BANQUE
ERIC STURDZA

MONTHLY NEWSLETTER
AUGUST 2023

CONTENTS
AUGUST 2023

1. Editorial
A breath of fresh air in the Summer heat.

2. Fixed-Income
Disinflation and soft-landing.

3. Equities
One word, one attitude, optimism.

4. Asset allocation
Reserved for Banque Eric Sturdza's clients

5. Performances

1. EDITORIAL

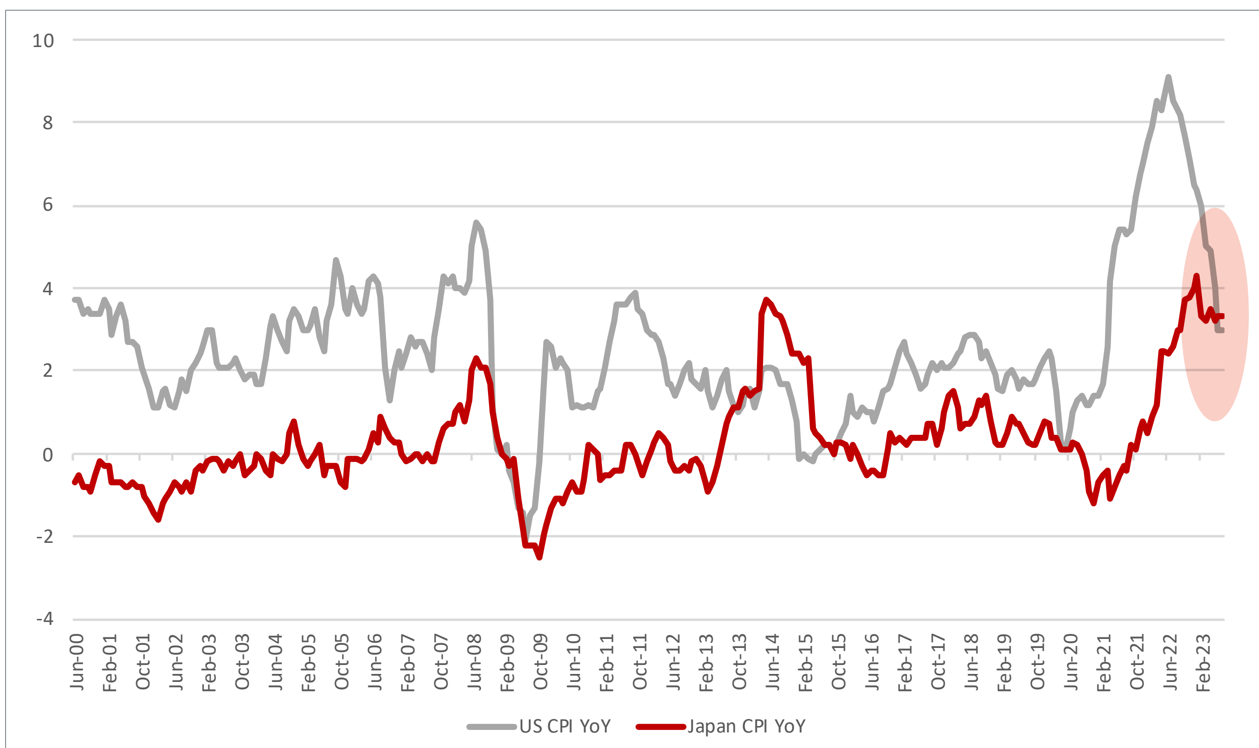
A BREATH OF FRESH AIR IN THE SUMMER HEAT.

Last month, we warned of 2023's peculiar nature, which seemed to have only three winners: the Federal Reserve in its battle against inflation, the Japanese market outperforming in local currency after decades of subpar relative returns and, of course, the 'Magnificent 7' (the FAAMGs – Facebook, Apple, Amazon, Microsoft, Google - + NVidia and Tesla), who were behind the US market's spectacular rise. With such monomaniacal markets, the summer promised to be quite boring... but on the contrary, this month has been particularly instructive.

With headline inflation down from 9.1% in June 22 to 3.0% a year later, at a cost of the most violent rate hike cycle since the Volcker era, and more astonishingly, without triggering either a rise in unemployment or a recession (at least for now), Jerome Powell could legitimately have claimed victory. Yet this did not stop him from raising his key interest rate for the 11th time in July, and leaving open the possibility of another. With core PCE, the Fed's preferred measure of inflation, at 4.1% we are still a long way from the 2% threshold anchored in central bank dogma and, above all, disinflation is mainly about falling commodity prices and the very favourable energy component comparison. Mr Powell is well aware of these factors and the base effect will become less favourable from September onwards.

While the Fed can at least claim a half-victory on inflation, the Bank of Japan (BoJ) is far from it. Headline inflation in Japan, at 3.3% year on year,

G1 : HEADLINE CPI YOY - JAPAN VS. UNITED STATES



Source: BLS, Japan Ministry of Internal Affairs & Communications, Banque Eric Sturdza

can even boast of being higher than in the US (see chart 1), a first for Japan since 2013 and the short-term CPI boost provided by the VAT hike. After being plagued for almost three decades by endemic deflation, the BoJ's tolerance of higher inflation is largely understandable. Nevertheless, it has its limits, and the impoverishment of Japanese housholds and the sharp JPY depreciation are among them, justifying the recent BoJ decision to tolerate higher long term rates (up to 1.0%) in its yield curve control. Although the repercussions on Australian and US rates – Japan remains the largest external holder of US Treasuries – are harder to quantify, it should support the Japanese yen over the long run, and its continued depreciation seems no longer inevitable.

Finally, with the earnings season in full swing, a number of lessons are emerging. The first is that the "Magnificent 7" are not behaving uniformly. Meta and Google's impressive results contrast with lacklustre Microsoft performance, where expectations were high against a backdrop of AI frenzy. Secondly, leadership this month goes to the financial sector, energy and small caps on the US market. Finally, and most impressively, Chinese stocks have started to rebound (at last). The economic reopening has fizzled out, and the authorities want to rekindle the "animal spirit" through further fiscal and monetary stimulus.

July has therefore proved less monotonous than anticipated. The soft landing of the US economy in 2023 and the end of the rate hike cycle are confirmed. Japan is asserting itself as a promising investment theme, but investors will have to count on a currency effect that will no longer necessarily be negative. China is (finally) waking up! In short, markets' breadth improved with increased participation (stocks, sectors, geographies and styles), a signal that is all the more encouraging in that it is not accompanied by a collapse of the previous leaders, but one that will need to be confirmed in the months ahead.

2. FIXED INCOME
DISINFLATION AND SOFT LANDING.

Fed, ECB and BoJ in action

In July, the fixed-income markets entered a period of transition. Those in favour of a recession were largely outnumbered by those in favour of a soft landing. A double soft landing to be precise: a simultaneous soft landing for economic growth and inflation. "Higher for longer" is the new consensus on US short term rates.

The FOMC meeting on 26 July came as no surprise. A 25 basis point hike, a cleverly distilled vagueness about a further rate hike on 20 September and unchanged quantitative tightening (QT)... The inflation rebound that will inevitably occur over the next two to three months means that we can no longer completely rule out Fed funds at 6% at the end of the year.

The ECB also raised its key rates by 25bps, though part of its territory is already in recession. Inflation is falling, but even more slowly than in the US. The next meeting on 14 September will be a risky one, and Madame Lagarde will have to justify her policy of continuing to raise rates during a period of sharp economic slowdown.

The most important of the three central bank meetings in July was that of the BoJ. With the inflation rate now at 3.3%, the BoJ modified its YCC (Yield Curve Control) policy by raising the ceiling it set for the 10-year JGB from 0.5% to 1%. This is likely to cause even more volatility on the US Treasury bond market in the weeks ahead, disrupting US long-term rates and the rest of the market by domino effect (the German Bund, for example).

Several shades of 'yes'

Our current convictions can be summed up as a succession of "yes'es" tinged with nuances ranging from "yes but" to "yes of course".

Yes to investment grade for its still attractive carry, but not for active management at these spread levels, which are considered too low. Yes, but in homeopathic doses in our global investment vehicle, to hybrid corporates after a brilliant run (+4.5% since the start of the year). A big yes to long duration in our global fund, with 10- and 30-year yields now at 4%. A very big yes to short-term Treasury bills at 5.5% and finally for the most qualified investors a huge yes to short (inflation-linked) TIPS on a buy-and-hold basis at 3.10% real rate over 18 months.

3. EQUITIES

ONE WORD, ONE ATTITUDE, OPTIMISM

The earnings results season is well under way. At the time of writing, almost 50% of S&P500 companies have already released their quarterly figures. Although it is still early to draw any conclusions, the surprises – in relation to lowered expectations – are generally positive in terms of both sales and profits.

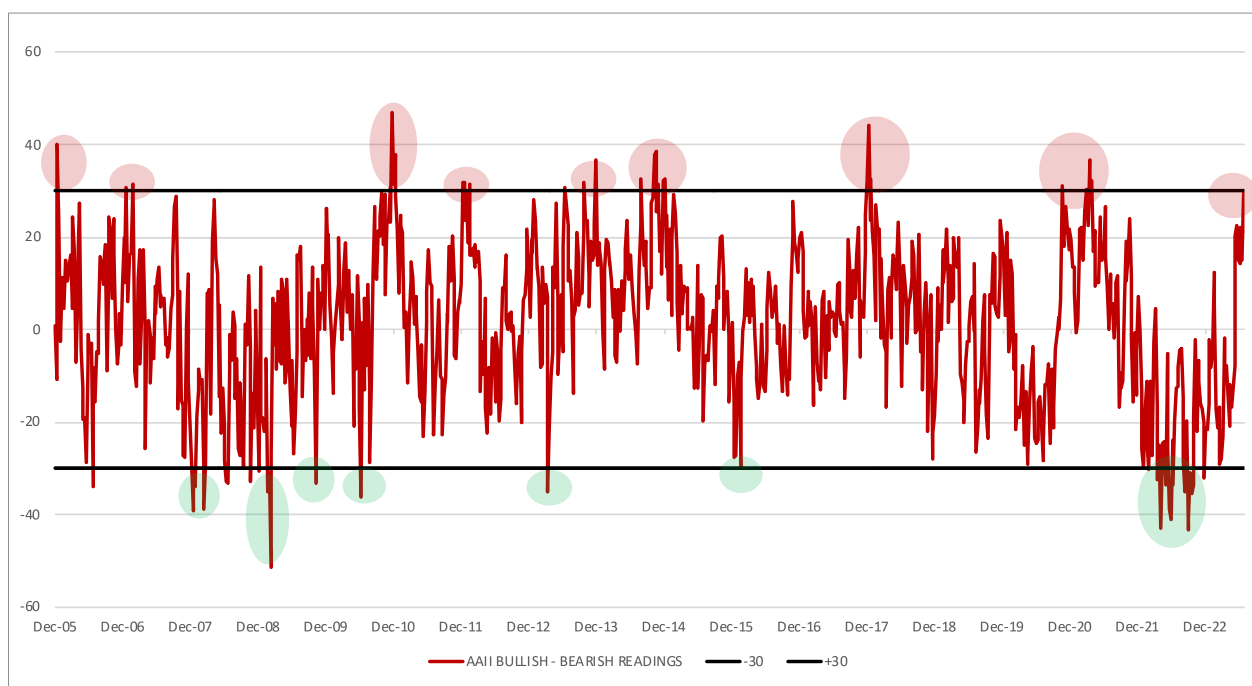
With the exception of a few sectors, such as materials and energy, all the others are seeing upward revisions to earnings growth. This helps to rationalise, at least in part, the valuation level at which US equities have been trading in recent months: estimated price to earnings are at 20.7 times, a multiple more than one standard deviation higher than its average of the past 20 years.

In addition, the Citi Economic Suprises indicator for the US economy is at its highest level since Covid. On the macroeconomic front, too, the US economy is doing better than expectations and appears unshakeable.

The indicators are therefore back in black in the US, and even headline inflation fell to 3% year-on-year in June, temporarily and strongly helped by the deflationary effects of energy costs. Core inflation (excluding energy and food costs) has eased, but remains at a (too) high level of 4.8%.

Against this reassuring backdrop, equity markets are gaining, with the MSCI AC World Index up 16.5% over the year, buoyed by significant gains in both the S&P 500 (up 19% YTD) and the Nas-

G2: AAII BULLISH VS. BEARISH READINGS



Source: AAII, Banque Eric Sturdza

daq Composite (up 36.7% YTD), two indices that clearly benefited from the outsized gains realized by the FAAMGs, NVidia and Tesla.

Regardless of very high US public debt, its debt to GDP ratio close to 120%, and the Federal Reserve's balance sheet, which despite its recently shrinkage remains twice its pre-Covid level at over USD 8 trillion, the dollar continues to trade above its merits and to be highly valued versus most other currencies on a purchasing power parity basis. The main reasons for this are higher short term interest rates, which continue to support the dollar in carry trades, the once-again proven resilience of the US economy and the fact that, despite the willingness to de-dollarise, the dollar is still the most widely used currency in international transactions and as a currency reserve.

Europe has not been forgotten, gaining almost 10% since the start of the year. Yet on the economic front, Europe's performance is struggling to convince.

The bull/bear spread is a market sentiment indicator based on surveys of professional investors. The indicator is published weekly and is used to measure the gap between investors classified as "bullish" and those classified as "bearish". It is used as a contrarian indicator when it reaches extreme levels on one side or the other. In other words, it tends to give a buy signal when too many investors are pessimistic, and vice versa. While the buy signal is generally very relevant even from a timing standpoint, the sell signal can be harder to read, as bullish investors can remain euphoric a bit longer.

Europe has not been forgotten, gaining almost 10% since the start of the year, led by the Spanish market (+15.5%), followed by the DAX (+15%) – despite the fact that Germany is already in recession – and the CAC40 (+12.1%) – thanks to luxury stocks and Air Liquide. By contrast, the UK and Swiss markets were disappointments, with modest gains of 2.0% and 3.0% respectively for the FTSE100 and the SMI, penalised by their commodity bias in the former case and by the strength of Swiss Franc in the latter.

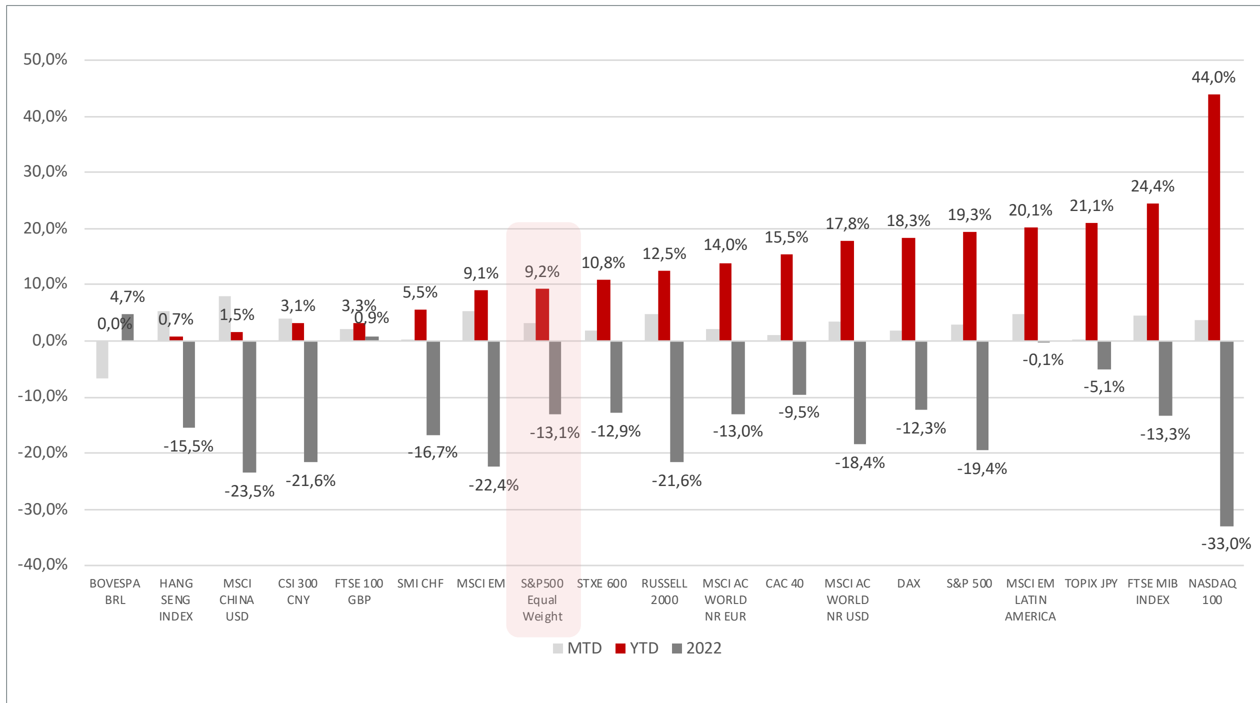
Yet on the economic front, Europe's performance is struggling to convince, with purchasing managers' indices (PMI) falling sharply and below the 50 threshold, marking a phase of economic contraction. Rising interest rates are already hitting credit activity with lower loan demand. Wage rises are now close to the inflation level, which seems to be levelling off at around 5.5%. This should help to partially absorb the drag on the eurozone economy, at least consumption, which remains buoyant as consumer spending in the eurozone is at pre-Covid levels.

There were a few pleasant surprises from China, where for the first time the regime acknowledged the current economic difficulties, lending credence to the implementation of a resolution process. Xi Jinping's government continues to announce support measures aimed at the consumer, promising in particular major support for the property sector. Chinese markets are not immune to this, and are recovering a small part of the ground they have lost.

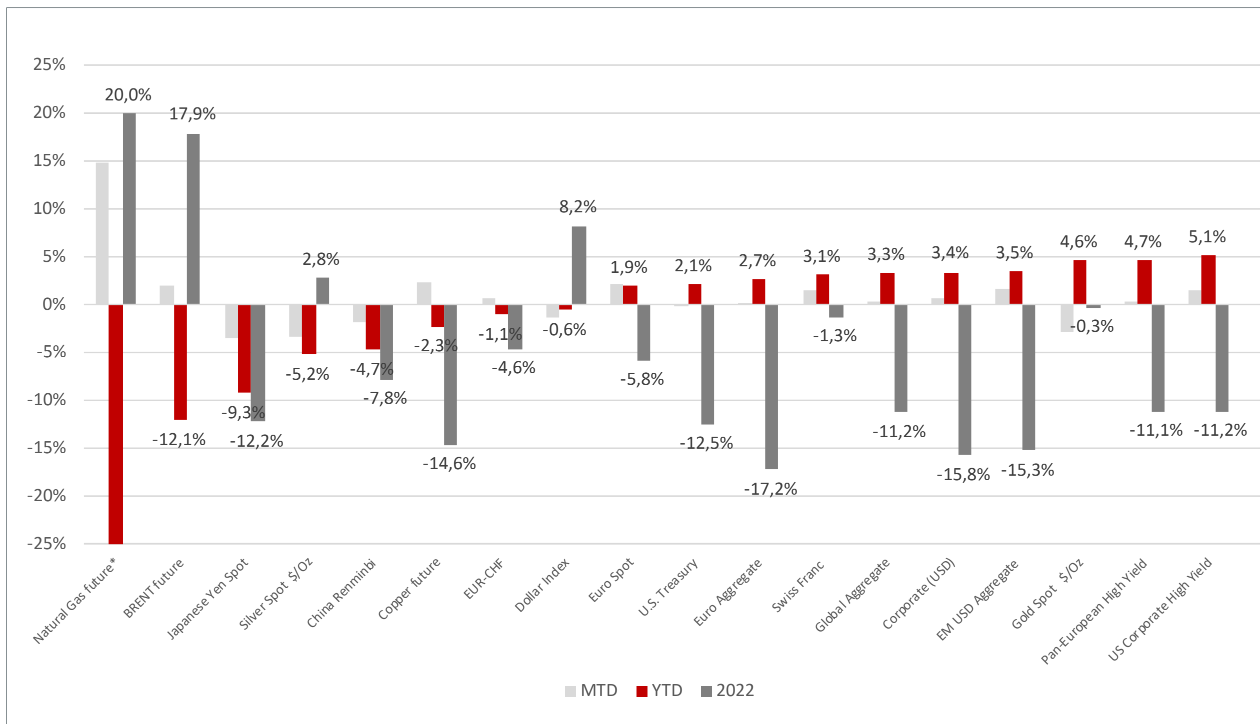
The word "recession" seems to be gradually disappearing from the radar. Investors are reassured by fundamental data and corporate earnings. Earnings per share growth expectations for 2023 are rising again, and the fall in inflation figures supports the current optimistic sentiment. We are taking advantage of these upward moves through our existing investments but remain vigilant, particularly on inflation, which may experience unfavourable base effects from September onwards.

5. PERFORMANCES

EQUITIES IN LOCAL CURRENCIES



FIXED INCOME, CURRENCIES AND COMMODITIES



Source : Bloomberg, Banque Eric Sturdza, 29/07/2023

** Natural Gas : -42 % YTD*

Legal information

This document intends to provide information and opinions on different matters. It is intended only for this purpose. This document does not constitute an advice, an offer nor a solicitation by Banque Eric Sturdza S.A. or on behalf of Banque Eric Strudza S.A. to buy or sell any financial instrument or to subscribe to any financial instrument. This document does not contain any recommendation personal or generic and does not take into account the investment objectives, financial situation or needs, or knowledge and experience of any persons. This document does not contain any offer or any solicitation to purchase or subscribe to any financial services or to participate in any financial strategy in any jurisdiction. It does not constitute an advertisement or an investment recommendation or a research or strategy recommendation. Moreover, it is provided for informational and illustrative purposes only and does not contain financial analysis. This document mentions and presents benchmarks which may only be used for comparison. The information provided must not be relied on and must not be the only source to make a decision about financial investments. It is also not a legal or tax advice, or any recommendation about any kind of financial services and is not intended to constitute any kind of basis on which to make a decision on a financial investment. Banque Eric Sturdza SA is not responsible and may not be held responsible for any loss arising from decision taken on the basis of the information provided in this document or for any liabilities arising from such decision. Although all due diligence has been performed to ensure that this information is accurate at the time of its publication, no guarantee is given regarding its accuracy, exhaustiveness or reliability. The information provided may change, even immediately after publication and there is no obligation to provide an up to date information at any time. Furthermore, the information provided in this document do not intend to provide all the legal and necessary information on financial instruments or on issuers. Other publications from Banque Eric Sturdza SA may in the past or in the future reach different conclusions from the information contained in this document. Furthermore, the present document and the information provided do not in any way engage the responsibility of Banque Eric Sturdza S.A., its affiliated companies, or its employees.

Information on risks

Investments are subject to a variety of risks. Before taking any decision of investment or entering in any transaction, any investor should request detailed information on the risks associated with the decision of investment and with the financial investment. Some type of products are in general bearing higher risks than others but general rules cannot be relied on. It is remembered that past performance is not a reliable indication of future results and that historical returns and past performance as well as financial market scenarios are not reliable indicator of future performance, significant losses remaining always possible. The value of any investment depends also on the fact that the base currency of the portfolio is different from the currency of the investment subject to the foreign exchange rates. The exchange rates may fluctuate and adversely affect the value of the investment when it is realized and converted in the base currency of the portfolio.

Distribution information

This document is not directed towards specified jurisdictions or toward specific person or entity resident in a specific jurisdiction and doesn't constitute any act of distribution, in jurisdiction where such publication or such distribution is contrary to the applicable law or regulation or would be contrary to any mandatory license requirement. This document is provided for the sole use of its recipient and must not be transferred to a third person or reproduced.

We are renovating our main building. In the meantime, we are happy to welcome you in our temporary offices.

Contributors
Edouard Bouhyer, CAIA – CIO
Marc Craquelin, Senior Advisor
Eric Vanraes, Head of Fixed Income AM
Pascal Perrone, Senior Portfolio Manager
Jeremy Dutoit, Head of Advisory

Sent to press on 29/07/2023

Contact
Banque Eric Sturdza SA
Edouard Bouhyer
invest@banque-es.ch
www.banque-es.ch