NOVUM
CAPITAL PARTNERS

Weekly Market Flash

Back to a macro dominated world

April 3, 2022

This week coincided with the end of the first quarter of the year, which gives us the opportunity to take stock of the performance of the main asset classes, and, above all, try to gauge the implicit messages that the numbers provide. The key themes are clearly inflation, war, growth and the aftermath of the Covid crisis (especially in Asia, but much less so in the West, where it seems to have been completely forgotten). The consequences on financial assets were considerable, with investors finding little to hide under. Overall, we're ending Q1 2022 with the dominant theme of commodities, the only (strongly) rising sector – with consequences for the sectoral and geographical returns of equities, as well as the trend in currencies (exporting versus importing countries) and bonds (with all bonds penalized, except for inflation-linkers).

Highlights

▪ The S&P 500 index ended the first quarter down 4.95%, the worst quarter since early 2020. Information technology stocks were weighed down by rising interest rates, while consumer staples and utilities (which are defensive sectors) outperformed.

▪ The continued acceleration in inflation (7.9% in the US and 7.5% in the Eurozone) led to another terrible month for fixed income. US Treasuries were down -5.6%, one of the worst quarters since 1973.

▪ The gap between the 2-year and the 10-year Treasury yield, after flattening all along the first quarter, ended Q1 at negative 6 bps. Many in the market view this contortion as a signal of an impending recession.

▪ US nonfarm payrolls came in with 430,000 new jobs, and unemployment was at 3.6%. But there are also signs of weakness in supply-side growth indicators, such as Friday's below-expected ISM.

▪ Axie Infinity's Ronin Network announced a loss of over USD625 million in USD Coin (USDC25.5 million) and ether (ETH 173.6k). It may be the largest exploit in DeFi history.

"We seem to be back to a world where macro-economic variables will once again dominate, and unfortunately, at this stage, the signs are not encouraging."

Markets & Macro | Back to a macro dominated world

Focus shifts to growth, inflation and earnings.

In Q1, geographically, European markets started out much better than the US, but this trend was reversed on 24 February, when the consequences of the war became the main driver.

The trend reversal between the US and Europe is also linked to the fact that in the first weeks of January, the selloff was caused by an adjustment in equity valuations following the Federal Reserve's (Fed) pivot to anti-inflationary monetary policy – although we are still talking about "normalization" of monetary conditions after the Covid excesses). However, the shock of the invasion of Ukraine and the escalation of geopolitical tensions in the heart of Europe has shifted the focus from valuations to the fundamentals of growth, inflation and earnings. As a result, we seem to be back to a world where macro-economic variables will once again dominate, and unfortunately, at this stage, the signs are not encouraging.

Figure 1: Q1 Performance Across Asset Classes

Equity	Last Value	Ytd
MSCI World	3,053.07	-5.04%
RPAR	23.66	-5.11%
Nikkei	27,665.98	-3.13%
EURO Stx	3,913.69	-8.60%
Mib	25,156.64	-7.62%
FTSE	7,543.98	3.28%
Canada	21,890.16	3.84%
Norway	1,546.85	5.83%
Shenzen	4,276.16	-13.44%
Honk Kong	22,039.55	-5.48%
MSCI EM	1,141.79	-6.99%
Nasdaq	14,220.52	-8.94%
S&P 500	4,530.41	-4.60%

Equity	Last Value	Ytd
BBG Commodities	124.36	25.41%
BBG Base Metals	324.98	15.27%
BBG Agriculture	72.70	19.59%
Golds	1,935.59	5.65%
Silver	24.75	6.02%
BBG Brent Crude TR	1,084.64	44.82%
BBG WTI Crude Oil TR	213.02	39.14%

Bond Indices	Last Value	Ytd
US Inv Grande	120.94	-8.19%
US High Yield	82.29	-4.35%
Euro Corps	250.57	-4.96%
JPM Maggie Govies	10,202.60	-4.07%
US Treasuries	2,360.57	-5.58%
China Aggregate	272.60	1.24%
EMBI Global	834.43	-9.26%
EMBI Local	130.73	-5.07%

Source: Bloomberg, as at April 1, 2022.

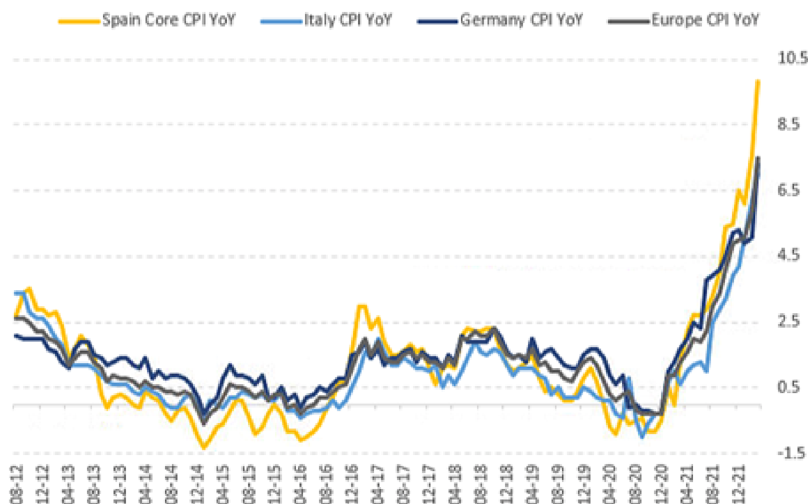
"Apart from the 25 bps Fed Funds hike in mid-March, the truth is that the main part of the tightening cycle has yet to begin. And it will be a big one with 235 bps priced in by the market..."

Our view: Europe seems to be stuck in a stagflationary scenario, with galloping inflation and anemic growth, while the US is much better off thanks to a strong labor market (this week's non-farm payrolls with 430,000 new jobs and unemployment at 3.6% speak for themselves). But some signs of weakness in supply-side growth indicators are starting to come through in the US as well (Friday's below-expected ISM is just the latest example, but there have been others in recent weeks). And, apart from the 25 basis points (bps) Fed Funds hike in mid-March, the truth is that the main part of the tightening cycle has yet to begin. And it will be a big one with 235 bps priced in by the market, and at least two 50 bps hikes in the coming months.

Europe looks much worse off from a macro perspective. Inflation levels are similar to the US, but accelerating, and the picture is unlikely to improve in the coming months with a weak exchange rate and skyrocketing energy prices. This week some nasty surprises came with headline CPI posting well above estimates in Spain (almost 10% year-on-year), Germany and the Eurozone as a whole (Figure 2). The European Central Bank (ECB) continues to show signs of caution in adjusting monetary policy, with only two hikes expected by the end of the year. On the one hand, we understand the central bank's dilemma, as the factors that are driving prices up are beyond the control of any central bank; on the other, it is clear that the loss of purchasing power is already affecting consumer sentiment significantly, and that the loss of real income will only have a negative impact on consumption in the coming months. All of this is taking place in a context of the government debts that we are all familiar with, with all Eurozone countries increasing their debt by somewhere in the range of 10-20% during 2020 and 2021.

"It is clear that the loss of purchasing power is already affecting consumer sentiment significantly..."

Figure 2: European Inflation



Source: Bloomberg, as at April 1, 2022.

On the subject of the war, we want to include an update of our thoughts on the main issues. It is clear that militarily, we are at a turning point, with the Russians retreating to the south-east of Ukraine. The important (and dangerous) confirmation of the news that the Americans and the British are willing to supply the Ukrainians with tanks exposes the paradox that it is the Ukrainians who are counter-attacking, and the Russians who are defending the areas they are gradually conquering. In fact, we have already written that Russia seems to have considerably reshaped the military and political objectives of their aggression.

“The underlying theme, from our point of view, is that no balance for the region can be achieved unless the Americans and Chinese sit down at the negotiating table.”

All this complicates two aspects: Europe's position (with public opinion so far universally in favor of the Ukrainians) and the negotiations in Turkey. The negotiations could in fact have had a chance of leading to at least a ceasefire of military activities, with a view to a real international peace conference that could take place in the years to come. The central themes of the negotiations obviously remain the territorial aspects and the neutrality of the country. As far as neutrality is concerned, the agreement will have to include militarization (especially no nuclear weapons) of the country and non-membership of NATO. The possibility of Ukraine joining the European Union is not excluded (at least on paper).

On the territories, the point is that the Ukrainians seem decidedly hostile to the idea of a mutilation of the country, even more so in light of the military successes they are achieving. The underlying theme, from our point of view, is that no balance for the region can be achieved unless the Americans and Chinese sit down at the negotiating table. Putin's broad objective is to redraw the balance of power in the region through arms control, not only in Ukraine but also in neighboring countries. In this regard, looking into the military operations, we seem to have learned that beyond what is said about the condition of the Russian army and the precarious logistics, the level of violence used by the Russian side is a fraction of what was done in Chechnya and Syria (with the exception of Mariupol, now practically razed to the ground, but in a key area for the division of territory in the negotiation phase). Our analysis is that this can be explained by 1) Putin's desire not to lose internal consensus (given the pre-existing "brotherhood" between the two peoples, and 2) that the reason is to maintain an open line with the West, as well as to protect the supply of gas.

Unfortunately, the signals coming from the US administration seem to us to be very far from this possibility, with a regime change in Russia evoked by the President this week (although denied by his own collaborators), and the dispatch of heavy vehicles announced yesterday. And a brief note on the gas issue and the payment in roubles imposed on "hostile" states, we must say that it has turned out to be a farce. European companies will have to open an account with Gazprombank in roubles, but they will be able to pay in euros, which will then be changed into roubles by the bank itself, and then transferred to their own account.

“A brief note on the gas issue and the payment in roubles imposed on "hostile" states, we must say that it has turned out to be a farce.”

Equities | Ebbing and flowing

Earnings season will shed light on demand destruction.

The S&P 500 index ended the first quarter down 4.95%, the worst quarter since early 2020. Information technology stocks were weighed down by rising interest rates, while consumer staples and utilities (which are defensive sectors) outperformed.

In general, stocks had a choppy trading week with macro data not conclusive for either direction. The market in Japan fell on declining sentiment based on the Bank of Japan’s Tankan survey of business confidence. Chinese equities gained for the week on news that China is considering allowing US regulators to inspect the audits of Chinese companies listed in the US.

"But the answers are not straightforward with history showing no clear timeline for when a recession or a market correction is to take place after the inversion of the curve."

Figure 3: Global Equity Market Performance

		Value	WTD % Chg	MTD % Chg	YTD % Chg
INDU Index	Dow Jones	34,818.27	-0.12%	0.40%	-3.72%
SPX Index	S&P 500	4,545.86	0.08%	0.34%	-4.28%
CCMP Index	Nasdaq	14,261.50	0.66%	0.29%	-8.68%
SX5E Index	Euro Stoxx 50	3,918.68	1.32%	0.41%	-8.48%
SMI Index	Swiss Market	12,179.08	0.71%	0.19%	-4.09%
UKX Index	FTSE 100	7,537.90	0.76%	0.30%	3.20%
CAC Index	CAC 40	6,684.31	1.99%	0.37%	-6.34%
DAX Index	DAX	14,446.48	0.98%	0.22%	-9.06%
FTSEMIB Index	FTSE MIB	25,163.30	2.46%	0.57%	-7.60%
NKY Index	Nikkei 225	27,665.98	-0.97%	-0.56%	-3.13%
HSI Index	Hang Seng	22,039.55	2.97%	1.00%	-5.48%
SHSZ300 Index	CSI 300	4,276.16	2.44%	1.74%	-13.44%

Source: Bloomberg, as at April 1, 2022. Performance figures in indices' local currencies.

Our view: Equity markets continue to ebb and flow on positioning, without any clear direction. Sentiment remains very low and most strategists have dug in their heels on a recessionary outcome. An inverted yield curve has also raised questions about the likelihood of a recession. But the answers are not straightforward with history showing no clear timeline for when a recession or a market correction is to take place after the inversion of the curve. We are starting to see anecdotal evidence of poor consumer sentiment beginning to impact demand, especially in Europe. The upcoming earnings season should shed more light on the extent of demand destruction and margin compression. However, until then, the ebbing and flowing continues.

Chart of the week

We return after a long while to talk about the famous 100-day moving average for the NASDAQ index. The indicator has been a multi support during the long rally from 2020 to 2021. After breaking at the beginning of the year, it's now become resistance to break. On the other side, the trend line that started in February 2021 is the support to monitor.

"...the trend line that started in February 2021 is the support to monitor."

Figure 4: Nasdaq Index

Source: Bloomberg, as at April 1, 2022.

Crypto & Blockchain | Axie Infinity's Ronin Network suffers hack

Online participants should get reimbursed.

On Tuesday, Axie Infinity's Ronin Network announced a loss of over USD625 million in USD Coin (USDC25.5 million) and ether (ETH 173.6k). It may be the largest exploit in DeFi history. Most of the funds remain and monitored in the attacker's address, though ETH 6,250 has been transferred to various other addresses. The company behind the popular Axie Infinity crypto game (Sky Mavis) said they are fully committed to reimbursing online participants by selling some of its Axie-related tokens

or selling the company's equity to raise cash. Alternatively, the Axie community could host a vote to approve liquidating enough funding from its "community treasury". Axie Infinity generated USD1.3 billion in revenue in the 12 months through February.

Axie Infinity is a popular blockchain game that was inspired by the Pokémon game series and Final Fantasy Tactics. The universe has a player-owned economy where players can own, buy, sell, raise and trade digital pets and resources they earn in the game through skilled-gameplay and contributions to the ecosystem. Axie Infinity has helped to define a new game genre, known as play-to-earn, since it allows users to earn an income in the form of AXS, SLP and items just from playing the game. New players will need to either buy (or borrow) a minimum of three Axies to begin playing between USD70 to USD250, depending on supply and offer dynamics. Whereas Axies with any sort of desirable body parts, abilities, or skills, will likely cost significantly more.

"Lucrative earnings from Smooth Love Potion have created a so-called "economy" over the past two years – and it has even become the main source of income for some communities in developing countries hit hard by Covid..."

Apart from gameplay related directly to Axies, players of Axie Infinity can also purchase virtual land and other in-game assets as NFTs. The record sale of a plot of virtual land was priced at USD2.3 million, as of 25 November 2021. This model has been described as a form of gambling and one with an unstable market that is overly reliant on the inflow of new players. At the same time, the lucrative earnings from Smooth Love Potion (SLP) have created a so-called "economy" over the past two years – and it has even become the main source of income for some communities in developing countries hit hard by Covid, including the Philippines, Brazil and Venezuela.

Fixed Income | The Fed's not scared of an inverted curve

Is a US recession imminent?

The continued acceleration in inflation (7.9% in the US and 7.5% in the Eurozone) led to another terrible month for fixed income. US Treasuries were down -5.6%, one of the worst quarters since 1973. The same goes for Europe, where government bonds registered negative performances not seen since the 90's. Credit did not escape the carnage with the US investment grade sector being the worst performer.

Our view: The rise in corporate bond yields in Q1 has, to a certain extent, been similar to the first quarter of 2020, when the pandemic rocked markets. But unlike the second quarter of that year, nobody sees a sharp reversal this time around. The main argument is the different attitude by major central banks, forced to enact a more aggressive tightening cycle than that expected only three month ago, including the Fed's envisaged commitment to hike rates in 50 bps increments if necessary. On the ECB, the market expectation is for at least two hikes in 2022, and other central banks are already well on track in hiking rates.

"Many in the market view this contortion as a signal of an impending recession. This time that won't happen, at least according to a Fed note... "

Those expectations fuel a new concern – namely the inversion of the US curve. The gap between the 2-year and the 10-year Treasury yield (blue line), after flattening all along the first quarter, ended Q1 at negative 6 bps. Many in the market view this contortion as a signal of an impending recession. This time that won't happen, at least according to a Fed note saying "statistical evidence indicating that the perceived omniscience of the 2-10 spread that pervades market commentary is probably spurious". The indicator the Fed considers more indicative of an impending recession is the spread between the current 3-month Treasury bill rate and bets on where it will be in 18 months, derived from the forwards market (black line).

Figure 5: US Treasury Curve

Source: Bloomberg, as at April 1, 2022.

"While history would say that US recession risks are now in the radar for the next 12-24 months out, the view at the Fed will not scare Powell & Co. away from their plan to raise interest rates in the near term."

While historically this forward spread has moved in tandem with the yield curve, it is currently moving in the other direction. So, while history would say that US recession risks are now in the radar for the next 12-24 months out, the view at the Fed will not scare Powell & Co. away from their plan to raise interest rates in the near term.

Elsewhere in the bond market, confusion reigns over foreign currency bonds of Russian debtors. On the one hand, JPMorgan (the paying agent on the prospectus for USD 7.5% sinkable Russia's debt due 31/3/2030) processed a payment amounting to nearly USD447 million on Thursday (coupon plus paydown instalment), allowing the nation to continue side stepping a default. Questions arose over Russia's ability to service its 2030 debt last week after Clearstream (the clearinghouse in bond documents) blocked the account for the National Settlement Depository, which receives the Russian government's payments on some of its foreign bonds for distribution. Yet Russia has shown it is able and willing to service its foreign debts despite international sanctions, so much so that two other payment bonds (coupon Russia 5.10% 2035 and final repayment of Russia 4.5% 4/4/2022) reached bondholder accounts.

"Russia has shown it is able and willing to service its foreign debts despite international sanctions their plan to raise interest rates in the near term..."

On the other hand, Russian Railways, EuroChem and Chelyabinsk Pipe Plant have missed deadlines to complete interest payments on their foreign-denominated bonds as the cash got stuck for compliance checks on its way to investors. The companies now face the risk of creditors declaring they are in default, since the funds failed to reach bondholders before the end of a grace period. Russian Railways missed a deadline to pay interest on a CHF-denominated green bond, after the funds got stuck. The grace period of 10 business days has expired without the cash reaching investors. Russian Railways is also struggling to make a coupon payment on its sterling-denominated bond due on March 25.

Week Ahead | Key events to watch for

- **The coming week is light in terms of data; February industrial indicators** from around the world will be released, as will the US Non-Manufacturing ISM, China's PMI and Japan's consumer confidence.

- **March's FOMC minutes** should shed some light on the balance sheet reduction plans.

Vittorio Treichler
Chief Investment Officer

Flavio Testi
Senior Fixed Income Portfolio Manager

Daniele Seca
FX, Crypto and Derivatives Portfolio Manager

Karim Khalil
Senior Equity Portfolio Manager

Please note that any views expressed herein are those of the author as of the date of publication and are subject to change at any time due to market or economic conditions. We believe the information contained in this material to be reliable but do not warrant its accuracy or completeness. They may differ from other views expressed for other purposes or in other contexts, and this should not be regarded as a research report. Any projected results and risks are based solely on hypothetical examples cited, and actual results and risks will vary depending on specific circumstances. Investors may get back less than they invested, and past performance is not a reliable indicator of future results