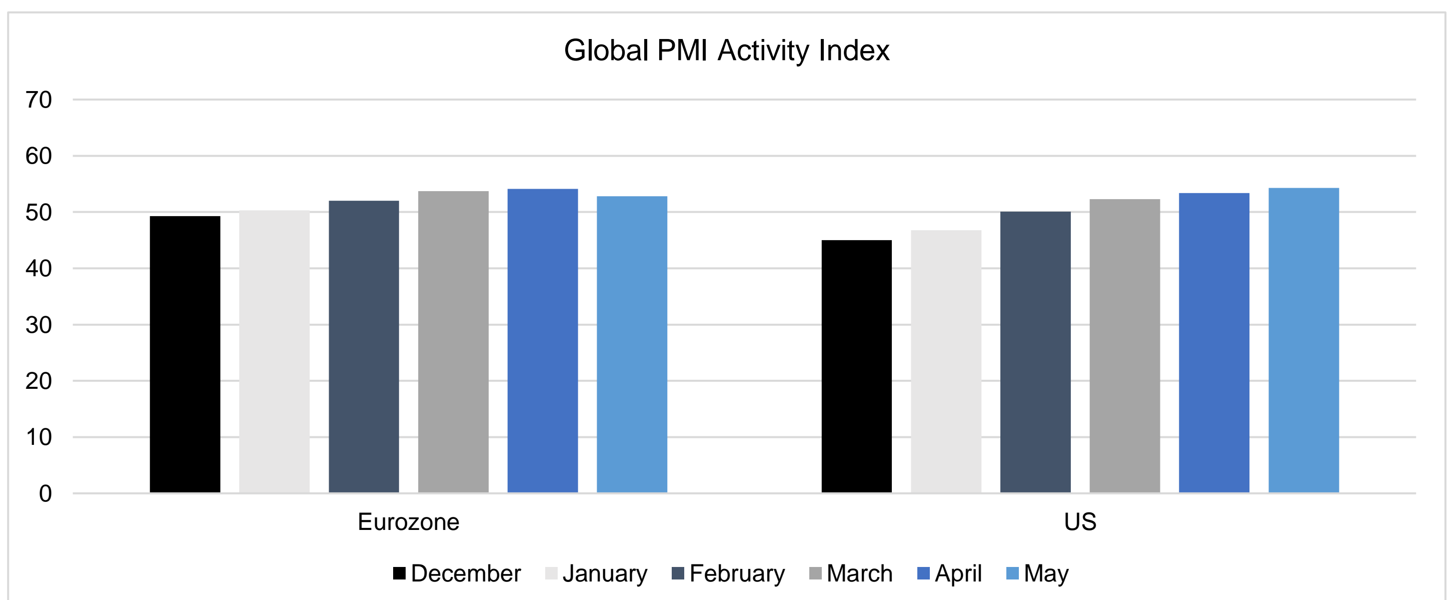
Letter from the CIO

June 2023

Tipping Point?

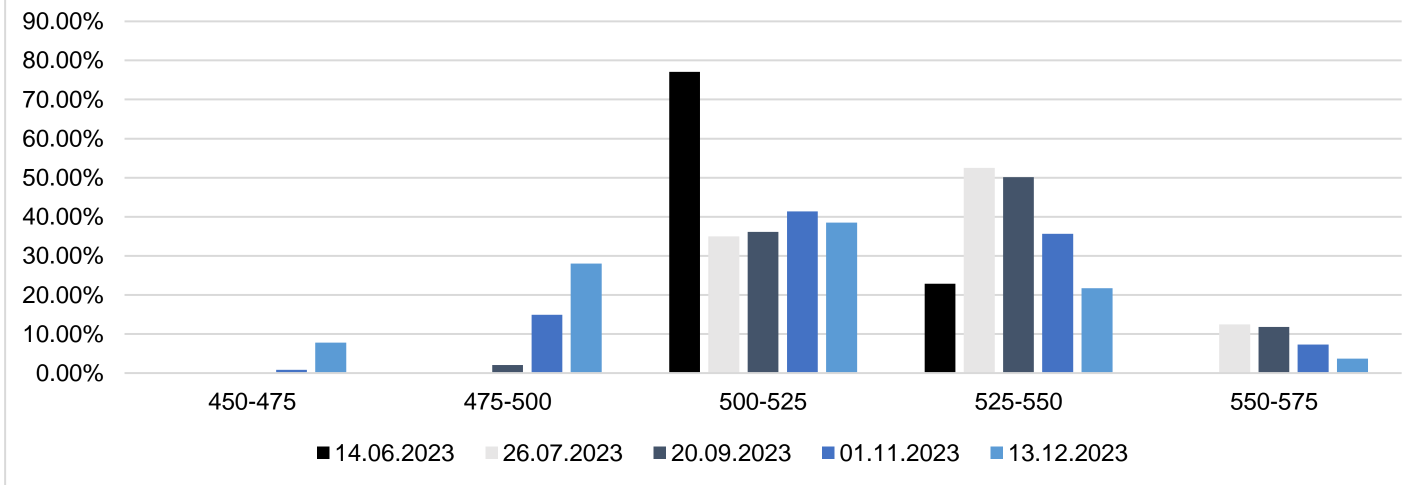
May was a lacklustre month as investors digested the significant rally in equity markets since the beginning of the year, while keeping a close eye on the next steps taken by central banks, with the FED due to announce its position on a potential further rate hike this week. The only event to keep markets on their toes during the month was the bitter negotiations between Republicans and Democrats in the United States to reach an agreement to raise the debt ceiling and prevent the country from defaulting on its debts. After many weeks of tragicomedy, an agreement has now been reached. The text adopted on the 1st of June provides for the debt ceiling to be raised until the 1st of January 2025, a few weeks after the presidential elections in November 2024 but before the next US president takes office on the 20th of January 2025. In return, Biden had to accept budgetary constraints, such as a cap on the growth of federal public spending for the next two years. So, it's half a victory for Biden... or half a defeat. The US S&P500 index closed the month slightly higher at +0.4%, while the Nasdaq soared by more than +5.8%, boosted by frenzied buying by investors in companies involved in artificial intelligence (AI). We are witnessing a phenomenon known as FOMO (Fear of Missing Out), caused by Nvidia's admittedly very good results, which enabled it to join the very exclusive club of companies with a market capitalisation of more than 1,000 billion dollars... but which is now trading at more than 40 times its sales! So we need to be rigorous, as it is very likely that the share prices of these companies will fall in the coming weeks! In Europe, markets closed lower, with the Euro Stoxx 50 closing down by 1.9%. The Swiss SMI also closed in the red (-1.6%), as did the French CAC 40 (-3.9%) and the German Dax 30 (-1.6%). The surprise of the month came from the Greek market, where the ASE index posted a spectacular performance of +12% in May and more than +31% since the beginning of the year. It was the general election victory of New Democracy, the party of outgoing Prime Minister Kyriakos Mitsotakis, that swept the Greek market. The leading opposition party, Syriza, led by Alexis Tsipras, fell well behind the right, even though the polls had predicted a tight race. Greeks clearly voted for stability. The conservative government's solid economic record seems to have won over a majority of voters, giving markets new hope after a decade of financial crisis. In the bond market, German Bund's yields changed little while the US yield curve rose again. The yield on 10-year US Treasuries ended the month at 3.59% (+17 bps). Negotiations over raising the debt ceiling and relatively robust macroeconomic data weighed on expectations. In the credit market, spreads remained stable, dampening the impact of the movements observed in the sovereign curves. This rise in interest rates and the strength of the dollar penalised commodities over the month. Gold lost 1.3% to close at $1962 per ounce, while WTI lost 5.9%. The euro weakened under the weight of the dollar, falling 3% against the greenback.

Our constructive view continues to be bolstered by resilient economic data, particularly in the United States. The recession seems in no hurry to show its face, and the landing could even be a soft one, particularly if the Federal Reserve manages to steer the reversal of its monetary policy skilfully. The country's gross domestic product has just been revised upwards for the first quarter 2023, to an annualised +1.3%. Consumer spending, the main engine of the economy, continues to drive US growth, offsetting the fall in business investment, which has been hampered by wage pressures, rising financing costs and rising commodity prices. The employment market also continues to be in an impressive shape, despite slowing growth. This strength in employment is partly due to the fact that US companies, which used to manufacture in lower-wage countries such as China, are increasingly transferring their production to the US because of geopolitical tensions. We expect this phenomenon to continue over the medium term, given the daunting task of repatriating production for certain industries. This is another positive point for growth over the coming quarters. Finally, although the latest PCE data point to stagnation in recent weeks (4.7% vs. 4.6% the previous month), inflation remains anchored in the right direction. The year-on-year Core CPI measure also confirms this trend.



Source: Bloomberg / Banque Heritage

We are now a little more concerned about Europe, although the employment and inflation components are also pointing in the right direction. The eurozone has just slipped into a technical recession in the first quarter of the year, after Germany, Europe's largest economy, saw its revised GDP contract by 0.3% in the first quarter, following an initial contraction of 0.5% at the end of 2022. The euro area is now forecast to contract by 0.1% in the first quarter of 2023, following a similar decline at the end of 2022. Nevertheless, the fall in GDP is not reflected in the labour market, which grew by 0.6% in the first quarter in the euro area, where the unemployment rate remains at an all-time low (6.5%). According to S&P Global, the composite purchasing managers' index (PMI), which includes the manufacturing and services sectors, came in at 53.3 in May, down from 54.1 in April. But while it is lower month over month, it is still well above 50, with the services sector more than offsetting the slowdown in manufacturing. So, there is no need to panic too much, but stagflation is well and truly entrenched in European countries and growth is likely to remain under pressure in the face of a European Central Bank determined to raise its key rates further.



Source: Bloomberg / Banque Heritage

The announcements by both the FED and ECB over the next few days will be closely watched by market participants. For the time being, investors are expecting no rate hike from the Fed at the June meeting, although a July hike already seems to be well priced in. The example of the Canadian Central Bank, which has just raised its rate after a period of status quo, shows just how dependent current monetary policies are on statistics, and that it is still too early to claim victory.

Optimism, rigour, and vigilance will be the watchwords of the coming weeks!

Have a great start to the summer!

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Chief Investment Officer

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