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BONHÔTE

Another rough week for equities

Overview

The war between Russia and Ukraine, the Chinese government's zero-covid policy and haze about monetary tightening in the US were the three pivotal themes that again weighed on global stockmarkets last week.

Amid high volatility, the S&P 500 was down 2.4% while the European Stoxx 600 index edged up 0.8%. The SMI gave up a minor 0.7%. The flagship Swiss index was down after Roche shares corrected sharply, following disappointing clinical results on Tiragolumab, an experimental drug treating lung cancer. Prior to these trial results, the drug had been on Roche's list of potential blockbusters. Roche's share price in the coming quarters will hinge on the launch of Vabysmo (ophthalmology) and, most of all, the results of the Graduate 1/2 trials investigating Gantenerumab (Alzheimer's), due in the fourth quarter.

SMI weighed down by Roche's sharp correction

US equities were hit by sell-offs in tech, while European stocks gained from the euro's 1.3% downswing against the US dollar.

Ten-year Treasury yields eased slightly, handing back 12 basis points (bp), while two-year T-bond yields remained stable. This contrasting picture may indicate that markets are becoming concerned about the impact of the prospective tightening in Fed policy, as measured by two-year yields (which are directly influenced by Fed Funds expectations) on medium-term US GDP growth, as reflected in ten-year yields.

Markets becoming concerned about impact of Fed's more hawkish policy

German government-bond yields were down by 13bp and 15 bp at two-year and ten-year maturities, respectively, which may be a sign that investors are reining in expectations of an ECB rate hike. Even if the latest inflation figure for the Eurozone was a lofty 7.4% in April, most of the price gains are externally driven, with no noticeable secondary effect on wage growth, which remains under control.

In the US, by contrast, annual wage growth was 5.5% in April versus 2.5-3.5% in the years leading up to the pandemic. Moreover, red-hot US inflation, though initially confined to manufactured goods, has spread to the services sector in recent months. The Dollar Index (DXY), which tracks dollar performance against the major international currencies, is up 0.9%, reflecting the view held in foreign exchange markets that the Fed can and should tighten monetary policy significantly more than other central banks.

The SMI nudged 11270 then staged a technical rally. Once a support, 11700 has become a resistance against further appreciation. In case of a breakout, retracement to 12080 is possible.

Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	1.00	1.04	11'650.42	3'703.42	14'027.93	6'362.68	7'418.15	4'023.89	11'805.00	26'427.65	1'004.52
Trend	↑	→	↓	→	→	→	→	↓	↓	↓	↓
YTD	9.84%	0.52%	-9.52%	-13.84%	-11.69%	-11.05%	0.46%	-15.57%	-24.54%	-8.21%	-18.46%

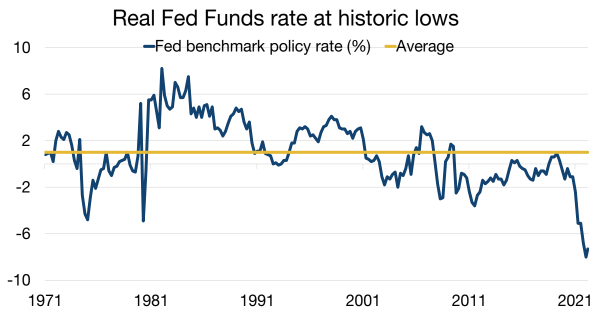
(values from the Friday preceding publication)

How far will the Fed raise its benchmark rate?

The market expects Fed Funds to stand at 2.75% in December, up from 1% today, and 2.86% by December 2023. Is this realistic?

We think that a sharp increase in key rates this year is plausible because the Fed wants to close the gap with inflation.

If the 250bp of tightening (from 0.25% to 2.75%) did occur, 2022 would then be the year marking the largest increase in the Fed Funds rate since 1994, when it advanced from 3% to 5.5%. Only the spectacular rises of the legendary Volcker era, between 1979 and the early 1980s, were of greater magnitude.



However, the current level of the real (i.e. inflation-adjusted) Fed Funds rate is -7.3%, the lowest level ever reached and leagues below the -0.7% level Volcker inherited when taking the helm at the Fed in August 1979. Between 1979 and 1984, the Fed was forced to maintain real policy rates between 5% and 8% to put paid to the runaway inflationary. Although the inflation spike is probably behind us at 8.5% in March 2022, it may take longer than expected to recede due to its increasingly external origin, thus requiring the real Fed Funds rate to be at least equal to its long-term average of 1%. This would imply that the Fed's tightening will continue at a solid pace in 2023, which could be highly disruptive to bond and equity markets.

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