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Weekly Market Flash
Are stock markets looking beyond the downturn?

April 16, 2023

The week ended once again with the major equity markets in positive territory—and once again led by European indices, with the Eurostox up 1.9%, the MSCI World up 1.27%, and the S&P 500 index up 0.9%. The most surprising aspect of the last few weeks has been the collapse in volatility, betraying even the last element of consensus that had been created following the new post-Covid and post-war macro environment: namely, that market volatility would be structurally high. Instead, the VIX index sits around 17, a level not seen in over 15 months (i.e. prior to the outbreak of war).

Highlights

▪ For the time being, optimism prevails, dictated by the fact that (as we have seen this week with the publication of the CPI and especially PPI) prices have started to fall, and the Fed is expected to begin its pause after the last hike in early May.

▪ Expectations for Q1 earnings are decidedly low, down 7% year-over-year. The fact remains that the decline expected is seen as temporary, with a strong rebound already forecast for Q4 2023, and throughout 2024.

▪ Ethereum has been underperforming Bitcoin, with uncertainty surrounding the Shanghai upgrade and potential supply dynamics from the unlock.

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Markets & Macro | Are stock markets looking beyond the downturn?

Positioning for a deteriorated economic environment.

What is even more surprising in recent weeks is that the downward acceleration in volatility has occurred just now, keeping in mind a number of reasons.

1. For one, we are on the doorstep of a fairly crucial earnings season. Estimates for Q1 have been significantly lowered, so it won't be hard to beat expectations, but the important part will be the outlook for the rest of the year—and here surprises may come.
2. In addition, the macro data in the US has started to disappoint, with the first signs of a slowdown in the labor market, following the Federal Reserve's (Fed) attempt to impact the demand side.
3. Further, the mini-banking crisis that led to the liquidation of the two regional banks in the US and Credit Suisse in Switzerland has also left its mark on the cost of funding for banks and the mechanisms for providing credit to the private and commercial sectors.
4. A final reading of the collapse in volatility is that the demand for stock market hedging (i.e. bids on volatility) is very low because investors are using gold and cryptocurrencies as alternative hedges, with good results at last (we have also participated in the movement).

Figure 1: Year-to-Date Performance of Major Indices

Equity Indices	Last Value	Week	Ytd
MSCI World	2,825.75	1.30%	9.31%
Nasdaq	12,123.47	0.30%	16.13%
S&P 500	4,137.64	0.82%	8.30%
S&P Equal Weighted	5,875.81	1.08%	2.92%
DJ Industrial	33,886.47	1.20%	2.84%
Nikkei	28,493.47	3.54%	10.20%
Eurostoxx	4,390.75	1.91%	16.51%
Swiss SMI	11,342.86	1.62%	7.98%
FTSE 100	7,871.91	1.76%	6.95%
Canada	20,579.91	1.90%	7.18%
Shenzen	4,092.00	-0.76%	5.73%
Hong Kong	20,438.81	0.53%	3.75%
MSCI EM	1,000.49	1.39%	5.14%

Commodities	Last Value	Week	Ytd
BBG Commodities	107.82	1.49%	-4.42%
BBG Agriculture	69.1	1.55%	0.41%
Gold	2,004.17	-0.19%	9.88%
Silver	25.35	1.48%	5.82%
BBG Brent Crude TR	1,086.70	1.53%	2.33%
BBG WTI Crude Oil TR	197.99	2.35%	3.50%

FX	Last Value	Week	Ytd
DXY Index	1,221.76	-0.37%	-1.99%
EUR/CHF	0.9827	-0.46%	-0.69%
GBP Index	633.18	-0.50%	1.66%
EM FX Index	1,699.51	0.64%	2.35%
USD/JPY	133.79	1.23%	2.04%
USD/CNY	6.87	0.02%	-0.43%
Bitcoin	30,384.15	8.94%	83.71%

Equity Sectors	Last Value	Week	Ytd
S&P value	152.45	0.92%	5.59%
S&P Growth	64.55	0.67%	10.68%
S&P Defensives	1,562.21	-0.57%	2.15%
ARK Fund	38.79	0.57%	24.17%
Fangs	6,044.84	-0.26%	35.95%
S&P Banks	82.98	3.18%	-16.88%
Euro Stoxx Banks	87.23	4.12%	14.51%
S&P Energy	87.23	2.65%	0.75%
Gold Miners	35.09	1.92%	22.44%

Bond Indices	Last Value	Week	Ytd
US Inv Grade	109.39	-0.85%	4.77%
US High Yield	75.28	0.59%	3.83%
Euro Corps	231.7	-0.79%	1.77%
JPM Europe Govies	9,593.19	-1.52%	3.94%
US Treasuries	2,252.19	-1.23%	2.92%
China Aggregate	261.99	0.66%	2.63%
EMBI Global	789.94	0.13%	2.82%
EMBI Local	130.45	0.54%	5.46%

Source: Bloomberg, as at April 14, 2023. Performance figures in indices' local currencies.

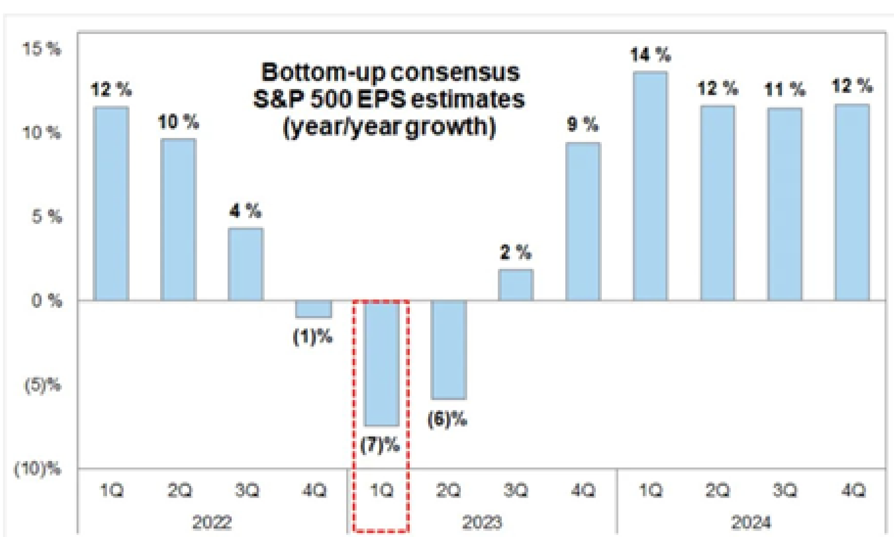
“There remains, in our view, a certain myopia in not wanting to look further ahead...”

Our view: The divergence of views between 'investor groups' therefore remains strong, an issue which we have already reported on and which is likely to be resolved in one direction or the other in the coming weeks. Very weak leading indicators versus hard data remain solid, in short. For the time being, optimism prevails, dictated by the fact that (as we have seen this week with the publication of the CPI and especially PPI) prices have started to fall, and the Fed is expected to begin its pause after the last hike in early May. There remains, in our view, a certain myopia in not wanting to look further ahead, i.e. that if the Fed starts to cut rates in the second half of the year, as discounted by futures, it will be precisely because the economy is contracting.

Looking further into the earnings season, Figure 2 shows that expectations for Q1 are decidedly low, down 7% year-over-year—so it should not be difficult to do better. The fact remains that the decline expected is seen as temporary, with a strong rebound already forecast for Q4 2023, and throughout 2024. This clearly explains the strength of the stock market, which is looking beyond the downturn we are seeing.

“This clearly explains the strength of the stock market, which is looking beyond the downturn we are seeing.”

Figure 2: EPS Estimates



Source: Goldman Sachs.

> “With market positioning still defensive, we are therefore likely to see sustained equities for a few more weeks...”

Another theme that will be interesting to monitor will be the trend in margins, an issue that is dear to us because it is at the heart of our forecast of a structural decline in earnings in the face of the possible recession to come. But it is not certain that we will have a confirmation of the trend already underway this quarter (Figure 3). With prices in the first quarter of the year still strong (i.e. revenues sustained), and the economy having re-accelerated (GDP growth around 2.5% annualized), we would not be surprised to see good overall numbers for this quarter. With market positioning still defensive, it is therefore possible to see sustained equities for a few more weeks, as long as economic data does not deteriorate enough to generate a real growth scare.

In terms of portfolio management, while maintaining a structurally defensive positioning, we took profit on half of the gold miners' positions that we had bought (a profit of almost 20%), and bought a risk reversal on the S&P 500 index that guarantees us a higher equity holding in the event of a rise above the 4'150 area of the index. This year, more than ever, could be interesting if the saying "sell in May and go away" proves true. So, we remain patient and loyal to our 3’400-3’500 target for the S&P 500 index. But we’re also putting ourselves in a better position to give the market time to incorporate a deteriorated economic environment, which will likely not materialize before the second half of the year, due to the usual lags of the effects of credit tightening.

> “This year, more than ever, could be interesting if the saying "sell in May and go away" proves true.”

Figure 3: Corporate Margins

Source: Bloomberg, as at April 14, 2023. .

Cryptocurrencies | Divergence between Bitcoin and ETH grows

Ethereum has potential to recover.

Investors in the crypto world have been witnessing two very different sides of the supply and demand story recently, with Bitcoin and Ethereum going in opposite directions due to various factors. As we discussed a few months ago, one of the reasons for the rally in Bitcoin was the anticipation of the upcoming halving possibility in 2024, which will create artificially scarce supply. If demand will remain at least the same, this could lead to demand outpacing supply, resulting in a potential rise in Bitcoin's price.

On the other hand, Ethereum has been underperforming Bitcoin, with uncertainty surrounding the Shanghai upgrade and potential supply dynamics from the unlock. The debate was centered around the unlocking of over 17 million staked ETH, worth more than USD30 billion, which could lead to a deluge of ETH into the market. This increased supply without a corresponding increase in demand could lead to an immediate price decrease.

"The Shanghai upgrade was designed to boost liquidity and reduce transaction fees, making it cheaper to transact on the network."

Before the "Merge," Ethereum relied on miners, who use computers to solve complex mathematical puzzles to secure the blockchain. Now, the network relies on validators, or ether holders who stake or lock up their coins to verify new transactions. These validators are rewarded with new coins, allowing them to earn passive income without selling the coins they hold.

Last week's Shanghai upgrade refers to a recent upgrade that was implemented for the Ethereum network. The Shanghai upgrade was designed to boost liquidity and reduce transaction fees, making it cheaper to transact on the network. Specifically, it introduced a new mechanism for determining transaction fees on the network, which is expected to lead to lower fees overall. This could make the Ethereum network more attractive to users and developers, potentially increasing demand for the cryptocurrency and driving up its price.

Overall, the Shanghai upgrade is an important development for the Ethereum network and could have significant implications for the future of the cryptocurrency. By making it cheaper and more efficient to use the network, the upgrade could help to attract more users and increase demand for the cryptocurrency, potentially driving up its price over the long term.

Since the risk event has now passed, with no substantial selling pressure, the market can unwind short hedges and rebalance toward ETH. Overall, the demand for unstaking ETH has been moderate, with many investors who had their ETH staked trading at a loss if they immediately withdraw. Therefore, investors may not be so quick to do so, leading to a more stable market. The biggest unstaker so far has been Kraken, which is shutting down its staking service for US customers.

"...with the success of the Shanghai upgrade, there is potential for Ethereum to recover and attract more investors."

Our view: In summary, while the anticipation of halving is boosting Bitcoin's demand, the uncertainty surrounding the Ethereum upgrade has led to an underperformance in its token price. However, with the success of the Shanghai upgrade, there is potential for Ethereum to recover and attract more investors.

Week Ahead | Key events to watch for

- **Flash PMIs across the western world** will be released next week, which will provide a better understanding of the state of the manufacturing economy.

- **China will be in the spotlight** with the release of Q1 GDP in the midst of the reopening.

- **Corporate earnings will set the tone** across the market, with banks and semiconductor companies announcing. Tesla, IBM and Netflix will also present their reports.

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