J. Safra Sarasin
Cross-Asset Weekly

15 September 2023

ECB delivers a dovish rate hike

The ECB has hiked policy rates by 25bp and indicated that the level of policy rates is now likely sufficiently restrictive to bring inflation down to target over the medium term. Although the door to another hike is not completely shut, markets interpreted the decision that way and started to price a first rate cut by March now. As a consequence, bond yields eased and the euro weakened, both of which will not help fight inflation, which is why we had favored (and predicted) a hawkish pause in the first place. On September 21, the SNB will have to make a judgement whether a hawkish pause would not deliver better results. Over in the US, the Fed will most likely opt for no hike at its next meeting. Given the relatively strong economic data and sticky inflation, they will maintain a hawkish bias. The FOMC will probably leave a final hike by year end in its updated dot plot, even though we don't think they will follow ultimately through with it.

China's structural problems are creating increasing headwinds for its economic growth profile, with spill-over effects to the G10 FX space. The AUD, NZD and the EUR will likely suffer due to their export reliance on China, while the USD, CHF, JPY and CAD should be the main beneficiaries.

Finally, we reiterate our call for value vs growth, which we think has room to catch up with the recent move in interest rates. The valuation discount is the highest since 2021. We also prefer UK equities and expect outperformance of income strategies in the short- to medium-term. They are both a derivative of value vs growth – or at least indirect beneficiaries.

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Contacts

Dr. Karsten Junius, CFA
Chief Economist
karsten.junius@jsafrasarasin.com
+41 58 317 32 79

Raphael Olszyna-Marzys
International Economist
raphael.olszyna-marzys@jsafrasarasin.com
+41 58 317 32 69

Mali Chivakul
Emerging Markets Economist
mali.chivakul@jsafrasarasin.com
+41 58 317 33 01

Alex Rohner
Fixed Income Strategist
alex.rohner@jsafrasarasin.com
+41 58 317 32 24

Dr. Claudio Wewel
FX Strategist
claudio.wewel@jsafrasarasin.com
+41 58 317 32 26

Wolf von Rotberg
Equity Strategist
wolf.vonrotberg@jsafrasarasin.com
+41 58 317 30 20

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ECB-Meeting

A hawkish pause would have been more effective

Dr. Karsten Junius, CFA
Chief Economist
karsten.junius@jsafrasarasin.com
+41 58 317 32 79

Supported by a "solid majority" in the Governing Council, the ECB hiked its policy rates by 25bp and indicated that they might be sufficiently restrictive for inflation to come back to target within the projection horizon. Financial markets interpreted this in a very dovish way and are pricing in a first rate cut by March now, hence the euro depreciated by around 0.5% - both of which don't help fight inflation. We feared that such a market reaction would occur, which is why we had favoured and predicted a hawkish pause instead. While the ECB did not close the door to further rate hikes completely, it will be heavy lifting to push it fully open again. While the ECB lowered its growth forecasts for 2023 and 2024, they still remain above ours. Hence, risks for further downward revisions to its growth profile remain, making another rate hike less likely. A long period of stable policy rates is the most likely path forward now during which markets will focus on the timing of the first rate cut.

Financing conditions have loosened after the rate hike

The ECB Governing Council (GC) members seems to be ready to hike rather too much than too little. Instead of a hawkish pause, as we would have favoured for tactical reasons, the GC delivered a dovish hike that triggered a market-friendly reaction. The euro depreciated and bond yields fell as markets are pricing in a rate cut by March now. They correctly interpreted what President Lagarde later explained to be the most important paragraph of the press release (emphasis added):

> *"Based on its **current assessment**, the Governing Council considers that the key ECB interest rates have **reached levels** that, maintained for a **sufficiently long duration**, will make a **substantial contribution** to the **timely return** of inflation to the target. The Governing Council's **future decisions** will ensure that the key ECB interest rates will be set at **sufficiently restrictive levels for as long as necessary**. The Governing Council will continue to follow **a data-dependent approach** to determining the appropriate level and duration of restriction."*

Market discussions will be on the timing of the first rate cut from now on

While this paragraph stresses the data dependency of future decisions and does not exclude the possibility of a further hike it also establishes a base case that they are not needed. As GDP forecasts were lowered less than we would have considered necessary and inflation forecasts are quite elevated for 2024 now, it is also unlikely that adverse data surprises would trigger another rate hike soon (Exhibit 1). It is noteworthy that the ECB considers the transmission mechanism to work faster than in previous cycles, and that it believes that falling corporate profit margins allow for rising wages. A long period of constant rates and a continuation of the current stagflationary environment is the most likely path forward until at least spring 2024.

ECB expects only 0.1% growth in 2H2023 pushing out its favourable growth projections by exactly two quarters.
In 4Q2025, headline inflation is expected at 1.9% and core inflation at 2.2%.

Exhibit 1: New ECB macro projections: lower growth and higher inflation forecasts for 2024

	2023		2024		2025	
ECB Macro projections in % yoy	*Jun 23*	Sep 23	*Jun 23*	Sep 23	*Jun 23*	Sep 23
GDP	*0.9*	**0.7**	*1.5*	**1**	*1.6*	**1.5**
Headline Inflation	*5.4*	**5.6**	*3.0*	**3.2**	*2.2*	**2.1**
Core inflation	*5.1*	**5.1**	*3.0*	**2.9**	*2.3*	**2.2**
Compensation per employee	*5.3*	**5.3**	*4.5*	**4.3**	*3.9*	**3.8**
Global growth ex euro area	*3.1*	**3.2**	*3.1*	**3**	*3.3*	**3.2**
Global trade ex euro area	*1.3*	**0.2**	*3.4*	**3.2**	*3.4*	**3.3**
Euro area foreign trade	*0.5*	**0.1**	*3.1*	**3**	*3.1*	**3**
Technical assumptions						
Oil price in USD	*78*	**82.7**	*72.6*	**81.8**	*70.4*	**77.9**
Natural gas price	*42*	**43**	*52*	**54**	*46*	**47**
Non-energy commodity prices in % yoy	*-11.5*	**-13.6**	*-2.0*	**-3.1**	*1.3*	**3.2**

Source: Macrobond, Bank J. Safra Sarasin, 14.09.2023

US macro – Fed preview

Fed to keep a final rate hike on the table

Raphael Olszyna-Marzys
International Economist
raphael.olszyna-marzys@jsafrasarasin.com
+41 58 317 32 69

It's almost certain that the Fed will 'skip' the September meeting and keep its policy rate on hold. But in light of the recent upside surprises both to activity and inflation, officials will want to maintain a hawkish bias. The updated dot plot will most probably still point to one final rate hike by year end, even though we don't think they will follow through with it.

Looking for a 'hawkish' pause

The Fed will almost certainly keep its policy rate unchanged when it meets next week. There is more uncertainty, however, as to whether it will need to push rates a little higher in November or December. Investors are evenly split, with half a rate hike currently priced in the futures market. There are valid arguments on both sides. But on balance, we think that lower inflation rates, a cooling labour market and our expectations that growth will drop below its trend rate in Q4 would point to no additional hike this year (Exhibit 1). The Fed, however, is likely to keep its options open given the acceleration in activity in the third quarter and the pick-up in inflation in August.

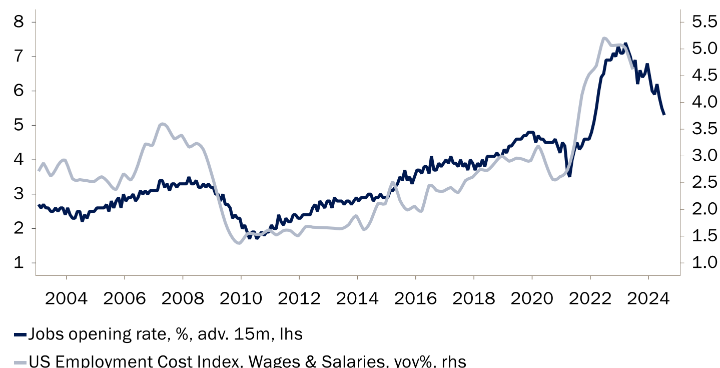
The updated dot plot will most probably point to a final rate hike for Q4

As such, it's very likely that Fed officials will keep the implicit hike for Q4 in their revised dot plot, which would signal a hawkish bias to the policy stance, even though we don't think they will follow through with it. Chair Powell's message is unlikely to diverge much from its speech at Jackson Hole. He will acknowledge the progress that has been made on the inflation front, as well as the cooling of the labour market. But he will also highlight that there is still a long way to go, and that a sustained pick-up in growth would be inconsistent with a sustained downward trend in inflation.

New projections to show stronger 2023 GDP growth rate, and possibly a lower core PCE inflation rate

Fed officials will also need to revise up their 2023 Q4/Q4 GDP forecast from 1.1% to something around 2% or more, given that activity data have largely surprised on the upside since the June meeting. They probably also have the scope to reduce a bit their year-end forecast of 3.9% for core PCE inflation. True, the rise in the 'supercore' services CPI component in August indicates that core inflation will not come down in a straight line (Exhibit 2). But the June projections imply that core PCE inflation will increase at 0.32% on a sequential basis each month between now and year end, which in our view is a little elevated. Finally, we think that the Q4 2023 unemployment rate forecast will broadly remain unchanged. We don't expect major changes to the 2024 and 2025 projections.

Exhibit 1: The labour market has cooled



Source: Macrobond, Bank J. Safra Sarasin, 14.09.2023

Exhibit 2: Prices of services ex rent of shelter rose strongly in August

Source: Macrobond, Bank J. Safra Sarasin, 14.09.2023

FX markets

Trading China momentum

Dr. Claudio Wewel
FX Strategist
claudio.wewel@jsafrasarasin.com
+41 58 317 32 26

Following peak optimism at the end of last year, China's recovery has been stalling and structural problems in the housing sector are becoming increasingly visible. We expect this trend to carry on and hence the CNY is likely to see some more downside. Within G10 FX, we favour USD, CHF, JPY and CAD longs, while AUD, NZD, and EUR are poised to suffer from the continued weakness in Chinese activity.

China's recovery has been stalling and we expect this trend to carry on

Following peak optimism at the end of last year, the recovery of China's economy has been stalling since April as investor and consumer sentiments turned sour. With indicators pointing towards weak activity, growth projections have been consistently revised downwards. Most pressing are the structural issues in China's housing sector, with real estate developers continuing to struggle. In our view, the PBoC's most recent attempt to support its currency and its economy should provide only a short-lived relief. Given our view that a large stimulus is not forthcoming, we think that Chinese activity is unlikely to rebound meaningfully anytime soon, begging the question of how China's weakness will affect FX.

We favour USD, CHF, JPY and CAD longs, while AUD, NZD, and EUR are poised to suffer

Not surprisingly, the most direct way to trade China's slowdown is to short the Chinese currency itself. Year-to-date, the renminbi (CNY) has weakened markedly, mimicking the widening of the US-China yield differential (Exhibit 1). We believe that the currency has more scope to weaken, even though the PBoC will be inclined to dampen the move in order to reduce the risk of capital outflows. Yet China momentum is also tradeable via a number of G10 FX pairs. Given its trade link, the Australian dollar (AUD) is a prominent example. Roughly half the country's iron ore exports go to China, which means that the AUD closely moves with Chinese activity (Exhibit 2). The AUD is followed by the New Zealand dollar (NZD) and the euro (EUR), which both reflect a high degree of economic integration with China. Instead, the British pound (GBP), the Canadian Dollar (CAD), the Japanese yen (JPY) and the Swiss franc (CHF) appear largely uncorrelated, while the US dollar (USD) can be used as an expedient hedge against the China slowdown (Exhibit 3). Moreover, we think that AUD and EUR will likely experience more downside against CAD and CHF, given that the BoC and the SNB sound relatively more hawkish. Yet we tend to be cautious about GBP longs as the BoE may have to stop hiking earlier than markets currently expect.

Exhibit 1: Ytd, CNY has weakened markedly

Chinese renminbi vs US-CN yield differential

Source: Macrobond, Bank J. Safra Sarasin, 14.09.2023

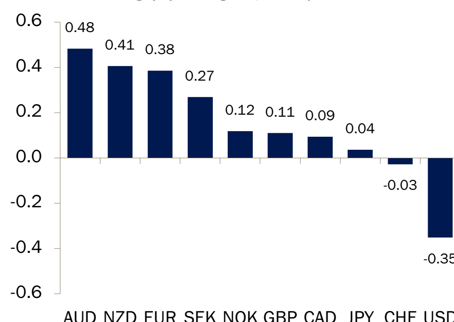
Exhibit 2: AUD moves with China activity

AUD-USD vs China activity

Source: Macrobond, Bank J. Safra Sarasin, 14.09.2023

Exhibit 3: USD is 'insulated' against China

Trade-weighted FX correlation with China Caixin Composite PMI, 1-month lag, yoy changes, past 5 years



Source: Macrobond, Bank J. Safra Sarasin, 14.09.2023

Global equities

Reiterate tactical opportunity in value vs growth

Wolf von Rotberg
Equity Strategist
wolf.vonrotberg@jsafrasarasin.com
+41 58 317 30 20

We reiterate our preference for value vs growth, which we think has room to catch up with the recent rise in interest rates. Value relative to growth performance has fallen back to levels last seen in 2021. Valuations have even touched the record discount of 2020 as relative earnings have displayed a lot more stability than prices. We think that value is thus priced for a much weaker macro backdrop (which is our base case) while the market appears complacent with regard to cyclical risks for growth. Other segments of the equity market, which should benefit from a relative recovery in value, are income strategies and UK equities.

We reiterate our preference for value over growth

We reiterate our preference for value over growth strategies, which we had first introduced in July. "Value" has stabilised versus "growth" over the past two months, but remains close to the relative lows it had last seen in 2021 (Exhibit 1). In the first half of 2023, value has given back almost all of the outperformance vs growth it had seen in the previous year, despite a relatively solid macro backdrop (which tends to be favourable for value), and even though interest rates remained elevated. We believe that the gap which has opened up to rates now provides room for value to catch up further and may well see the style outperform vs growth into the fourth quarter of this year (Exhibit 2).

Exhibit 1: Value vs growth has pulled back after a strong 2022

Source: Refinitiv, Bank J. Safra Sarasin, 13.09.2023

Exhibit 2: Recent surge in rates implies substantial upside for value

Source: Refinitiv, Bank J. Safra Sarasin, 13.09.2023

Relative valuations have dropped back to the lows from which value bounced over the past 3 years

It is noteworthy that the earnings trajectory of value vs growth has been range-bound on a relative basis, while the relative performance has decoupled to the downside (Exhibit 3). This has resulted in the price-to-earnings discount of value vs growth dropping back to the record lows it had touched twice in the last three years, during the downturn in 2020 and when growth surged in 2021 (Exhibit 4). While we continue to regard tech and growth as clear strategic preferences for any long-term equity allocation, we believe that the current valuation discount of value provides an attractive entry point to benefit from a tactical rebound (Exhibit 5).

We think that value is cheap while growth is not yet priced for any kind of slowdown

Even though risks to the cycle prevail, we think value is already priced for substantial downside. Meanwhile, growth is unlikely to be as immune against a slowdown in demand as it was during the COVID recession. The market does not yet appear prepared for that.

Value vs growth is not a trade that requires the market to move higher

Outperformance of value does not necessarily have to go hand-in-hand with rising index levels. As growth dominates global equities, index level moves are often positively

correlated with growth outperformance (Exhibit 6). What dilutes the correlation between value vs growth and index moves further is the fact that value boosts a relative overweight in traditionally defensive sectors, such as health care, staples and utilities. We would thus argue that a value vs growth position does not contradict the view that end-year index targets are below today's levels.

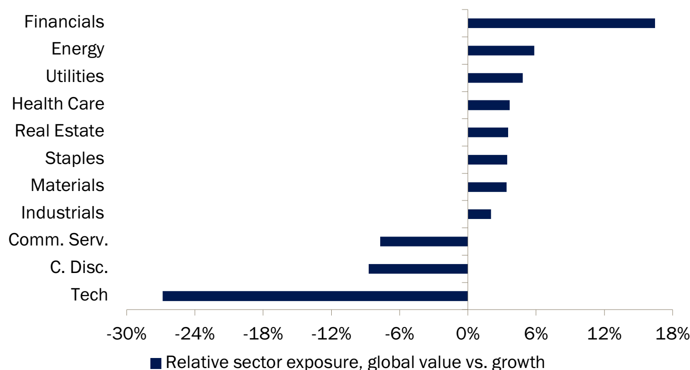
Exhibit 3: Relative earnings have been range-bound

Source: Refinitiv, Bank J. Safra Sarasin, 14.09.2023

Exhibit 4: Relative valuations back at record lows

Source: Refinitiv, Bank J. Safra Sarasin, 14.09.2023

Exhibit 5: Value vs growth is a financials & energy vs tech trade



Source: Refinitiv, Bank J. Safra Sarasin, 13.09.2023

Exhibit 6: Value doesn't have a positive correlation with the index

Source: Refinitiv, Bank J. Safra Sarasin, 13.09.2023

Income strategies should do well if value performs

What's more, income strategies should also benefit tactically. A factor analysis shows that they are heavily exposed to value, less so to growth (Exhibit 7). The past two years of relative performance reinforce that finding as global income's relative performance has moved one-for-one with value vs growth. Notably though, income's relative performance has displayed around half of the variance of a value vs growth position, which derives from the fact that income tends to be tilted towards the higher quality and more defensive end of value (Exhibit 8).

We prefer value over growth, income strategies and UK equities

Bottom-line, we think that the current level of rates, the macro backdrop as well as relative valuations, support a tactical value vs growth position. Valuations have moved to previous lows, with value already priced for a substantial correction to earnings while the market appears complacent regarding cyclical earnings downside for tech and growth. Consequently, we also have a preference for UK equities and expect outperformance of income strategies in the short- to medium-term. They are both a derivative of value vs growth - or at least indirect beneficiaries.

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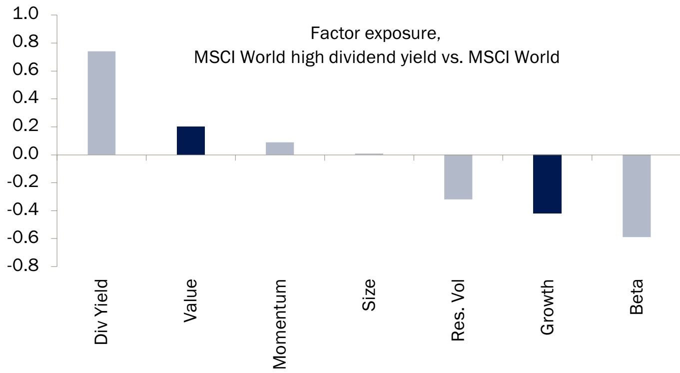
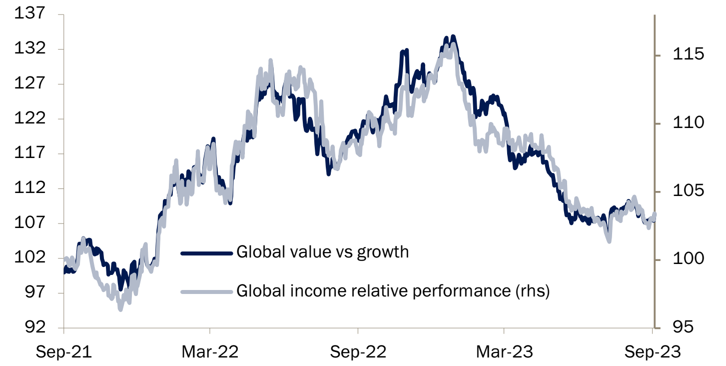
Exhibit 7: Income is o/w value and u/w growth



Source: Refinitiv, Bank J. Safra Sarasin, 14.09.2023

Exhibit 8: Income tends to outperform in line with value



Source: Refinitiv, Bank J. Safra Sarasin, 14.09.2023

Economic Calendar

Week of 18/09 – 22/09/2023

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 18.09.2023						
US	14:30	NY Fed Services Business Act.	Sep	Index	--	0.60
	16:00	NAHB Housing Market Index	Sep	Index	50.00	50.00
Tuesday, 19.09.2023						
US	14:30	Housing Starts MoM	Aug	1'000	1440k	1452k
	14:30	Building Permits	Aug	1'000	1450k	1442k
Wednesday, 20.09.2023						
UK	08:00	CPI MoM	Aug	mom	--	-0.40%
	08:00	CPI YoY	Aug	yoy	--	6.80%
	08:00	CPI Core YoY	Aug	yoy	--	6.90%
US	13:00	MBA Mortgage Applications	Sep15	wow	--	-0.80%
	20:00	FOMC Rate Decision (UB)	Sep20	%	5.50%	5.50%
Thursday, 21.09.2023						
UK	13:00	Bank of England Banks Rate	Sep21	%	--	5.25%
US	14:30	Initial Jobless Claims	Sep16	1'000	--	--
	14:30	Philadelphia Fed Business Outl.	Sep	Index	-2.00	12.00
	16:00	Leading Index	Aug	mom	-0.40%	-0.40%
Friday, 22.09.2023						
JN	01:30	Natl CPI Ex Food, Energy YoY	Aug	yoy	--	4.30%
	03:00	BOJ 10-Yr Yield Target	Sep22	%	--	0.00%
UK	08:00	Retail Sales Ex Auto Fuel MoM	Aug	mom	--	-1.40%
	08:00	Retail Sales Ex Auto Fuel YoY	Aug	yoy	--	-3.40%
GE	09:30	German Manufacturing PMI	Sep P	Index	--	39.10
EU	10:00	Eurozone Manufacturing PMI	Sep P	Index	--	43.50
	10:30	UK Manufacturing PMI	Sep P	Index	--	43.00
US	15:45	US Manufacturing PMI	Sep P	Index	--	47.90

Source: Bloomberg, J. Safra Sarasin as of 14.09.2023

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Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W (bp)	Δ YTD (bp)	TR YTD in %
Swiss Eidgenosse 10 year (%)	1.04	0	-58	5.0
German Bund 10 year (%)	2.59	-2	2	1.3
UK Gilt 10 year (%)	4.28	-25	61	-1.2
US Treasury 10 year (%)	4.28	1	40	-1.0
French OAT - Bund, spread (bp)	53	0	-1	
Italian BTP - Bund, spread (bp)	175	1	-40	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	11,098	17.5	1.0	6.5
DAX - Germany	15,805	11.5	0.6	13.5
MSCI Italy	916	8.0	2.5	21.5
IBEX - Spain	9,549	9.7	2.6	19.8
DJ Euro Stoxx 50 - Eurozone	4,280	12.2	1.4	16.2
MSCI UK	2,193	11.0	3.2	5.5
S&P 500 - USA	4,505	20.7	1.3	18.7
Nasdaq 100 - USA	15,474	27.8	1.4	42.3
MSCI Emerging Markets	982	13.5	1.0	5.2

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.89	7.1	0.2	-3.2
EUR-CHF	0.95	5.1	-0.2	-3.6
GBP-CHF	1.11	6.7	-0.1	-0.6
EUR-USD	1.07	7.0	-0.4	-0.4
GBP-USD	1.24	8.1	-0.3	2.9
USD-JPY	147.5	9.2	-0.2	12.5
EUR-GBP	0.86	5.3	0.0	-3.1
EUR-SEK	11.90	6.9	0.0	6.6
EUR-NOK	11.43	8.6	0.0	8.8

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	108	7.4	1.6	-4.1
Brent crude oil - USD / barrel	95	17.4	3.4	16.8
Gold bullion - USD / Troy ounce	1,918	6.5	-0.1	5.1

Source: J. Safra Sarasin, Bloomberg as of 14.09.2023

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