PLEION WEALTH PARTNERS

Weekly - July 11, 2022

PERFORMANCES 2022	
EQUITIES	
MSCI World	-19.4%
S&P 500	-18.2%
Nasdaq	-25.6%
Stoxx 600	-15.4%
SPI	-14.1%
Nikkei	-6.9%
China	-11.9%
Emerging	-18.9%
BONDS	
CHF Corp	-6.6%
US Govt	-9.6%
US Corp	-14.3%
US HY	-12.9%
EUR Gvt	-13.3%
EUR Corp	-11.2%
EUR HY	-13.0%
CURRENCIES	
USD index	+12.4%
EURUSD	-11.0%
EURCHF	-4.5%
USDCHF	+7.3%
USDJPY	+18.8%
EM FX	-5.5%
COMMODITIES	
Gold	-5.0%
Silver	-17.8%
Brent	+35.6%
Copper	-22.3%
CRB index	+23.8%

New divide

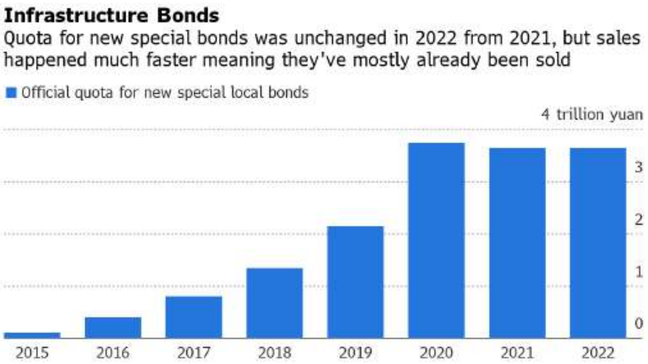
One brakes when the other re-accelerates

Western countries are trying to live with the virus. Governments acknowledge for the population Covid fatigue. The sharp rise in infections is quasi-neglected. It will most probably remain so as long as neither hospital become saturated, nor death rates resurge. It would probably take a more dangerous strain of the virus, possibly by the end of S2, for a change of policy.

Western countries, plagued by overheating / rising inflation, are attempting to engineer a soft landing. Some of them (Europe) disproportionally suffer from the rise of energy prices. They want to sufficiently tame (excess) demand to calm prices, but not too much to provoke a recession. Monetary and fiscal policies have become definitely restrictive in most Western countries except for Japan and Europe and will remain so for at least some time. Central banks' balance sheets are expected to deflate, fueling further evaporation of liquidity. Growth is visibly decelerating, and odds of a recession have become significant.

China is trying to get out of its bad economic and sanitary situation. The country is starting to - quietly - relax its extremely restrictive policy against Covid. We know the weaknesses of the country in the face of the pandemic. The vaccination rate is relatively low, and the Chinese vaccine is not very effective. This is new, the population is clearly showing signs of exasperation, even though the latest economic data are seriously worrying. The Prime Minister has even made some rather critical comments about the - too strict - management of the pandemic by the public authorities. The party is now taking small steps, without formally denouncing itself, to avoid further congestion in the major production centers, notably Shanghai. Confinements are less severe, shorter. Certain sectors of activity, deemed to be priorities, are subject to exemptions.

China is benefitting from western sanctions on oil prices to replenish its strategic reserves at a - very – significant discount prices. Inflation pressure is limited, providing a room to maneuver for reflation policies. Hence, according to Bloomberg, China is rumored to contemplate a direct stimulus to its economy by launching an infrastructure program backed by a $220 billion in bonds issuance. We expect the reflation to accelerate next months to set good economic conditions ahead of the upcoming 20th Party Plenum by yearend, a crucial event for Xi expecting re-appointment.



Source: Ministry of Finance, Bloomberg

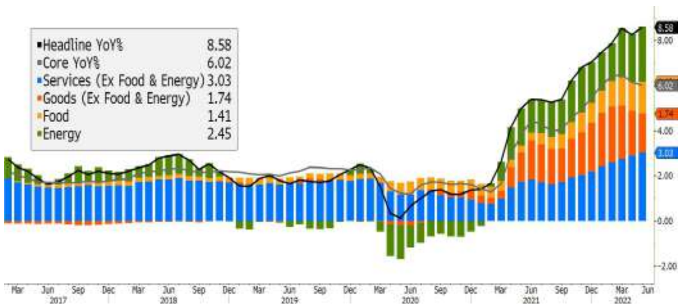
China and the Western countries have been shifting apart at the political, military, technological and financial levels From now on, their economic and monetary trajectories will also take very divergent paths

- *The de-synchronization between large countries / blocks often rhymes with volatility and turbulence in financial markets*
- *Chinese assets will remain highly decorrelated from Western ones. But they may suffer from relative disinterest / outflows (risk premium) due to geopolitics / governance concerns*

Fixed income. Fed fighting inflation at any price

The minutes of the June 14th-15th FOMC meeting, when the Fed hiked by 75bps, reveal a central bank focused on defending its inflation target. The Fed made it clear that it is prioritizing inflation over economic growth. The FOMC acknowledged that a more restrictive stance could be appropriate if elevated inflation pressures were to persist. FOMC members have clearly highlighted their concern about inflation expectations becoming unanchored. As many of them saw the risk of entrenched inflation, they signaled that another 75bps hike at the July FOMC is most likely.

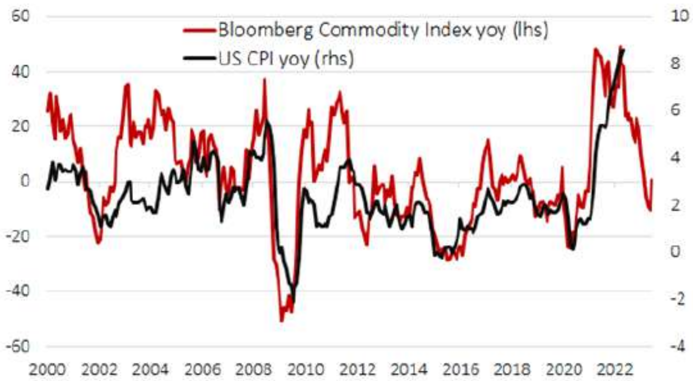
US inflation contributors



Source: Bloomberg

US Inflation data coming this week will be key. They will stay at very elevated levels as energy prices rose in June. The average fuel and gas price were 10% higher than in May, while commodity prices plunged. Services prices have been rising at an increasing rate due in part to higher rents, which could be nearing a peak. On the other side, supply pressures eased. According to Fed regional manufacturing surveys, current delivery times fell, and China-US freight rates dropped amid uncertainties about growth. Furthermore, the labor market is cooling. New job postings track down, the outlook for hiring is also deteriorating sharply.

Commodity prices play a key role in the recent inflation overshooting



Source: Bloomberg

However, things have changed since mid-June. First, over the past 2 weeks commodity prices have slidden. While supply issues are here to stay, recession fears are impacting prices. And it is not just in the industrial metal complex, but also more surprisingly in agricultural space. Even in the energy complex, we have assisted to some setback, even if for now they remain marginal.

Second, manufacturing data confirmed the slowdown underway in the US economy. The ISM manufacturing index fell to 53 in June, its lowest level in the past 2 years, and well off the level of 56.1 a month earlier. While it is still in expansion territory, it confirms that a slowing trend is in place since April. New orders and employment were a particular drag on the June reading. On the service side, business activity rose during the month. The ISM Services index remains above the 50-threshold designating expansion from contraction. However, new orders are declining too.

And finally, the most relevant market-based leading economic indicator, the US yield curve has inverted again. After being slightly inverted in early April, it has turned back into negative territory just after the latest Fed minutes were released, as investor sentiment weakened.

The rapid rise in mortgage rates has wreaked havoc on home affordability, with bigger monthly payments. This has translated into 40% higher monthly payments for a new buyer in the current environment. Cracks are starting to emerge. Realtor.com data indicates a doubling in the number of houses that have seen price cuts, while homes with rising prices have fallen by 1/3. Inventories will eventually rise, which will start to exert downward pressure on prices. This is all part of the clearing process, which will feed into lower shelter costs.

If global commodity prices remain unchanged over the coming months, their contributions to US CPI will tighten.

Activity is an inflation expectations leading indicator

Source: Bloomberg

- *Stay away from linkers even if they have already retreated*
- *Favor nominal over TIPS bonds*

Equities. We remain in a bear market rally

6% rally for stocks over the last 3 weeks. But there is nothing to be so enthusiastic about. US economic data was solid last week (ISM services, durable goods orders and employment), signaling that there is no urgency for the Fed to have a more dovish rhetoric. Its first fight remains inflation. We are heading for increases of 75 bp on July 27th and 50 bp in September. As for profits, they will decelerate, probably decline. If history is any guide, stock indices behave badly when these two situations come together (rising rates and falling profits).

However, there is a positive factor: all commodity prices are falling and inflation expectations are easing.

MSCI World

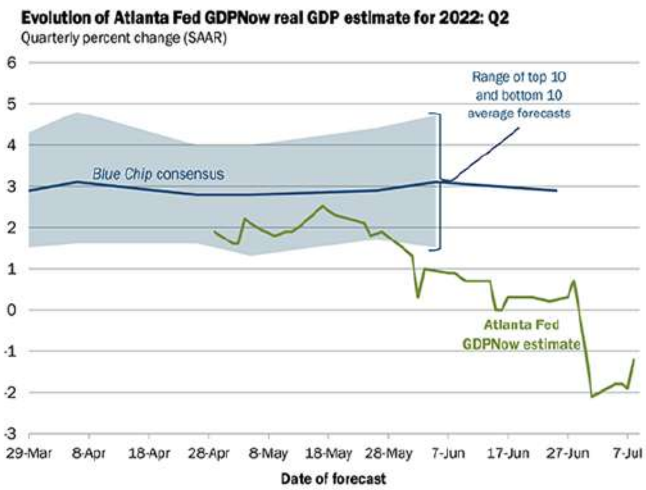
Source: Bloomberg

This week will be important: the June US inflation will be released on Wednesday July 13th and July 14th will be the opening of the earnings season with US banks. We will have Pepsico on the 12th, Delta Airlines on the 13th, then the 14th JPMorgan Chase, First Republic Bank, Conagra, Morgan Stanley, American Outdoor Brands, Cintas, Taiwan Semiconductor and the 15th Wells Fargo, Citigroup, PNC Financial, Bank of New York Mellon, U.S. Bancorp, State Street, UnitedHealth.

The great resilience of corporate profits and margins did not prompt analysts to revise their profit estimates. If there are downward adjustments to be made, it will be during this quarter. For US profits, FactSet and Alpha Lipper remain on a base of +6% in 2Q22, +11% in 3Q22 and +10.5% in 4Q22.

Still, early indications from Asia are pretty solid. Samsung's results boosted the semiconductor sector with a 21% rise in revenue and 12% in operating profit. TSMC reported higher than estimated sales with a 44% rise, signaling that demand is holding up much better than expected. Demand is strong for high-performance chips. The other Taiwanese, Foxconn, announced a 31% increase in sales in June and raised its forecasts for 2022; supply chains are stabilizing and sales of electronics are increasing, including iPhones. Hon Hai Precision Industry anticipates strong sales growth in telecommunications and servers.

We remain cautious. A recession and a decline in profits will result in a further decline in equities. After a 1.6% drop in US GDP in 1Q22, the Atlanta Fed expects a 1.2% drop in GDP in 2Q22. In a "normal" recession, profits fell by an average of 20%. Profits have never grown in a recession.



Some analysts consider lubricants company WD-40 as a precursor to future US results, with inflation, the appreciation of the dollar and economic uncertainties. Its results were below estimates with a 9% decline in sales and 15% in net profit and therefore margins under pressure. Its sales in Europe fell by 21% with the war in Ukraine. WD-40 also signals the negative impact of dollar strength. The other international companies should suffer the same negative factors.

- *The rally could continue, but still in a bear market*
- *Stock indices rise in weak momentum*
- *We maintain our defensive stance*

Raw materials. Fall of prices

Commodity prices have been falling for several months: -36% for industrial metals since March, -16% for precious metals since April, -15% for agricultural products since May and -20% for energy since June.

Source: Bloomberg

Even the prices of agricultural products expected to suffer a supply shock due to the war in Ukraine are falling. The price of wheat has returned to pre-war levels. The soya does not move. Corn prices are recovering a little, but because of the heat in Europe, a cereal that needs a lot of water to grow.

Three factors mainly explain its negative performance: expectations of a global recession, doubts about the Chinese economic recovery and the strength of the dollar.

The positive point is the expectations of a decline in inflation and probably a peak in the United States between April and June.

Inventories remain tight on many commodities, but hedge funds have sold them off amid fears of a recession and demand destruction. They went from long to short positions, even in agriculture, on sugar, cocoa and wheat. The week of June 28, sales of long futures contracts in agriculture were the second largest in history. In oil, prices are easing despite a warning from the JPMorgan bank which says that the price of Brent could reach $380 a barrel if Russia completely halted its exports. On copper, short positions have reached their highest level since 2015.

- *Commodity prices will no longer rise, globally, until the market anticipates an economic recovery*
- *China is a big uncertainty for industrial metals*
- *Russia may completely cut off its gas exports to Europe, but it is not certain that prices will rise sharply, as there could be a sharp drop in demand*
- *There will be buying opportunities, in a few months, as the Supercycle remains valid with the energy transition. In the short term, the recession, China and the dollar are powerful opposite winds*

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