Market Review March 2023

What if inflation is once again a source of concern for investors? After several consecutive months of disinflation, inflation has shown signs of strength in recent weeks. Although energy prices are stagnating after their recent decline, it is mainly food and services that are contributing to this recovery. In Europe, France and Spain have seen price increases for the 2nd consecutive month. In the United States, the PCE index, which is the Fed's preferred indicator of inflation, rose from 5.3% in December to 5.4% in January, while the consensus was for 5%. This comes as the potentially inflationary effects of China's reopening have yet to be felt. Indeed, commodity prices have tended to fall in February, which has led to a decline in the share prices of companies active in this sector. The European commodities sub-index gave up more than 6% last month and is now the worst performer. Moreover, in Europe, the automotive sector (+6.45%) was the best performer thanks to strong earnings reports. Despite the strong rebound in interest rates, the technology sector was also among the winners. In terms of the overall European indices, the performance ranged between +2 and +4% for most of them. The picture is not the same in the United States. While the Nasdaq limited the damage by losing only 0.49% over the month, the S&P500 and the Dow Jones suffered losses of 2.61% and 4.19% respectively. For the latter, this correction even brings the annual performance into negative territory (-0.99%). The European outperformance is therefore very clear at the beginning of the year. This can be explained by the fact that the valuation of European equities is low compared to US equities, which generates investment flows from the US. The weakening of the Euro in recent years against the US Dollar is also probably an additional argument.

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Interest rates rose again in February. The latest statistics suggest that economic activity remains robust, as does the job market with unemployment at its lowest level in over 50 years in the US despite high inflation. This has been reflected in long rates, but even more in short rates. The US 10-year yield approached 4%, while the 6-month yield rose above 5.10%. The inversion of the curve between the 10-year and the 2-year rate has further increased to reach -90 basis points, the lowest level since the 1980s. More than 90% of the U.S. curves are inverted. Historically, when more than half of them are in negative territory, the probability of facing a recession within 12 months is high. The movement has been just as pronounced on German rates where the 10-year yield has risen from 2.28% to 2.65%. However, credit spreads remain at relatively low levels, which confirms the good health of corporate balance sheets and that they should be able to cope with the rise in rates. In this context and after four consecutive months of decline, the Dollar Index has regained color by gaining 2.42% in February, which allows it to return to positive territory since the beginning of the year. As we said in the introduction, commodities have suffered from declines. Gold and silver were not spared, losing 5.26% and 11.88% respectively. Digital assets continued their recovery, but remain far from their historical highs of 2021.

Market trends at the end of February 2023

	Equities in Local Currencies							
End of February	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
Perf 1 Month	-2.53%	-2.61%	1.80%	2.62%	3.99%	-1.66%	-6.54%	-2.10%
Perf 3 Month	-0.23%	-2.70%	6.90%	7.86%	12.33%	-0.26%	-0.85%	5.62%
Perf YTD	4.30%	3.40%	11.72%	12.27%	14.16%	3.44%	0.80%	5.11%

	Commodities				Currencies vs EUR			
End of February	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
Perf 1 Month	-2.31%	-0.71%	-5.26%	-2.84%	2.73%	-1.85%	0.22%	-0.14%
Perf 3 Month	-4.35%	-1.80%	3.30%	8.76%	-1.59%	-0.22%	-1.88%	-1.25%
Perf YTD	-4.00%	-2.35%	0.16%	7.04%	1.23%	-2.49%	0.66%	-0.70%

	Bloomberg Indices Bonds Total returns							
End of February	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
Perf 1 Month	-3.32%	-2.59%	-2.09%	-3.24%	-5.08%	-3.14%	-1.89%	-2.23%
Perf 3 Month	0.39%	-0.04%	-3.56%	-1.27%	-10.52%	0.69%	2.88%	1.75%
Perf YTD	-0.15%	0.41%	0.08%	-0.18%	-0.59%	0.49%	2.21%	0.90%

Source: Bloomberg 28/02/23.

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The Central Banks

The main central banks will meet again in the next few days. If the situation seems clear on the ECB side (Mrs. Lagarde has confirmed several times that the key rate should be raised by 50 basis points in March to bring it to 3%), it is a little less clear on the FED side. The consensus is for a 25-basis point hike, but following recent economic data releases, the market is increasingly speculating on a potential 0.5% increase. In addition, the terminal rate has risen sharply in recent weeks, both in Europe and in Uncle Sam's country, where it oscillates around 3.5% and 5.5% respectively. The markets are progressively integrating that interest rates could go higher and stay higher for a longer period of time, which is what the central banks have been hammering out for several months.
On the other hand, it seems that the equity market is not really discounting this new deal. As already mentioned, the technology sector, which as we saw in 2022 is very sensitive to changes in interest rates, still continues to perform well since the beginning of the year. So, it seems that equity investors' macroeconomy interpretation has changed. Last year, equity investors welcomed weak economic data because it meant a potential spike in inflation and, a slowdown in the central bank rate hike cycle. Since the beginning of the year, opinion seems to have reversed. Since inflation is gradually contracting, investors are more concerned about recession, so every better-than-expected economic activity statistic tends to push stocks higher because it implies that the risk of recession is receding. It seems that we are at a crossroads between the risk of inflation and the risk of recession, and investors don't know which way to turn. Nevertheless, bond investors seem to be discounting the risk of inflation, and this is clearly reflected in the rally in rates on both sides of the Atlantic. Who is wrong? Historically, bond investors have proven to have a better macroeconomy reading regarding the evolution of the economic cycle, unlike equity investors who tend to act more wildly and look for short-term profits... only time will tell which asset class is wrong.

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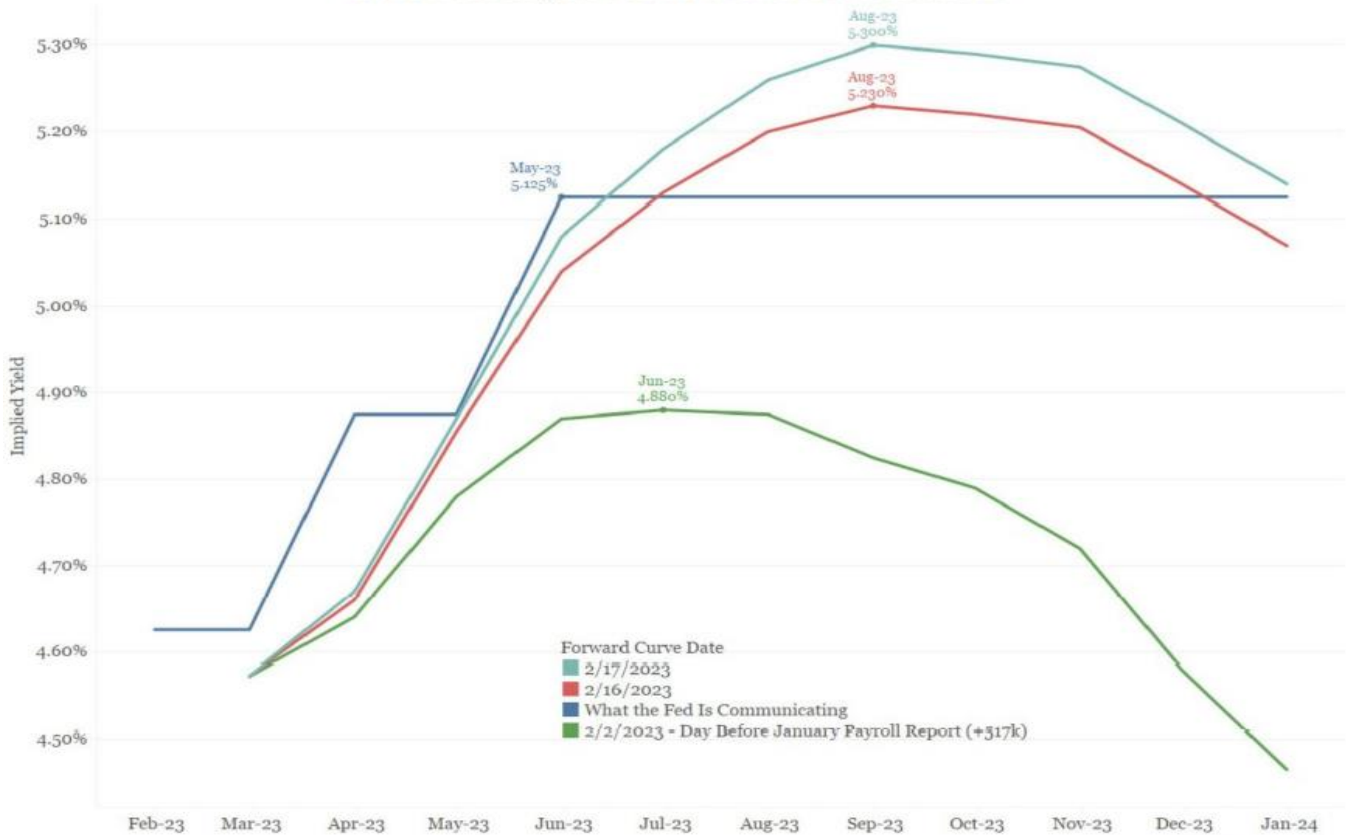

A new governor has been appointed to head the Bank of Japan (BoJ). Mr. Kazuo Ueda, a pragmatic academic, will succeed Mr. Kuroda. His term will begin in April 2023. People who have known Mr. Ueda for a long time say he is difficult to label as "hawkish" or "dovish". He is a consensus builder, a good listener, and does not necessarily seek the role of a leader who imposes his own ideas. These characteristics seem to have already been confirmed. If the market tried to anticipate a normalization of monetary policy at the time of his appointment, which initially pushed up the Yen, Mr. Ueda immediately set the record straight. In his first speech, he confirmed that he will maintain the same policy as his predecessor for the time being. Even the January inflation figure, which was released a few days later and stood at 4.2%, its highest level since 1981, did not raise any eyebrows for the new governor. His mandate is not going to be a smooth one, especially when we know that more than 50% of the Japanese national debt is held by the BoJ. Good luck Mr. Ueda!

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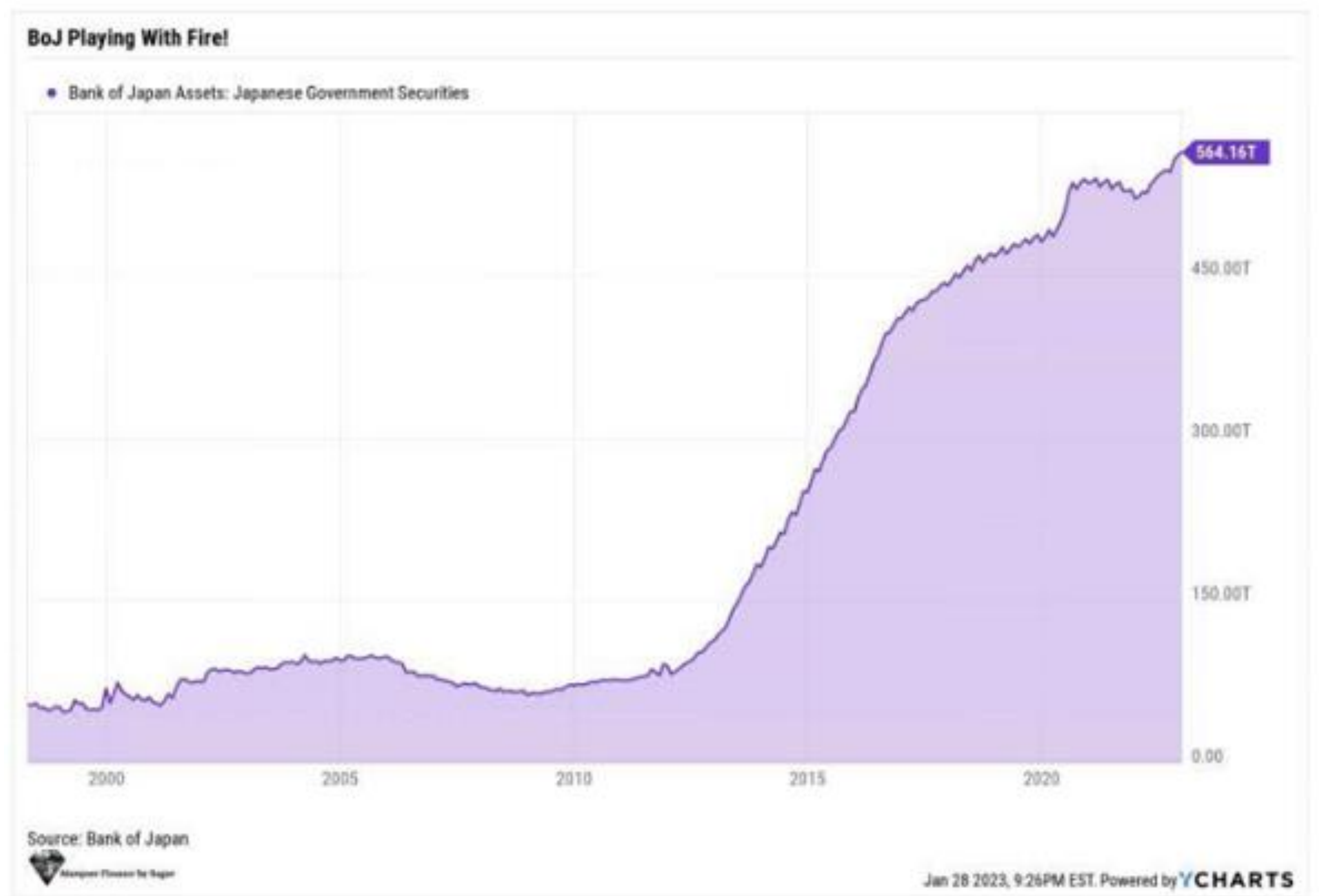

Post-Brexit agreement

Historic! The European Union and Great Britain seem to have finally put an end to the diplomatic tensions that led to extensive press coverage and cost the job of several British politicians (Mr. Boris Johnson will certainly not contradict us on this statement). Mrs. Von der Leyen, President of the European Commission, and Mr. Sunak, British Prime Minister, have reached a trade agreement to avoid customs controls on goods transiting between England and Northern Ireland. This very sensitive issue was a source of contention from the first Brexit negotiations. It should be noted that this agreement must still be ratified by the Northern Irish MPs, but it would seem that a major step forward has already been taken to finally turn the page on this "conflict". This agreement should make it possible to unblock many other files that were at a standstill between the two areas, particularly on scientific cooperation. It is difficult at this stage to assess the potential economic benefits. The positive point for the moment is that European cohesion has been strengthened. This has been undermined in recent years, caught in the "crossfire" of trade tensions between the United States and China. The situation in Ukraine is perhaps not insignificant to this surge of friendship between European allies.

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Source : Le Monde

The private debt of Americans

Last month, we talked about the US public debt and the consequences of the rise in rates on the US budget. Today, we are going to focus for a moment on the US private debt, which is constantly on the rise and worries some political circles. It is important to know that it is cultural for Americans to live on credit. At the end of 2022, the stock of private debt will reach more than 16,000 billion dollars. More than two thirds of this total is mortgage debt, which is partially or fully secured by real estate. We can see from the chart below that other consumer debt has also tended to increase in recent years. The U.S. Supreme Court is currently ruling on the legality of writing off some 400 billion of the 1,630 billion in student debt. In August 2022, President Biden and the Democratic Party took the liberty of implementing a campaign promise by simply forgiving $10,000 of debt for all individuals earning less than $125,000 per year and $20,000 for students who were on scholarship. Following this announcement, more than 26 million applicants filed applications. The bill has been blocked by the courts because some opponents believe that the one authority able to cancel these debts rests within the Congress, not the president. The Supreme Court must take a position by June 30.

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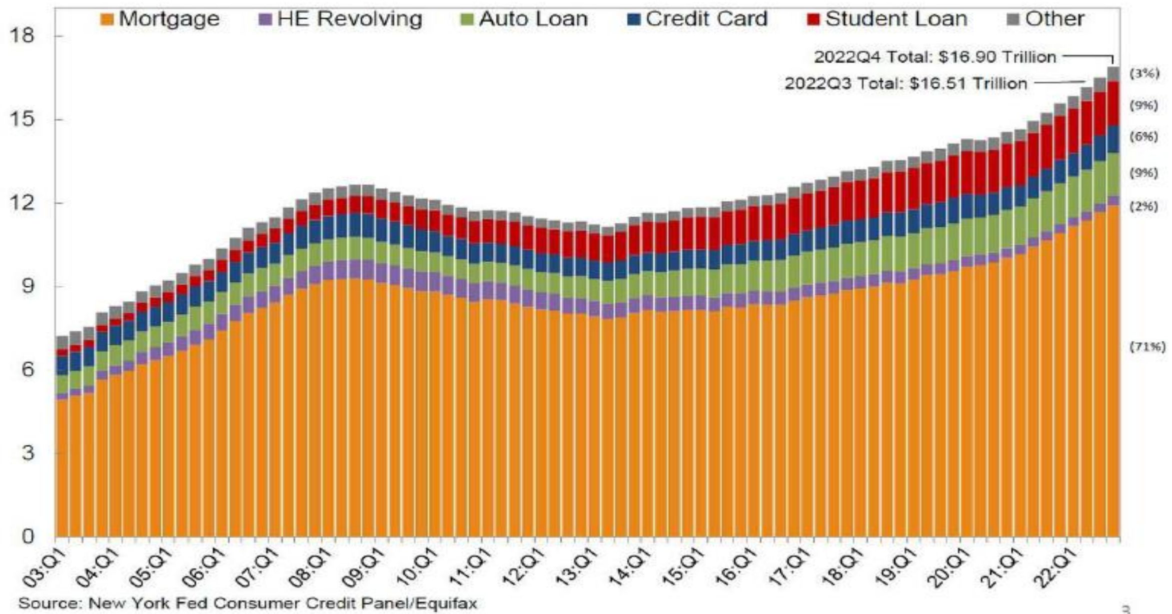
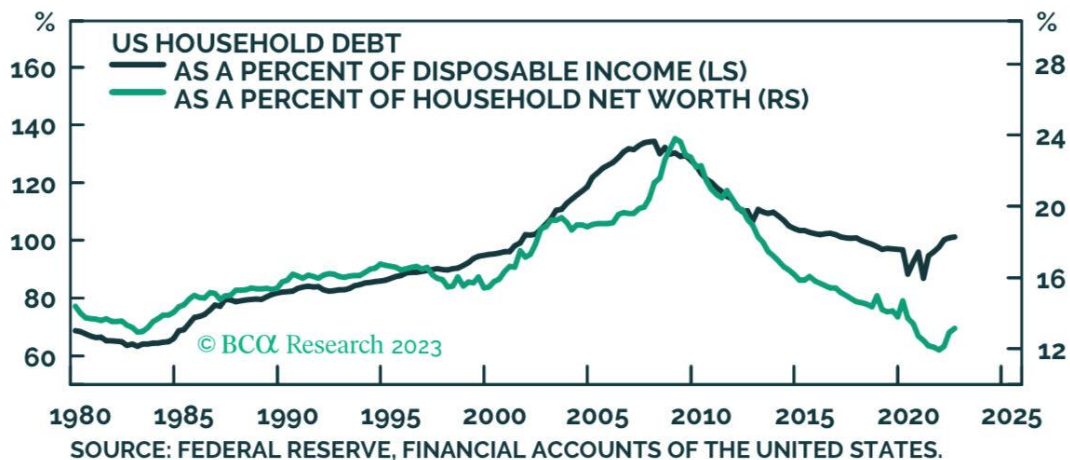


In spite of this colossal amount of accumulated debt, we must nevertheless consider the fact that the financial situation of American households is not catastrophic. On the contrary. As we can see on the graph below, the stock of debt represents less than 15% of the global wealth of Americans. This rate is relatively far from the level reached during the financial crisis of 2008-2009. However, these consolidated figures should be taken with a pinch of salt, because they are consolidated! We can imagine that, on a case-by-case basis, the situation must be less rosy for some over-indebted people. The debates around debt, whether public or private, are not about to end. As long as a profound reform of consumer habits is not elaborated, this problem will remain irresolvable.



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Based on the latest economic statistics, the recession scenario is moving away, but in our opinion, we should not claim victory too quickly. History has shown us that it takes between 9 and 12 months for a central bank rate hike to be reflected in the real economy. Investors are pleased that economic activity remains robust, while the first-rate hikes were 12 months ago in the US and 9 months ago in Europe...the economic statistics of the next few months will be decisive in confirming a soft-landing scenario or a more painful recession. After the TINA effect "There Is No Alternative" which reinforced the bullish trend on equities between 2020 and 2021, the average American investor can legitimately ask himself if it is still worthwhile to invest in risky assets today. Indeed, when a 6-month government investment offers you a return of more than 5% annualized, is it worth taking more risk? Assuming, of course, that government bonds are risk-free. As a reminder, the 1-year CDS is still hovering in the 70-basis point zone due to fears that the failure of the debt ceiling negotiations will negatively impact future US growth. This level does not of course signal a risk of default in the short term, but it is still quite worrying. This context should maintain a high level of volatility in the coming months. This should provide interesting opportunities.

We wish you a good transition to spring.

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