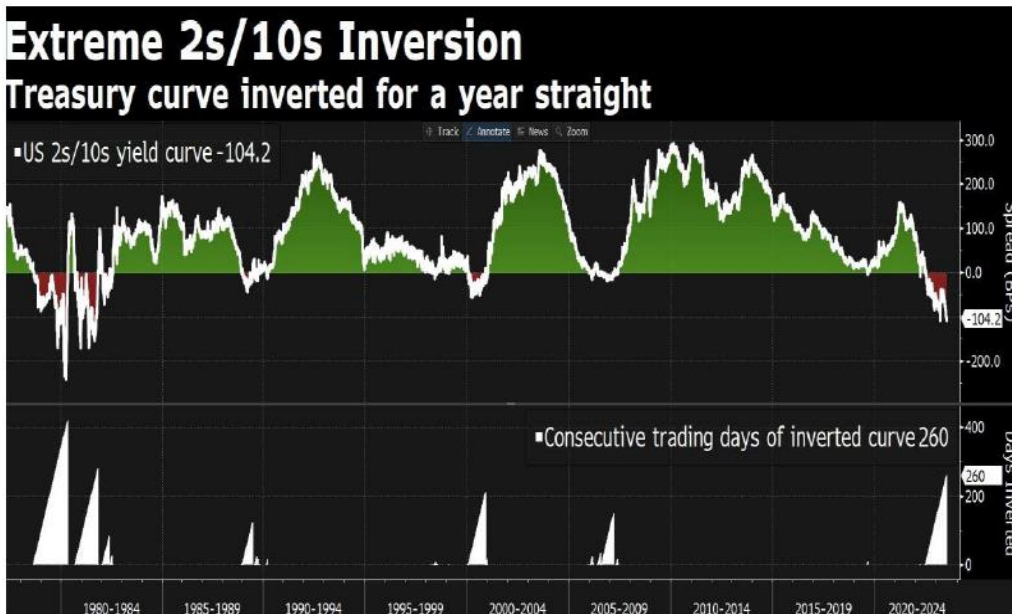


As for interest rates, the trend remains bullish. After flirting with the 5% level, the US 2-year yield ended close to its highs, while the 10-year yield hovered around 4%. The spread between these 2 yields remains at historic levels of -100 basis points. Over 95% of the US yield curve is currently inverted. While nominal yields are lower in Europe, the trend is the same, which is no surprise given that central banks in both zones are applying similar monetary policies. This inevitably keeps the pressure on the entire bond market, which unlike equities, is far from having recovered its 2022 losses.



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Although the trend has been downward since the beginning of the year, most commodities have rebounded since the start of summer. The Bloomberg Commodity Index has risen by over 10% since its May lows, mainly thanks to a strong recovery in oil. The US government's willingness to replenish its inventories and OPEC's recent announcements of production cuts have enabled black gold to find an inflection point to bounce off its $66 support. It's hard to say at this stage whether this rebound will be sustainable, but with a less gloomy economic outlook in the USA and a Chinese government anxious to revive its economy, there are plenty of arguments for oil to return to a price range between $90 and $100 per barrel, despite the colossal investments expected over the next few years to finance the energy transition. Russia's decision to withdraw from the agreement with Ukraine on grain exports to African countries via the Black Sea has brought volatility to grain prices. Following this announcement, wheat and corn futures rapidly gained nearly 20%, only to drop by the same amount a few days later. As a reminder, it was this agreement, among others, that had allowed the FAO Food Price Index to deflate after rising sharply between June 2020 and March 2022. This index is often used as an indicator of famine around the world, particularly in African countries. The yellow metal also performed well in July (+2.38%), but is currently struggling to find the strength needed to break through its resistance of $2,000-$2,050 per ounce. The consolidation experienced by commodities since the start of the year does not call into question the secular trend in this segment. We remain convinced that the energy transition will generate strong demand over the next decade and maintain upward pressure on metals prices in particular. Gold, copper and lithium are among our favorites.

Market trends to end-July 2023

	Equities in Local Currencies							
End of July	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
Perf 1 Month	3.29%	3.11%	1.64%	1.32%	0.51%	0.26%	5.80%	4.48%
Perf 3 Month	8.05%	10.06%	2.57%	0.08%	4.33%	-1.12%	7.15%	-0.36%
Perf YTD	17.74%	19.52%	17.86%	15.82%	17.16%	5.40%	9.47%	3.69%

	Commodities				Currencies vs EUR			
End of July	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
Perf 1 Month	15.80%	14.23%	2.38%	6.21%	-0.81%	0.62%	0.29%	1.90%
Perf 3 Month	6.54%	7.57%	-1.25%	2.75%	0.20%	-4.09%	2.34%	2.78%
Perf YTD	1.92%	-0.41%	7.73%	5.49%	-2.65%	-10.26%	3.33%	3.21%

	Bloomberg Indices Bonds Total returns							
End of July	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
Perf 1 Month	0.69%	-0.07%	0.17%	-0.62%	-2.11%	0.90%	1.96%	1.18%
Perf 3 Month	-1.28%	-1.51%	0.20%	-3.29%	-1.79%	-0.20%	3.35%	1.92%
Perf YTD	2.13%	2.02%	2.42%	0.96%	1.45%	4.34%	7.29%	4.52%

Source: Bloomberg 07/31/23.

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In addition to the release of corporate results for Q2, which on the whole produced no unpleasant surprises, it was the central bank meetings that caught investors' attention in July. Firstly, the FED, as widely expected by the consensus, raised its key rate by 0.25% to a range of 5.25%-5.50%, the highest level since 2001. At the press conference following the announcement, Chairman Jerome Powell confirmed that the battle against inflation was not over, but that the decline in inflation was encouraging. He also announced that a rate cut was not expected before 2024, but that the first could come before inflation reached its 2% target. Future economic data releases will continue to determine the course of monetary policy ("data dependency"). The market has interpreted these comments as relatively dovish, and therefore believes that the end of the rate hike cycle is slowly but surely approaching. Given that these announcements were widely expected, short rates tended to remain relatively stable after the speech. The next day, the tone was more or less the same on the other side of the Atlantic. As expected, Mrs. Lagarde confirmed the European institution's decision to raise rates by 25 basis points to 4.25%, and also hinted that the ECB's future actions would depend on the evolution of economic statistics in the euro zone. The Bank of Japan, meanwhile, had market participants in a state of panic. As we have mentioned on several occasions, unlike Western central banks, the Bank of Japan adopts an ultra-accommodative monetary policy and controls the entire yield curve with an iron fist. At the end of July, its President Mr. Ueda surprised investors by announcing that he was widening the fluctuation band for interest rates from 0.5% to 1%. This was interpreted as the beginning of a change in monetary policy and tended to push the yen higher. Hopes were short-lived, however, as the following day the same central bank announced a new bond repurchase program worth 300 billion yen, or just over $2 billion. As is often the case, the Nikkei reacted inversely to the currency, initially falling, only to recover very quickly. The index is up by more than 27% in local currency since the start of the year, while the Japanese currency has fallen by 8.5% over the same period.

The Japanese Stock Market's "Margin of Safety" Over Government Bonds Far Exceeds the U.S.

Country	10-Year Government Bond Yield	Forward P/E Ratio, Equal-Weighted Basket	Earnings Yield (Reciprocal of P/E Ratio)	Earnings Yield Minus Bond Yield
United States	3.85%	20.1	4.98%	1.13%
Japan	0.46%	15.2	6.58%	6.12%

Source: Refinitiv, WisdomTree Digital Portfolio Developer. Bond yields as of 7/20/2023. Forward P/E ratios as of 6/30/2022. Baskets are the S&P 500 and the MSCI Japan Index. File #0536

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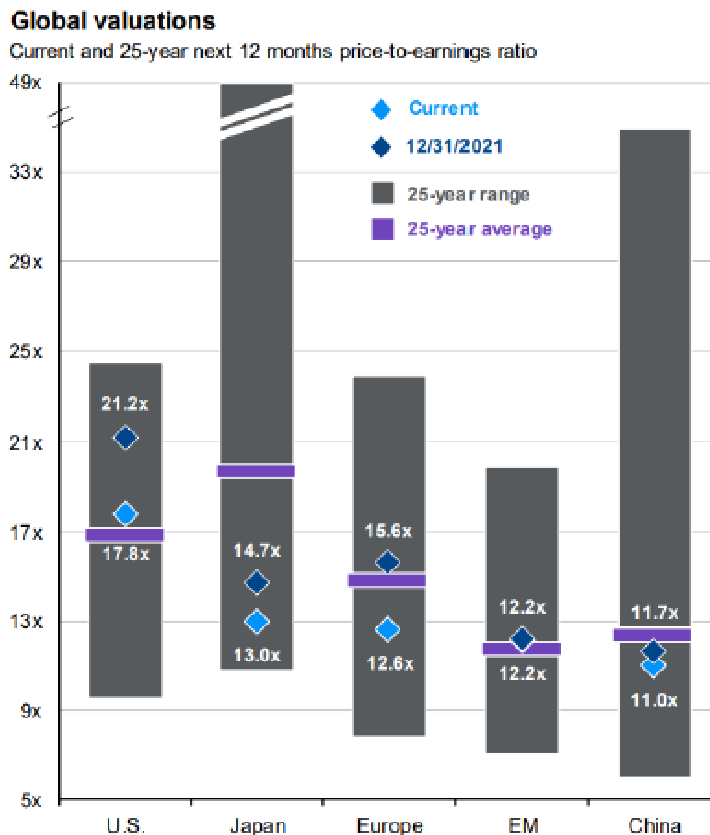
As we mentioned in our last letters, the scale of China's economic recovery has been disappointing since the country's reopening. Even if the PBOC maintains an accommodating monetary policy, economic activity lacks vigor and the manufacturing PMI index has been in contraction territory (below 50) since April. The real estate market is at a standstill, with players as indebted as ever, while domestic consumption is stagnating. This is probably what prompted the Political Bureau of the Central Committee of the Chinese Communist Party (Politburo) to adopt a more accommodating tone in the minutes of its latest summit. The government will launch a vast stimulus operation to revitalize the country's growth. Indeed, even if China's GDP grew by 6.3% in the 2nd quarter, the government's long-term objective of 5.5% per annum cannot be guaranteed, especially if investment and consumption do not accelerate. At this stage, not much has been announced in the way of concrete measures, but it would appear that property ownership standards will soon be eased, while avoiding the temptation to engage in property speculation. Other, more consumer-oriented measures should be announced shortly. Although investors expecting a concrete fiscal stimulus were left wanting, the Chinese market benefited from these announcements. The HSCEI index gained 7.4% over the month, finally posting a positive performance since the start of the year, while the CSI300 index, which tends to represent domestic companies, gained 4.5% in July and is up 3.7% over the first 7 months of the year. This market is lagging behind the European and American indices in 2023. The "common prosperity" principles applied by Beijing since 2021 have scared off many Western investors. Even if "the party comes first", it would seem that, in order to avoid any social unrest, economic recovery is once again a priority for the latter.



Source : JP Morgan

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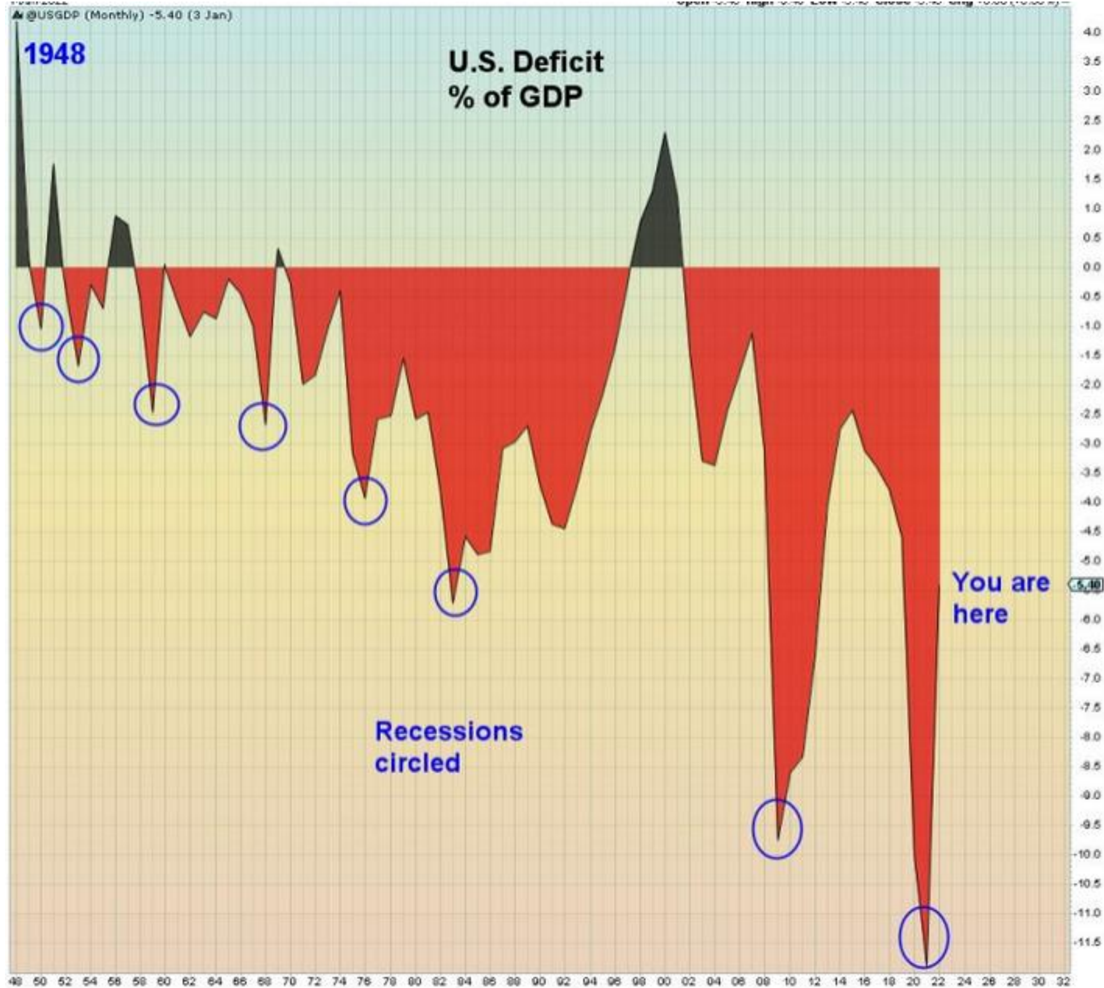
Rumors have been swirling for a few weeks, but now the news is finally out! Following in the footsteps of S&P in 2011, its counterpart, Fitch, has announced that it is downgrading the USA from AAA to AA+. It would appear that the debt ceiling agreement finalized at the last minute in May was not enough to convince the rating agency's economists to maintain their "maximum rating". The main arguments put forward were, firstly, the ever-increasing deficit and, secondly, the erosion of governance, which has led to repeated political conflicts that have put the country in a bad position over the last two decades. Strange as it may seem, at the time of S&P's downgrade in 2011, the US 10-year yield tended to fall... in fact, this decision initiated a wave of "fly to quality" among investors, as US debt remained one of the safest in the world. The S&P500 index quickly lost 10%, but only a few weeks later, the losses had been recouped. Given that Fitch's downgrade occurred only a few hours ago, it's too early to draw any conclusions, but it's fair to say that investor reaction remains rather muted for the time being. Nevertheless, the decision has been roundly criticized by both government officials, such as Janet Yellen, and independent economists. The main criticism levelled at the rating agency is that the timing is not right at a time when the country's economic situation is improving... The fact remains that, since the debt ceiling was lifted, the USA has increased its debt from 31,400 billion to over 32,500 billion, i.e. an additional 1,000 billion in the space of a few weeks. To be mediated.



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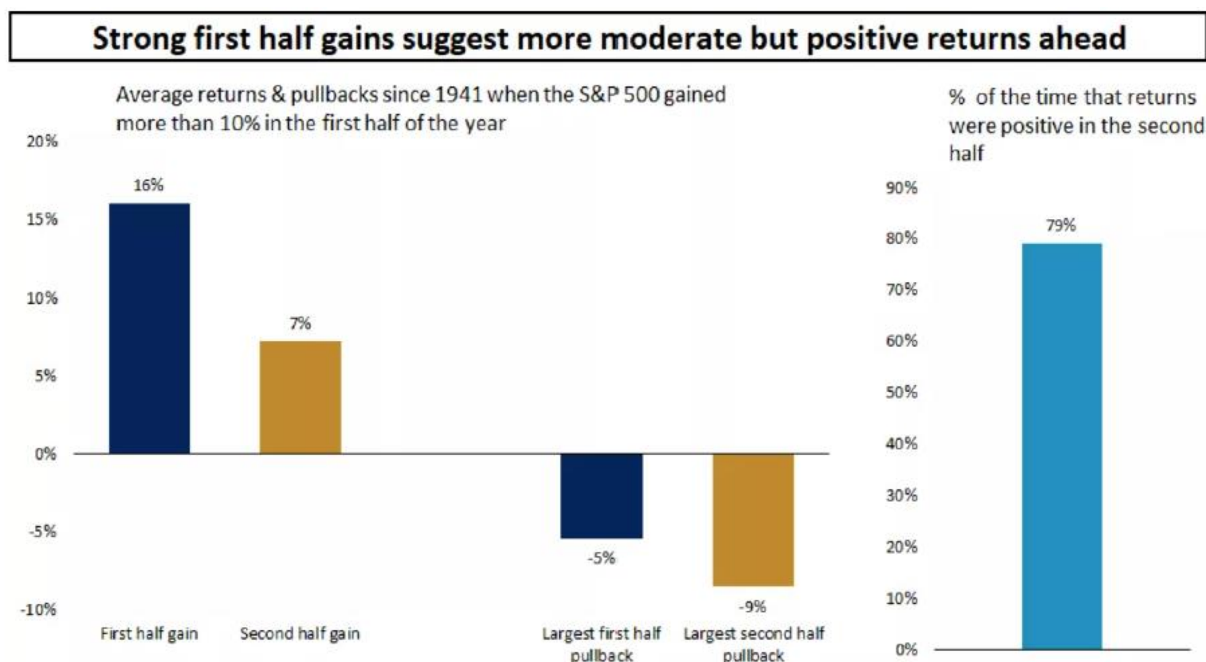
Since the beginning of the year, investors have been looking at the glass as half full. This can be explained by the fact that last year, the degree of pessimism reached its peak. Of course, there are still some areas of risk to keep an eye on, such as the real estate market, which has been hard hit by recent rate hikes. The inversion of the yield curve also prompts caution. On the other hand, companies are doing relatively well, as they demonstrated in the last quarter. Some segments suffered more than others, but overall, results were of good quality, even if future pressure on margins cannot be ruled out given the current level of interest rates. For companies holding a lot of cash, high rates even tended to improve results thanks to the perceived return on their liquidity. Despite high inflation and the fastest rate hike cycle in 40 years, the resilience of the labor market and consumers has surprised many. The advent of artificial intelligence, and the productivity gains it brings, also argue in favor of a positive market trend. Given that the rise in the markets since the start of the year has been mainly due to multiple extensions, we are of course not immune to a correction over the coming months, but if the leaders of listed companies are to be believed, the horizon seems to be brightening somewhat.
We wish you a wonderful month of August and, for those of you lucky enough to be there, a wonderful vacation.



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