Key Take-Aways

- Strong recovery in financial markets, with global equities posting their best monthly performance since November 2020. US equities outperformed most of other equity indices, with the S&P 500 gaining 9.2% in July.
- Inflation continues to surprise to the upside, with the latest US CPI figure at 9.1%, well above the expected 8.8% and the previous month's 8.6%.
- In this environment, Central Banks continue tightening financial conditions, with the Federal Reserve hiking for the fourth time this year. The ECB hiked 50bps for the first time this year, and with this the deposit facility rate is no longer negative (this for the first time in eight years).
- A recession in the US is now widely expected due to the hawkishness of the Fed. This has led to a sharp drop in long term yields, which has translated to a positive month for Fixed Income. Corporates were also benefited by tightening spreads, with US high yield spreads falling close to 100bps.
- Italian government bond spreads vs German government bonds have almost doubled since the beginning of the year. Given the political turmoil together with the high level of debt, this will likely be an important factor for future ECB policy. The ECB has therefore put in place the Transmission Protection Instrument (TPI) – a tool basically aimed to deter speculators against the single currency.
- Of the companies in the S&P 500 that have reported Q2 earnings, 75% of them have presented better than expected results, which is slightly below the five-year average of 77%, with profits growing by 6.7%. In terms of sectors, energy continues to deliver exceptional earnings growth, with 2Q profits expanding almost 300%.
- During July, the Euro went briefly under parity with the dollar, as the European currency continues to struggle to recover against the dollar due mainly to the ECB's softer policy.

July Review : Financial Markets with a Strong Rebound

So far, European equities had their best month of 2022, mainly driven by Tech & Autos, who had their supply routes benefitting from Covid-19 restrictions easing in China. US equities, had their best month since November of 2020, outperforming their global peers.

The world Bond market was dominated by concerns over the harshness of the global economic downturn, amid US GDP dropping consecutively in Q2, marking a technical recession. A slowdown in global economic activity was evidenced by deteriorating manufacturing data in the Eurozone and US. In Europe, the manufacturing PMI has contracted to below 50, a level than indicates a contraction in the activity.

Most G7 CBs reaffirmed their commitment in lowering inflation, as a series of aggressive rate hikes took place. By the end of the month, the FED has enacted its fourth interest-rate hike since the beginning of 2022, elevating the range for federal funds rate by 75bps to (2.25-2.5%) as a measure to combat inflation. The ECB has moved its Deposit Facility Rate hiking 50bps (reaching 0%) for the first time in 8 years. Consequently these moves have downgraded growth forecasts, as CBs prioritize taming inflation over boosting growth.

July provided some consolation to bonds, which rebounded, contrasting the severe hit they have experienced so far in 2022. The performances of Investment grade and High Yield bonds have improved, supported by spread contraction and decreases in longer term interest rates. European and US HY which gained 5% and 6%, respectively in July, were amongst the best performers of the fixed income class. European HY credit has lost around 10% since the beginning of the year, while US HY has lost 9%.

Chinese Government bonds remained amongst the most resilient, even though returns in US dollar terms were eroded by the strength of the US Dollar vs. Chinese Yuan. The Euro has increased its depreciation against the USD to -10% since the beginning of the year, influenced by a softer ECB policy than the FED During the month the Euro briefly traded below parity, something that has not happened for 20 years.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,130	1.43	4.15	9.22	9.22	-12.59	17
Nasdaq	12,391	1.88	5.17	12.39	12.39	-20.45	23
Russell 2000	1,885	0.66	3.72	10.44	10.44	-15.45	18
Euro Stoxx 50	3,708	1.53	2.88	7.47	7.47	-11.21	11
Stoxx 600 EUR	438	1.28	2.84	7.76	7.76	-7.78	12
FTSE 100	7,423	1.06	1.64	3.66	3.66	2.61	10
SMI	11,146	0.15	0.15	3.77	3.77	-11.08	15
NIKKEI 225	27,802	-0.05	0.38	5.34	5.34	-2.36	15
CSI 300 China	4,170	-1.29	-0.95	-6.33	-6.33	-14.10	11
MSCI EM Index	994	-0.37	0.75	-0.17	-0.17	-17.68	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,130	1.43	4.15	9.22	9.22	-12.59	17
UTILITIES	376	0.86	5.19	5.50	5.50	4.92	20
ENERGY	599	4.58	6.42	9.72	9.72	44.44	8
TELECOM	193	0.56	2.78	3.71	3.71	-27.57	14
CONS STAPLES	774	-0.72	1.18	3.30	3.30	-2.47	20
REAL ESTATE	277	0.31	4.81	8.54	8.54	-13.29	35
CONS DISCRET	1,282	4.27	6.45	18.94	18.94	-20.10	23
MATERIALS	491	1.32	3.65	6.14	6.14	-12.86	14
HEALTH CARE	1,542	-0.35	1.44	3.32	3.32	-5.29	16
INFO TECH	2,523	1.56	5.73	13.54	13.54	-17.01	21
FINANCIALS	560	1.44	2.32	7.21	7.21	-12.86	12
INDUSTRIALS	808	2.00	5.21	9.50	9.50	-8.88	16

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	105.903	-0.42	-0.54	1.16	1.16	10.70
EUR-USD	1.0220	0.23	0.00	-2.52	-2.52	-10.11
USD-JPY	133.27	-0.74	-2.50	-1.81	-1.81	15.81
USD-CHF	0.9524	-0.26	-1.23	-0.28	-0.28	4.33
EUR-CHF	0.9731	-0.03	-1.27	-2.80	-2.80	-6.21
GBP-USD	1.2171	-0.07	1.06	-0.06	-0.06	-10.06
EUR-GBP	0.8393	0.25	-1.07	-2.51	-2.51	-0.24
JP EM FX Index	50.42	-0.19	0.38	-2.37	-2.37	-4.08

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	2.65	-3	-15	-36	114	114
Germany	0.82	-1	-20	-52	99	99
UK	1.86	-0	-7	-37	89	89
SWITZERLAND	0.44	2	-22	-63	57	57
Japan	0.19	-2	-1	-5	11	11
US IG Spread	155	-2	-4	-14	55	55
US High Yield spread	508	-14	-19	-83	238	238
EUR High Yield spread	602	-20	-6	-79	256	256

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	121.8	1.28	3.18	4.08	4.08	22.85
Gold Spot $/OZ	1765.9	0.58	2.68	-2.29	-2.29	-3.46
Crude Oil WTI	98.6	2.28	-0.98	-6.75	-6.75	28.09

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	21.3	-1.00	-2.03	-7.38	-25.71	4.11

Source: Bloomberg 7/31/2022

Macro & Rates: Bad News is Good News

The month of July was marked by the Fed and ECB which both increased their benchmark interest rates. On the 21th, the ECB for the third time in the institution's history and after eight years with zero rates hiked rates by 50bps. On the 27th, the Fed again hiked interest rates by 75bps, bringing the Fed Funds rate to 2.5%.

Central banks are finally trying to combat inflation which is skyrocketing. In the US, the last reading of CPI YoY came in 9.1%, well above the expected 8.8% and the 8.6% in the previous month. In the Eurozone, CPI YoY stands at 8.6%, with some countries such as Spain witnessing double-digit inflation at 10.8%. Even in Germany, hit by soaring energy prices, the CPI YoY is 7.6%.

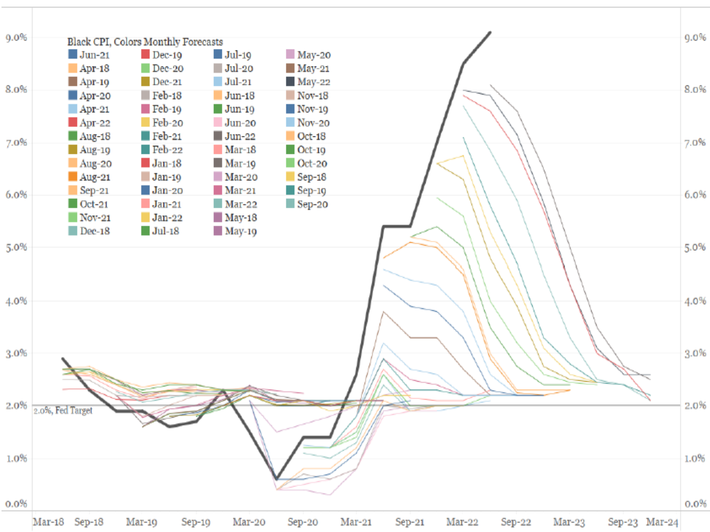
On one hand, central bank tightening was overdue and has positive aspects. Firstly, with the ECB stepping out of negative interest rate territory, a tax on European banks disappears and higher rates are good for financials in general. Secondly, recent hawkishness has clearly dampened inflation expectations. Wall street analysts now forecast US inflation to be back in the 2% - 3% range by March 2024. Unfortunately, neither 5-year/5-year TIPS breakeven inflation nor the Michigan 5- to 10-year Inflation Survey have predicted inflation accurately in the past…

On the other hand, a likely outcome of the tightening is to push the economy into recession. In the US, GDP has already contracted in the first quarter (-0.9% QoQ). The Atlanta Fed is forecasting a contraction in the second quarter, too, which would – if it materializes - mean that the US is in a recession.

A common assumption is that bear markets preceed recessions. However, the contrary is usually true. In eight of the eleven bear markets since 1929, the economy was already in the midst of a recession when the stock market entered bear territory. Thus, the strong equity market correction since the beginning of the year would fit that picture. The 2-year/10-year US Treasury curve is already inverted. If central banks continue to hike and even the shorter-end of the curve inverts, an additional signal for a recession in the US would be in place. Manufacturing PMIs are falling including in the US (52.2), and are already negative in the Eurozone (49.8).

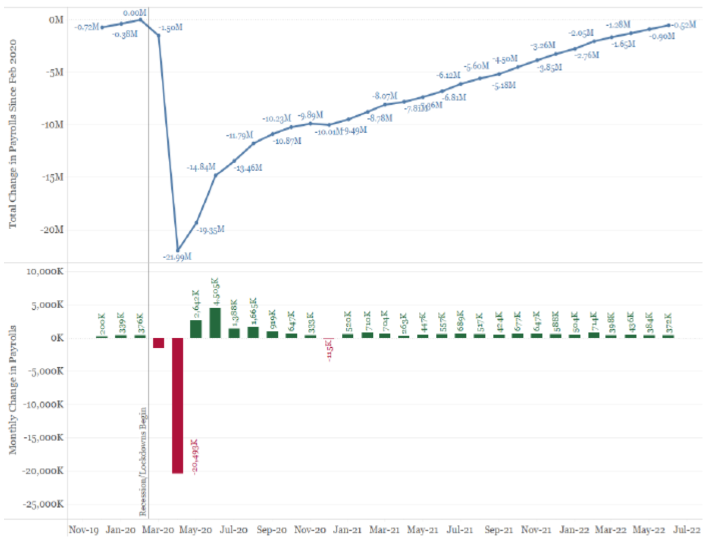
Central banks face the dilemma of strong economies and labour markets which they may have to «break» in order to reign-in inflation. Debt-laden economies will, however, struggle with higher interest rates, and therefore central banks may also chose to live with somewhat higher inflation. Any weaker data from the real economy will lower rate-hiking expectations thereby leading to a scenario whereby «bad news is good news» for equities. Finally, the mid-terms in the US as well as geopolitical tension in Ukraine and Taiwan will continue to weigh on sentiment.

Wall Street Inflation Forecasts



Source: Bianco Research LLC

US post-Pandemic Jobs Restoration



Source: Bianco Research LLC

Fixed Income: Recession Fears helping Bonds

While the real economy remains strong in spite of recent signs of weakening, a recession in the US is now widely expected due to the hawkishness of the Fed. This has led to a sharp drop in the Treasury curve in July. The 2-year/10-year part of the curve is now inverted and for 7-year maturities yields fell almost 100bps since mid-June.

For bonds, July was thus a good month. While the YTD total return of the Bloomberg US Aggregate Bond Index is still the worst since the 1970ies, it seems that bond total returns have found a bottom around mid-June. The future direction of the bond market will depend on inflation and central banks' reaction to it. But it is safe to say that higher yields alone provide already a support for total returns of USD fixed income.

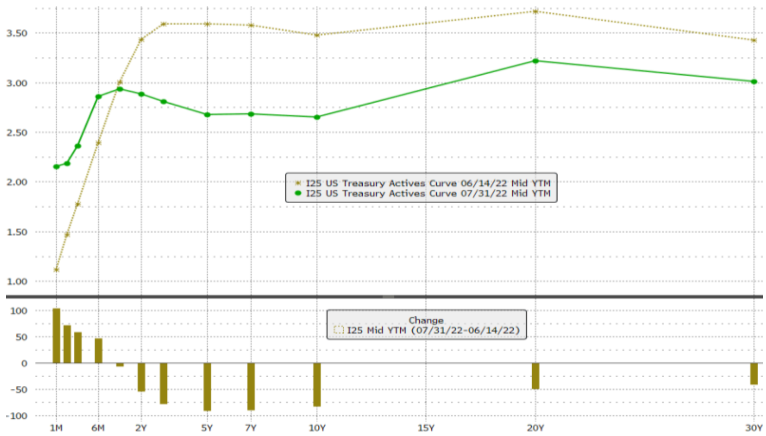
In-line with the risk-on sentiment in equities, credit spreads have fallen in July, The CIS Barclays index measuring USD HY spreads fell from 6% to 5% and the Bloomberg USD Liquid Investment Grade spread index ended the month at 1.55%.

Since 1973, the Fed has never stopped hiking rates before the Fed funds rate was higher than CPI. If this will repeat this time, either the Fed has to hike many times more (from 2.5% now), or the CPI will indeed fall quickly (from 9.1% now).

Our base-case scenario lies somewhere in between: central banks will continue to hike rates several times before inflation will come down. We believe, however, that inflation will remain structurally higher than currently expecte by the market.

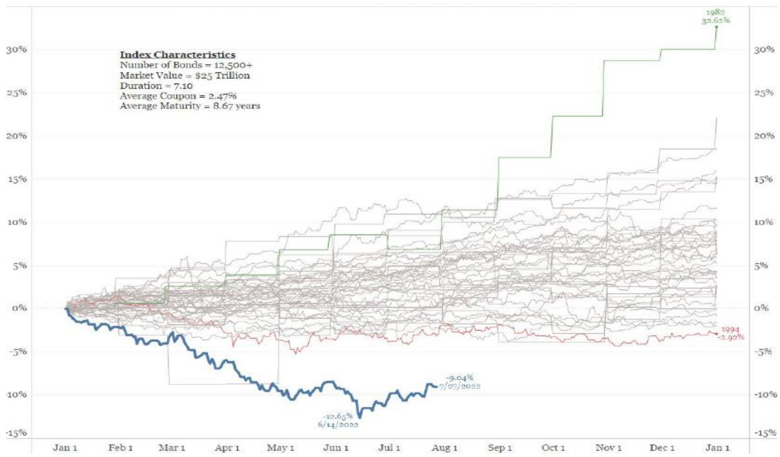
Rising interest rates in the Eurozone always expose the «weak links in the chain». Italian government bond spreads vs German government bonds have almost doubled since the beginning of the year. Given the political turmoil together with the high level of debt, this will likely be an important factor for future ECB policy and European equity markets. The ECB has therefore put in place the Transmission Protection Instrument (TPI) – a tool basically aimed to deter speculators against the single currency.

US Yield Curve shift 14.6.22 – 3.8.22



Source: Bianco Research LLC

YTD Total Return – Bloomberg US Aggregate Index



Source: Bianco Research LLC

Italian 10-year government spread vs. Germany

Source: Bloomberg

Equity: Markets begin Second Semester with Strong Recovery.

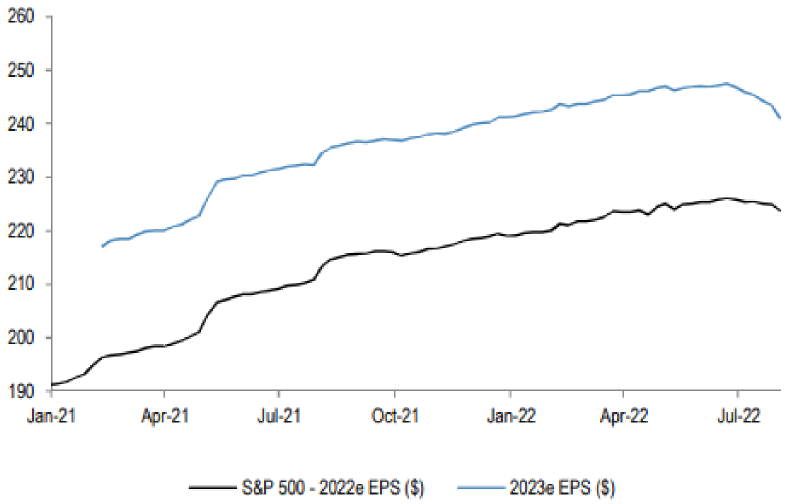
After a challenging first half of the year, global markets delivered strong performance in July, with the S&P 500 Index gaining more than 9% and the MSCI World Index almost 8%, with this being the best month since November of 2020. This was remarkable, as it was a month where we had several macro headwinds, such as weaker leading indicators and higher than expected consumer inflation. Performance was supported by lower interest rates, as investors diminished their expectations regarding the magnitude at which the Federal Reserve would continue to hike rates, as economic conditions starts to deteriorate. With this, some of the sectors that have been hit the hardest this year due to rising rates and led to significant repricing in valuations, were in July some of the best sectors, with IT gaining more than 13%.

Despite these strong gains in July, we think that the next months will continue to be volatile and thus investors should maintain a balanced approach in their equity portfolios. As we continue to grasp the combination of several impacts as high inflation, supply chain disruptions, geopolitical risks, tightening of financial conditions and worsening of economic activity, it is hard to see a reason for volatility to decrease in the short-term. Short-term strong recoveries during a bear market are not uncommon, as they may be justified by relatively better news or also due to technical factors such as short squeeze. Although we maintain invested in equities, we continue to take a cautious approach, as there may be further downside in the short-term.

As we approach the Q2 earnings season final stages, with more than 80% of companies in the US having reported, earnings have remained resilient despite macro indicators revealing a worsening of conditions. *75% of companies have presented better than expected results*, which is slightly below the five-year average of 77%, *with profits growing by 6.7%, above the 4.0% expected for this quarter*. In terms of sectors, energy continues to deliver exceptional earnings growth, with 2Q profit expanding almost 300%. Industrials, Materials and Real Estate are also achieving solid growth rates of 27%, 13% and 11%, respectively.

Regarding guidance, the second half estimates for profits have been cut by -3.8% and are now below those at the beginning of the year. For 2023, expectations for growth in earnings have also fallen. Nonetheless, from an absolute perspective 2023 EPS on the S&P 500 are expected to be around $240, higher than the $220 forecasted earlier in the year. *Earnings growth for the entire of 2022 are now expected to be around 10%, also higher than what was forecasted at the beginning of the year*.

S&P500 2022e and '23e EPS



'22e and '23e consensus EPS growth expectations

	2022e EPS Growth, %		2023e EPS Growth, %	
	Current	Jan '22	Current	Jan '22
MSCI World	10.9%	7.1%	6.4%	8.6%
S&P 500	10.1%	8.7%	7.7%	10.1%
Stoxx 600	15.6%	7.1%	3.4%	6.8%
Euro Stoxx	13.5%	8.2%	4.9%	8.7%
FTSE 100	17.6%	4.2%	0.0%	3.1%
Topix*	11.2%	8.2%	5.6%	7.2%
EM	9.9%	5.4%	7.5%	9.9%

Source: J.P Morgan, IBES

Forex And Commodities: No End to the Dollar Rally in Sight ?

After reaching a new decade high mid-July at 109.3. The Dollar Index slipped by -2.85% but quickly snapped back to momentum when Fed officials made clear that they will stay ahead of their peers and continue to maintain their rising rates policy.

A new paradigm emerges as the global economy is expected to slow significantly, a path that is usually not in favor of the USD. However, for the USD to weaken, we should see a political regime more concerned about economic slowdown than about inflation, which is not the case yet. Moreover, for most other currencies to expect to strengthen vs the greenback is even more difficult in such an environment. Therefore, a short to mid-term change in the dollar trajectory seems unlikely. Global investors' sentiment remains that the dollar strength has yet to peak.

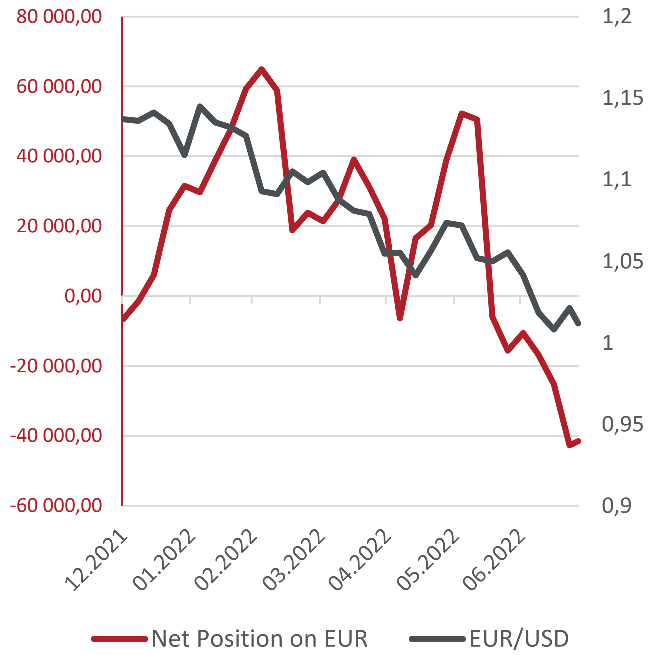
The Euro went briefly under parity with the dollar. The European currency saw a bit of a rally in July, and stabilized at the 1.02 level. However, the Euro is still struggling to recover against the dollar due mainly to the ECB's soft policy. In a short-term view, the EUR should remain in a consolidation area, offering a 1.03 vs dollar to be resistant, while the 1.01 underneath offers support. *However, the possibility to witness again an EUR/USD going below parity and remaining there, is still present.* Technically the pair is now influenced largely by headlines and Hedge funds. After being quite neutral on EUR during a large part of the year: Hedge Funds became mainly seller in July as parity was nearly reached and became one of the key driver which weakened the EUR even more. As a consequence, locating an outstrike at parity acts as a "black hole" for forex investors, once spot enter in this area it could be difficult to exit. The key level of parity could be breached again and this time is likely to go much lower and longer beneath it (0.98 as next target).

The USD/CHF retreated after hitting support at 0.9650. Further short term rebound could be expected from the dollar but the Swiss franc seems now established in a pattern with an upside break at 0.9550 and a resistance at 0.9885. As for the EUR/CHF, it is now well consolidated below parity.

Anticipation of rising inflation in Japan pushed the USD/JPY pair to accelerate its move lower from the 24-years high made in July. Despite that, the BOJ kept its status quo and continued to maintain its lose monetary policy.

Gold and others precious metals are reaching a turning point, on one side gold could continue to rally as geopolitical tensions won't be going away any time soon. On the other side, the prospect of continuously rising interest rates in the short term could turn the price direction to a new downside level similar to 2013.

Traders became Net Short on EUR positions, impacting lower EURUSD direction



Source: Bloomberg

Historical Gold direction vs 10-year Treasury Yields, which Path for Gold ?

Source: Bloomberg

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