2pm PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly market review

APRIL 2023

Editorial

A first quarter full of surprises...

Despite the most aggressive US monetary tightening since the early 1980s, the equity markets behaved rather well during this first quarter, apart from the bearish break in the first half of March linked to the upheavals in the banking sector. Thus, the Eurostoxx50 rose by 13.74% from December 31 to March 31, while the S&P500 posted an increase of 7.03%. But how to explain this rather "risk-on" mood, as the Anglo-Saxons say, when the international context is still very turbulent?

First of all, we must mention the levels of activity in Europe, China and the United States, which were positively surprising. Let's recall the expectations of operators last fall. A large part of investors feared that the energy shock caused by the Russian-Ukrainian conflict would lead to a recession in Europe and a pronounced economic slowdown in the United States. But against all expectations, the growth momentum remained positive. It is true that the relatively mild winter which has just ended made it possible to attenuate the energy crisis and its impact on the economy of the countries in the Euro Zone, even if the ECB followed in the footsteps of the American Federal Reserve in the level of monetary tightening with no less than 6 bursts of rate hikes since July 2022. On top of that, more fundamentally, on both sides of the Atlantic, consumers have benefited from the drop in energy prices, the improvement in the job market, and stabilized or slightly increasing real incomes. China, for its part, surprised by the speed of its about-face movement regarding the Covid-19 epidemic. In the last days of 2022, Beijing abruptly ended three years of a strict policy marked by drastic lockdowns and repeated testing. Faced with growing protests from the population, the authorities eased the pressure, including on the question of quarantine for arrival in the country, a decision which was eagerly awaited by the world business community. The rebound in leading indicators was not long in coming and in January, the PMI index of Chinese purchasing managers, a reflection of the health of the industrial world, was back above 50, a sign of a recovery in growth of the second largest economy in the world, in a context of improvement in terms of supply chains, after 3 complicated years due to the pandemic and site closures.

We must then remember that monetary actions only affect economic conditions after a lag "both long and variable", to use an expression of the famous economist Milton Friedman. Historically, it took an average of two and a half years after the Fed's first rate hike for a recession to kick in. The first of the cycle that concerns us took place in March 2022. Operators have thus taken a retrospective view of this delay, in an environment that is somewhat where corporate results have been particularly resilient for the moment.

That being said, the collapse of the Silicon Valley Bank three weeks ago highlights the risks associated with aggressive interest rate hikes by central banks. This establishment, whose main clientele is made up of companies in the high-tech sector, was the subject of a panic that led to its bankruptcy. The SVB found itself unable to cope with the flood of its clients' deposit refund requests, forcing the American authorities to react quickly and vigorously with a kind of "whatever it takes" with a Californian swing, ensuring depositors to get their assets back, including beyond the $250,000 limit. Despite its $210 billion in assets, SVB has gone under the radar of banking supervision, which requires institutions to have a sufficient liquidity cushion to face difficulties. Believing that this regulation was hampering the efficiency of the American banking sector, Donald Trump decided in 2018 to raise the threshold from 50 billion to 250 billion from which these solvency rules apply. The boss of SVB, Greg Becker, therefore had free rein to manage the balance sheet of his bank in a rather questionable way. By investing massively in US Treasury bills and long-term real estate bonds, the manager found himself trapped by the rise in Federal Reserve rates, key rates which rose from 0% to more than 4.5% in one year and which triggered a rapid upward normalization of long yields (and therefore a decline in bond prices). When clients wanted to recover their assets, the SVB suffered significant losses on its bond portfolio, which became unsustainable due to the massive nature of the withdrawals.

48 hours later, Signature Bank, which had specialized in cryptocurrencies, was also experiencing significant customer disengagements, thus causing its downfall. And to top it off, on the other side of the Alps, the Swiss authorities were forced to bring about a whirlwind takeover of Credit Suisse by UBS over the weekend. The Swiss bank had accumulated errors and scandals in recent years. Since 2019 alone, it had lost two CEOs, caught up in wrongful deeds. The first one, Tidjane Thiam, had to resign in 2020 after a spy scandal involving se-

	Q1 2023	YTD 2023	Close 31/03/23
DOW JONES	0.38%	0.38%	33 274.15
S&P 500	7.03%	7.03%	4 109.31
FTSE 100	2.42%	2.42%	7 631.74
EUROST.50	13.74%	13.74%	4 315.05
CAC 40	13.11%	13.11%	7 322.39
FTSE MIB	14.37%	14.37%	7 631.74
MSCI EM	3.54%	3.54%	990.28
CRUDE OIL	-5.72%	-5.72%	75.67
GOLD	7.96%	7.96%	1 969.28
EUR/USD			1.0839
EUR/CHF			0.99218
EUR/GBP			0.87902
EURIBOR 1M			2.915%

veral bank employees. Then, it was António Horta-Osório, a famous Portuguese banker, called to the rescue to straighten out Crédit Suisse and who had to throw in the towel in 2022 for having repeatedly violated the health rules relating to confinement during the Covid-19 pandemic. In the meantime, the bank had been accused in 2020 of having failed in its verification obligations and thus financed a Bulgarian drug cartel. But above all, they lost crazy sums in 2021. They had bet nearly $10 billion in Greensill Capital, a British investment fund which went bankrupt in 2021 and lost $5.5 billion during the high profile collapse in the same year of the Archegos family office. But it was not so much the takeover of Credit Suisse by UBS that shook bond markets in mid-March as the fact that the bailout deal included a loss of CHF 16 billion for the holders of "Co-cos", AT1 hybrid debt (additional Tier One). The impact was significant because many European funds were exposed to this type of subordinated debt. With a somewhat strange subliminal message from the Swiss side, namely that ultimately, it is less risky to be a shareholder than a debt holder. The next day, the ECB also felt compelled to specify that in the Euro Zone, things would have happened differently…

The relatively strong macroeconomic data so far, combined with the threat of instability in the financial sector, leaves central banks with difficult choices, as we will detail in our Grand Angle on page 2. Still relatively high core inflation means that further rate hikes would likely help across the Atlantic, but concerns over financial stability are pushing the Fed to hold back. The banking system shock is also expected to act as a form of monetary tightening through tighter lending standards.

In the coming months, we will pay close attention to the possible occurrence of a mild recession in the United States, a hypothesis currently suggested by the inverted shape of the yield curve.

(continued from page 1) Slight, because the solid finances of US households and companies are an undeniable positive point and a brake on an excessively marked recession. This environment, however, is once again becoming more favorable to the holding of government bonds. And in recent weeks, the turmoil observed in the banking sector and the visible tensions on subordinated debt have led us to increase the quality of our bond allocations.

Another subject that we will be monitoring closely is that of earnings expectations. The 12-month earnings forecasts of the I/B/E/S (Institutional Broker Estimate System) have become a little more cautious in recent months, both in the United States and in the Euro Zone. But analysts are not yet predicting the roughly 15% drop in earnings per share that can traditionally be seen in a recession. What's more, price-to-earnings multiples have fallen substantially over the past two years (the P/E of the S&P500 has thus fallen from 23 to 18x earnings, while the Eurostoxx 50 is trading at less than 13x), a sign that in some extent, traders have already priced in some declines in earnings. Always the same difficulty for us managers: trying to determine what is or is not already priced in by the markets... If core inflation were to fall in the coming months, long rates could stop rising, or even start falling again, which could constitute significant support, both for the bond market and for equity markets. Provided, of course, that economic activity remains resilient and that corporate earnings per share do not fall too much.

In China, valuations look attractive. The economy is reopening and Beijing has announced a GDP growth target of around 5% as inflation remains low and the Chinese government has opted not to let housing construction expand aggressively. Despite the significant underperformance recorded by our China equity funds over the past two years, we believe that we must hold our positions, even strengthen them slightly, because the fundamentals are good and the potential for a rebound is real.

China, which today, not content with just being a major economic player, including in former areas of influence such as Africa, is an essential pillar in world diplomacy. If Vladimir Putin still has little support (Iran, North Korea, etc.), he can in any case count on that of the Chinese giant, whose leader was received with great fanfare two weeks ago in the Kremlin. The two leaders promised each other an unlimited partnership and signed a series of agreements. A few weeks earlier, Xi Jinping presented his twelve-point peace plan for Ukraine, which in fact is more of a catalog of good intentions and in any case a way for China to place its pawns. In this balancing act vis-à-vis the rest of the world, Beijing said at the end of 2022 that it wanted to stand on the right side of history. But the balance leans rather for the moment on the Russian side. Because, what unites Beijing and Moscow is their hostility to the Western way of life and their common enemy, the United States, whose hegemony they denounce. Volodymyr Zelensky therefore recently appealed to China, calling on it to become "a partner in the search for a settlement of the conflict in Ukraine". Because of what everyone fears; that China will agree to deliver weapons to the Russian army. For the moment, this is not yet the case. But if that were to happen, it would clearly not be good news for peace in the region. And probably an additional risk for the markets.

Christophe Carrafang

The Big Picture

Central banks: the dilemma between inflation control and financial stability

Reading the latest macroeconomic figures, the persistence of inflation and the resilience of the economy have led investors to revise their interest rate expectations significantly upwards. The robustness of the US labor market, like the economic activity within the Euro Zone, combined with slower-than-expected disinflationary dynamics, fueled expectations of additional monetary tightening on both sides of the Atlantic. However, following recent events – the bankruptcy of the American SVB bank and the forced takeover of Credit Suisse by UBS – central banks have been forced to review their copy. Indeed, tightening monetary policy in order to fight inflation begins to threaten the stability of the financial system. In recent Fed and ECB monetary policy meetings, they have continued to tighten monetary policy – this is the eighth straight hike for the Fed. But, the inflection was clear, both in the projections and in the speeches.

The ECB had clearly announced, at its previous meeting in February, that it would raise rates by 50 bp. By maintaining its rate hike, the ECB has shown that it is not panicking in the face of recent events and has shown its confidence in the European banking sector. They have kept consistency with their objectives and their previous speech. However, they were cautious about further tightening. Christine Lagarde declared that "it is not possible to determine at this stage the future trajectory of rates". Decisions will therefore be made meeting by meeting and based on the data.

In the United States, the Fed opted for a measured increase of 25 bp, which brings the rate range to 4.75%-5%. Members' projections for the terminal rate are now at 5.1% for the end of 2023, down sharply in recent weeks. Fed officials have tried to balance the need to bring down inflation, which is still high, and the risk of increasing pressure on the banking system. Jerome Powell said that "the American banking system is strong and resilient. Recent developments are likely to lead to tougher credit conditions for households and businesses and weigh on economic activity, hiring and inflation." In the words of the Fed, we feel that we are probably close to the end of its rate hike cycle. Powell explicitly indicated that a tightening of credit conditions was equivalent to an increase in key rates.

Central banks will be attentive to price developments over the coming months and will pay particular attention to financial stability. They cannot afford to allow inflation to run, and must at the same time restore calm to the banking sector. They said they had the tools to deal with both risks.

In Jerome Powell's press conference, we can interpret that a contraction in credit conditions could be the element that would push the Fed to a pivot. The next data on the evolution of bank lending figures will be closely monitored. The credit crunch, which is beginning to materialize, will have an impact on growth and could accelerate the US's entry into recession. To mitigate this risk, we recently increased the allocation of Investment Grade bonds and government bonds in the portfolios.

Damien Beasse

Macro-economy

Inflation:

- **The evolution of prices in the USA continues to decline. From a maximum of +9.1% in June 2022, the indicator is now +6% and, excluding economic factors, +5.5%.**
- **In the Euro Zone, inflation growth is also down to +6.9% vs +10.7% in October last year. The “core” indicator, meanwhile, continues to rise; +5.7% for the month of March.**
- **Inflation in China remains largely under control, going from +2.8% in September to +1% in February. With the reopening of the economy, this figure should reverse in the coming months.**

Manufacturing activity:

- **Despite deceasing penalizing producer prices and supply issues that are about to be resolved, manufacturing activity has remained sluggish in recent months. Rising interest rates weigh on investment projects.**
- **In the Euro Zone, the indicator has remained stable since September around 47/48.**
- **In the United States, there has been a slow deterioration since the middle of last year from 52.8 to 46.3 over the last six months.**
- **On the other hand, in China, the rebound has started but remains contained, with manufacturing activity dependent on export orders.**

Services:

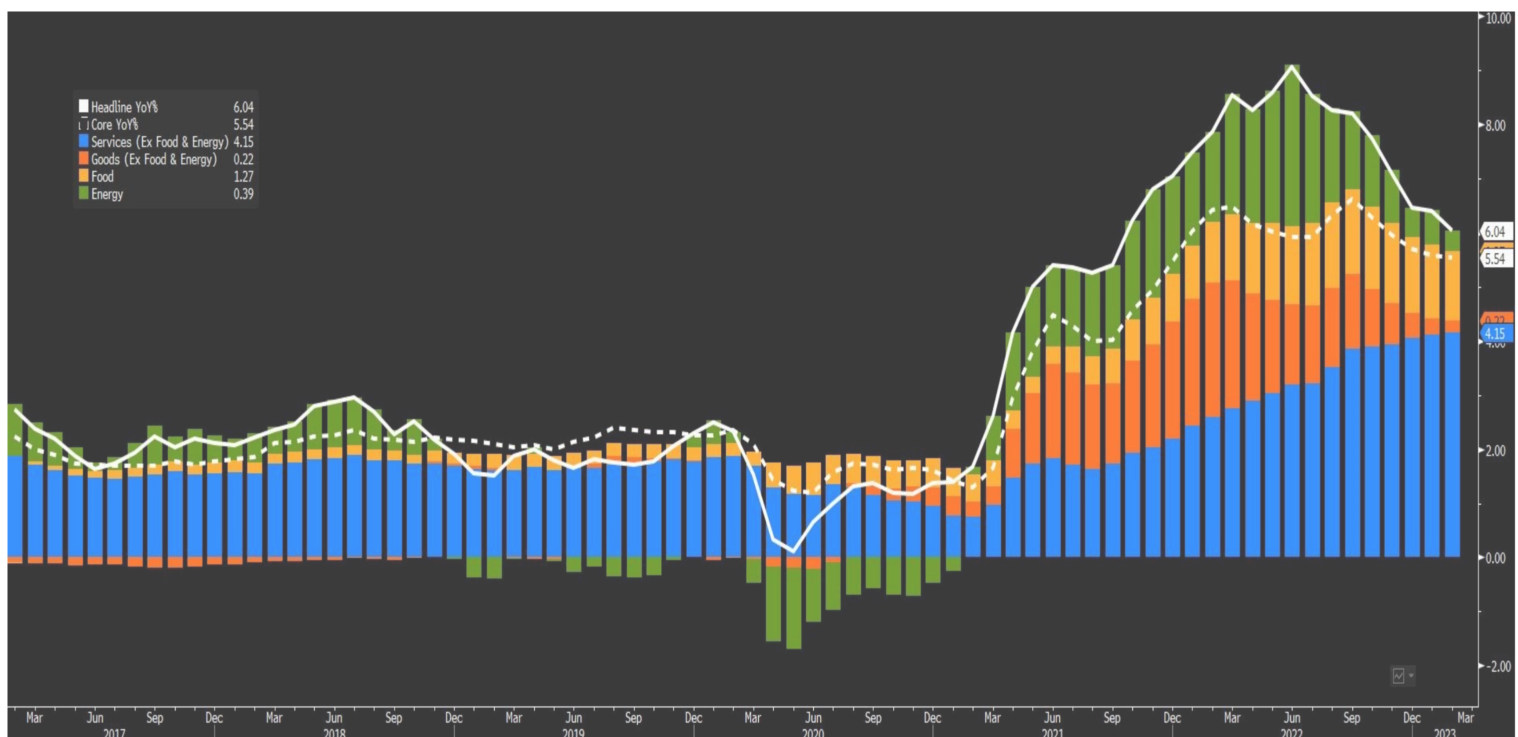
- **Unlike the manufacturing sector, activity in services was broadly stable in March.**
- **With the reopening of the country, the Chinese services PMI rebounded strongly to 58.2.**
- **In the Euro Zone, the index reached the level of 55; a continuous rise since the lows of November which corresponded to the peak of energy crisis fears.**
- **In the United States, activity in services fell to 51.2 after several quarters of stability at high levels (55).**

Job market:

- **Overall, the labor market remains very dynamic with very low unemployment rates and still problems related to the scarcity of the workforce.**
- **In the United States, weekly jobless claims remain low and the unemployment rate at 3.6% has been stable for nearly a year.**
- **In Europe, wages continue to rise; +5.7% over 2022. The unemployment rate is historically low at +6.6%.**
- **In China, with the strong rebound in service activity, unemployment fell to +5.6%, particularly among young people.**

Damien Liegeois

US CPI YoY since 2017



Special Topic

Are we heading towards a shortage of mineral raw materials?

The commodities sector experienced a long desert crossing that lasted from 2010 to 2020. In order to survive in the face of historic price drops, companies in the sector had no choice but to deleverage and to drastically reduce their investments, particularly in exploration; the goal was to make profitability in a world of low prices.

From now on, the situation has changed: not only will there be an energy shortage, but moreover, evolving, at a forced pace, towards a renewable energy mix will require colossal efforts. Added to this is the war in Ukraine, which made Europe aware that it had to move (finally) towards energy independence; the pressure is even stronger.

The challenges are significant. It is thus necessary both to build infrastructure (wind turbines, solar panels, etc.), to adapt and modernize the entire electricity network in order to connect it to these new energy sources, and to accelerate the transition of modes of travel towards a world fleet not dependent on fossil fuels (electric vehicles, hydrogen, etc.).

Each stage of this transition - and this is where the problem lies - consumes a lot of raw materials such as copper, nickel, cobalt, lithium, vanadium... whose demand is only increasing.

For example, between 2015 and 2022, the demand for lithium was multiplied by 4, a trend which should continue in the same proportions over the coming decades. Other eloquent figures: an electric vehicle uses three times more minerals than a thermal vehicle, and charging an electric vehicle for daily trips (40km on average) doubles the electricity consumption of a household...

The last general increase in investments and discoveries dates from the period 2000-2012. Since then, the amount of investments has fallen by 60%. Thus, from this year, on certain minerals, the market will be in deficit: cobalt and many rare earths. Next year, (except in the event of a big recession), it will probably be copper and since 2020, the nickel market has been on a regular basis with sharp one-off price increases. The urgency is there because it takes on average 8 to 10 years between the design of a mine and the mass exploitation of the ore. By 2030, without immediate effort or technological discoveries disrupting the energy storage sector, most markets will be in deficit by 20 to 50%.

Certain objectives, such as the already unattainable goal of no longer selling internal combustion engines in Europe by 2035, will have to be reviewed. Heat engines must contribute to the effort by becoming less and less oil-consuming.

From 2020, on the strength of our convictions, we began to invest in this theme rather downstream, in companies linked to the design, construction and operation of equipment. For the past few months, we have also been interested in what is happening upstream, through funds specializing in mining companies; these will indeed be essential in this transition process and will benefit from the almost certain increase in the price of mineral raw materials.

Damien Liegeois

Lithium mine in Mexico

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