Market Review May 2022

After a little bit of respite in March, risky assets started to fall again in April. The reasons for the correction remain the same, but the situation for some of them has deteriorated further in recent weeks. China's zero-Covid policy, which is experiencing a sharp increase in contamination cases, continues to strain supply chains, keeping pressure on inflation and Central Banks to combat it. The armed conflict in Ukraine is stalling on the ground, while relations between Russia and NATO countries continue to deteriorate. This was all it took for the equity markets to resume the downward trend that began at the beginning of the year. Most indices lost between 2 and 8% during the month with US equity indices underperforming. The Nasdaq even lost more than 13%. The flagship technology stock index, which has outperformed its peers for more than 10 years, is losing its steam. Weaker growth prospects for the coming quarters and inflation that is reaching record levels every month are a lethal cocktail for this segment of the stock market. Netflix, which fell 49% in April after disappointing investors with its first-quarter results, is a perfect example. We believe that the technology sector is not dead, but it is clear that the current economic environment is not favorable to the sector. Valuation ratios have already "deflated", but the pressure could last for a few more months, at least until the market believes that inflation is stabilizing.

European rates continued to rise. The German 10-year approached 1% while the rest of the curve moved into positive territory, at least from the 2-year maturity. Despite Macron's re-election, the French 10-year yield spread widened compared to the German yield in April. The movement is even more pronounced with southern European countries like Italy (+34 bps to 183). The end of quantitative easing and the lack of visibility regarding the ECB's monetary policy are the main reasons for this divergence.
In the United States, the US 10-year yield flirted with the 3% barrier (2.9336% at its highest). The 2 year also rose but to a lesser extent, allowing the yield curve to move back into positive territory after a brief inversion at the very beginning of the month. As you know, an inversion of the 10/2 year yield curve is often a leading indicator of a future recession. That said, statistically, the probability is higher if the spread stays in negative territory for more than 3 months and if more than half of the other yield curves also invert. We will therefore follow this indicator closely, but at this point in time, the probability of a recession in the United States in the next 18 months remains low, even if the statistic published at the end of April is worrying...
Indeed, a few days ago, the first estimate of the US GDP for the first quarter took a good part of investors by surprise. The U.S. economy contracted by 1.4% while the consensus expected 1% growth. This poor result is due to weaker than expected exports (is the strength of the dollar the cause?) and inventory creation penalized by a base effect compared to the 4th quarter. With supply chain problems omnipresent for several months, many companies have been looking ahead during the 4th quarter 2021 to build up large inventories. This strong contribution was therefore logically not repeated in the 1st quarter 2022. We will follow the revision of the second estimate in a few weeks, but this number is not to be taken lightly.

Market trends to the end of April 2022

	Equities in Local Currencies							
End of April	**MSCI World**	**S&P 500**	**EuroStoxx**	**CAC**	**Spain**	**Switzerland**	**MSCI EM**	**CSI 300**
Perf 1 Month	-8,43%	-8,80%	-2,55%	-1,89%	1,65%	-0,27%	-5,75%	-4,89%
Perf 3 Month	-8,61%	-8,50%	-8,90%	-6,65%	-0,33%	-0,80%	-10,93%	-12,00%
Perf YTD	-13,49%	-13,31%	-11,53%	-8,66%	-1,49%	-5,80%	-12,65%	-18,71%

	Commodities				Currencies vs EUR			
End of April	**WTI Oil**	**Brent Oil**	**Gold**	**Copper**	**USD**	**JPY**	**GBP**	**CHF**
Perf 1 Month	4,40%	1,33%	-2,09%	-5,84%	4,97%	-1,66%	0,44%	-0,48%
Perf 3 Month	18,76%	19,88%	5,55%	2,77%	6,55%	-5,56%	-0,38%	1,48%
Perf YTD	39,20%	40,58%	3,70%	0,50%	7,87%	-4,42%	0,27%	1,11%

	Bloomberg Indices Bonds Total returns							
End of April	**Global Aggregate**	**US Aggregate**	**Euro Aggregate**	**US 10 Year Treasury**	**German 10 Year Bund**	**Global Credit**	**Global High Yield**	**Emerging Sovereign $**
Perf 1 Month	-5,48%	-3,79%	-3,42%	-4,14%	-7,05%	-5,74%	-4,59%	-4,33%
Perf 3 Month	-9,45%	-7,51%	-7,61%	-8,30%	-13,88%	-10,30%	-7,68%	-10,81%
Perf YTD	-11,30%	-9,50%	-8,65%	-10,47%	-15,44%	-12,95%	-10,02%	-13,15%

Source: Bloomberg 30/04/22.

There is also a lot going on with currencies right now. In times of geopolitical instability, the US dollar often acts as a safe haven and tends to appreciate. This is exactly what is happening...the US dollar is rising against the Euro because Europe is directly more impacted by the Ukrainian conflict and because the ECB is slow to act to curb inflation. It is also rising against the Yen as the Central Bank of Japan (BoJ) continues to pursue its ultra-accommodative monetary policy. Against the Pound (BoE) the lack of post-Brexit visibility could continue to weigh on the British economy. Even the Chinese Renminbi (heavily controlled by its Central Bank) devalued against the dollar in April. As we can see in the chart below, the Dollar Index (which represents the evolution of the US dollar against a basket of currencies) is at the highest level in the last 20 years. The last time it was above these levels was in 2000, in the middle of the internet bubble bursting...A strong dollar is a very good thing for the foreign purchasing power of Americans, but it is a very bad thing for exports and we could notice it in the last estimate of the US GDP.

We are watching the current level very closely. A monthly close above 105 could add to the dollar's strength and we could even see the Euro momentarily drop below parity. This is not the scenario we favor, but in the current climate of uncertainty, nothing is impossible.

Source: Bloomberg, Weisshorn

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Let's go back for a moment to the conflict between Russia and Ukraine. After the various sanctions imposed by Western countries on Russian companies and some indvidiuals, the Kremlin has brandished a weapon that was not really expected. The latter has requested that from April 1st, gas invoices addressed to "hostile countries" should henceforth be paid in Rubles. The European Union immediately objected to this condition. The fact remains that these first invoices are due and, in the eyes of Russia, are overdue. As a result, Gazprom has decided to stop gas deliveries to Poland and Bulgaria due to unpaid bills! This decision can be seen as an attempt to intimidate, because the first due date for unpaid invoices in Rubles to Germany is May 4th. We will be very attentive to Russia's reaction if this invoice remains "unpaid" on that date... Since February 24th and Russia's invasion of Ukraine, the European Union has been struggling to reduce its dependence on Russian gas imports. As already mentioned in this letter, several substitution projects are being developed with the United States, the Middle East and Norway. Even though imports of American LNG (liquefied natural gas) have increased in recent weeks, it will take time for Europe to be able to operate without Russian gas. This is likely to keep tensions high, especially if Mr. Putin continues to raise the nuclear threat as he has done recently.

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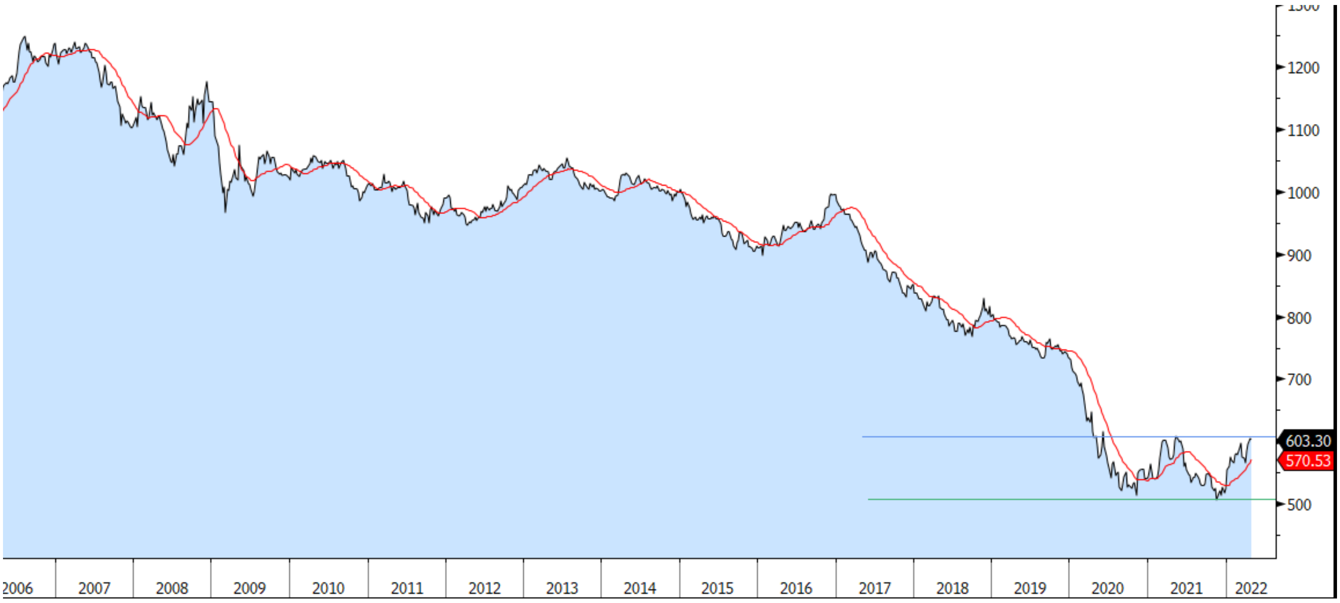
As we said in the introduction, the Nasdaq lost more than 13% in April, bringing its correction to more than 21% since the beginning of the year, while the Dow Jones Industrial lost "only" 9.25% and the Eurostoxx 50 dropped by 11.5%. We've talked about this before: Growth and Value stocks have been in a constant tug-of-war for several months, more precisely, since the Covid vaccines came to market in late 2020, a little over a year ago. If we extend the observation period, we can see that Growth stocks have outperformed Value ones for over 13 years, since 2006. Investors have placed higher valuations on technology companies in recent years, mainly due to their penetration with consumers, which has allowed companies like Apple or Microsoft to reach stratospheric market capitalization levels of over $2 trillion. Moreover, these technology conglomerates, which do not hesitate to use all the tricks of the international tax system, are viewed with a bad eye by the defenders of fair competition, which has brought them more and more pressure from certain states, particularly in Europe. The sector is therefore undergoing a real revolution. Firstly, because growth levels over the next three years may not be as high as previously expected. Secondly, because investors are no longer comfortable paying double-digit multiples of company value compared to sales (Price-to-Sales) or triple-digit multiples of operating profits (EV/EBITDA). Is this theme dead? We don't think so. As we have said frequently, in a weaker growth outlook, we need to be more selective and favor the companies that are best able to defend their margins and market shares. As we see below, the trade-off between Value and Growth is at a key point. A continuation of the outperformance of Value over the next few weeks could reverse a 13-year old trend that is currently in a consolidation phase.

Relative performance of Value stocks versus Growth stocks



Source: Bloomberg, Weisshorn

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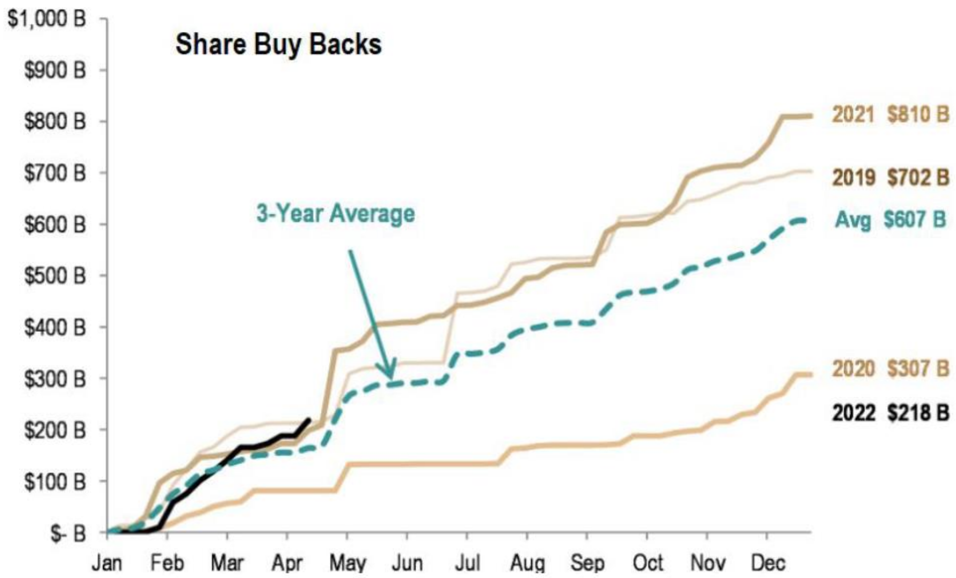
Like every year, April is marked by the release of the first quarter earnings. In the current economic and geopolitical context, the latter was more than ever awaited. Investors are hoping to get some visibility on how companies are doing for the rest of the year. So far, companies have announced results above expectations. We must be careful not to celebrate too soon, as most analysts have significantly lowered their expectations in recent months. Still, most sectors performed well between January and March with a special mention for the Energy sector for the reasons we know. Defensive sectors such as Food&Beverage also performed very well. Danone and Nestlé reported results well above expectations, which allowed them to appreciate by 15.21% and 4.83% respectively over the month. Unsurprisingly, the Consumer Discretionary sector lagged, heavily impacted by the galloping inflation of the last few months. On a positive note, many companies announced new share buyback programs, demonstrating strong financial health... this should support their share prices in the coming months.



In conclusion, even though the equity markets will remain volatile in the coming weeks, we remain constructive. Many companies have very healthy balance sheets and are sitting on "tons" of cash (they are proving it by buying back their own stock). With the recent correction, some companies are becoming potential targets for hostile takeover bids (like Twitter) which could support the markets. Global growth in 2022 will be weaker than initially expected, but it should be respectable (the IMF has once again reduced its estimates and now expects global growth to be 3.6% compared to 4.4% previously). Central Banks will be less accommodating by reducing liquidity in the markets (the famous "tapering") and by raising key rates (the market is already expecting 10 rate hikes in the US to bring key rates to 2.75% in 2022), but we are for the moment far from rate levels that could choke the economy. Especially since the last planned rate hikes might not materialize if the economy were to slow down faster than expected.

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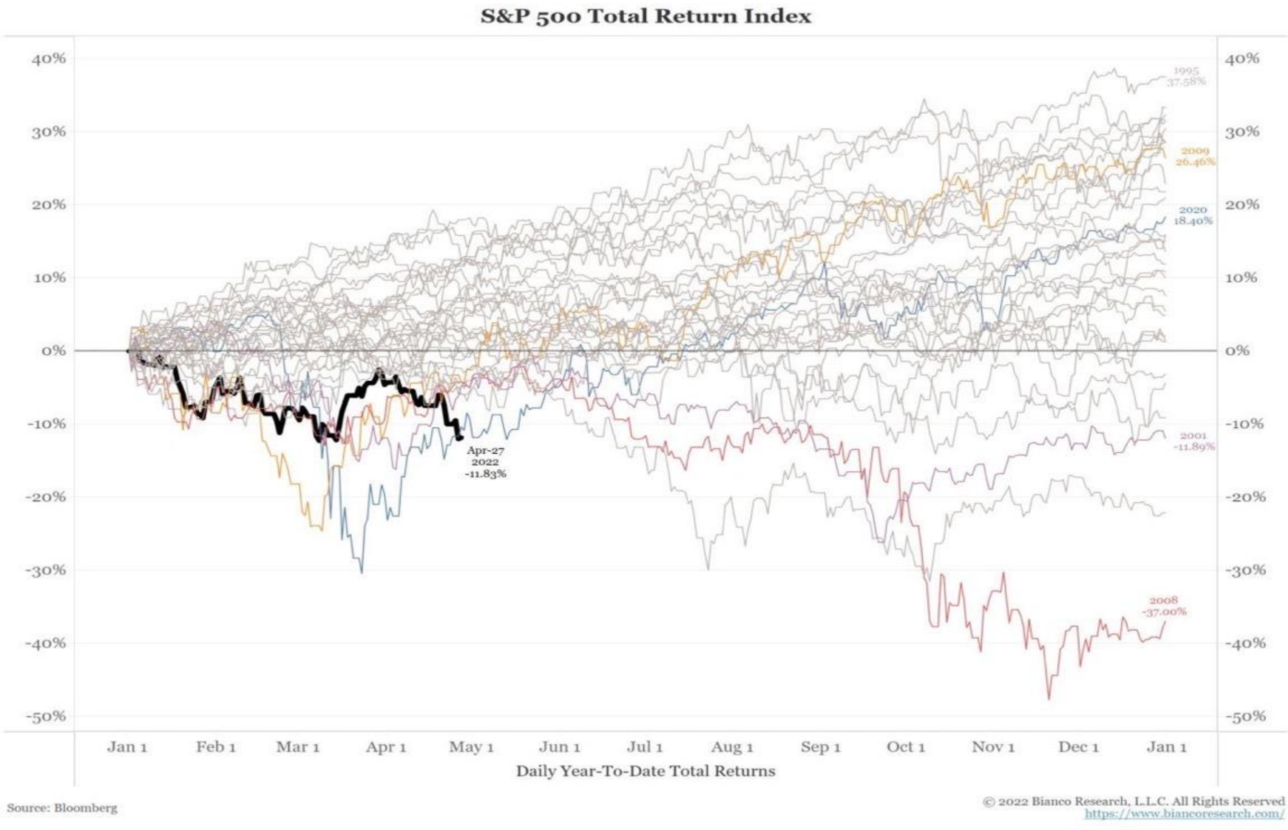
China is slowing down due to the various lockups, but this should be temporary and the Central Bank (PBOC) has made it clear that it will support its financial system and economy if needed. For all of these reasons, we believe that risky assets could do relatively well, despite the high volatility. The real shadow that could linger and even worsen comes from Ukraine/Russia. Markets have discounted that energy prices will keep inflation high in the short term. However, the real "Black Swan" that investors would certainly not want to experience comes from a nuclear threat from Mr. Putin. Oil prices would get out of control and a 3rd world war would start... We are obviously not there yet, this hypothesis is not our central scenario, but we cannot ignore it. Beware also of the relations with China and India. Western countries seem to be more and more annoyed by these two nations that do not officially punish the Russian invasion and even take advantage of it to intensify their trade with Moscow since the beginning of the conflict.

Despite the complicated environment in which we have to operate, we wish you a beautiful month of May.



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