MyStratWeekly
Market views and strategy

This document is intended for professional clients in accordance with MIFID
N° 089 // **November 7, 2022**

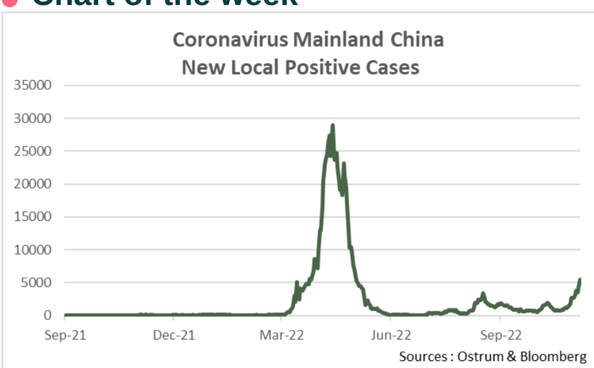
Topic of the week: Economic inconsistencies

- **Survey data is deteriorating rapidly and pointing to a black economic future. Conversely, "hard" data is resilience. This "sentiment"/"reality" gap is unusual;**
- **Paul Samuelson suggested the "revealed preference theory",rather than asking economic agents for their preferences, we look at their concrete choices;**
- **If companies say they are pessimistic they do not act accordingly and take bets that commit to the future. The coming recession could therefore remain moderate.**

Market review: Powell prolongs the monetary cycle

- **Fed: slower but longer monetary tightening**
- **BoE already under pressure to stop tightening?**
- **Sharp rise in equities on hopes of China reopening**
- **Tensions on bond yields amid upbeat credit markets**

Chart of the week



The market has recently played with the idea of a reopening of China and in particular the idea that China would use a foreign vaccine, one much more efficient.

Recent data on the number of cases does not seem very encouraging in this regard. The number of cases is accelerating strongly and while the level is still far from the peak at the beginning of the year, the trend is unquestionably worrying.

We remain very skeptical about these expectations of a rapid reopening of the Chinese economy.

Figure of the week

4.5

Source : Ostrum AM

ESG debt as of Q3 2022, which was $3 trillion in Q3 2021 and 1.5 trillion in Q3 2020.
ESG issuance reached $950 billion over the first three quarters of 2022.

Stéphane Déo
Head of markets strategy
stephane.deo@ostrum.com

Axel Botte
Global strategist
axel.botte@ostrum.com

Zouhoure Bousbih
Emerging countries strategist
zouhoure.bousbih@ostrum.com

Aline Goupil- Raguénès
Developed countries strategist
aline.goupil-raguenes@ostrum.com

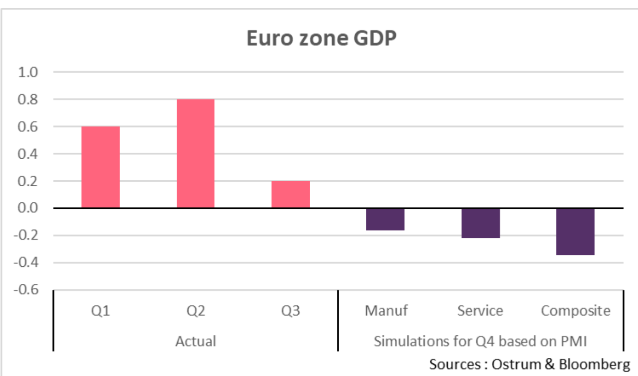
Topic of the week

Economic inconsistencies

Survey data is deteriorating rapidly and pointing to a complicated, and frankly catastrophic, economic future. On the other hand, the “hard” data show strong resilience. This gap between “sentiment” and “reality” is both worrying and unusual.

Sentiment: between bad and catastrophic

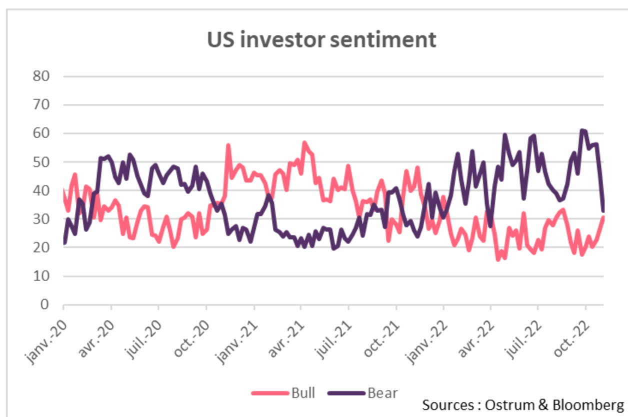
All surveys are deteriorating in Europe with PMIs settling below 50, a sign of future contraction. Components are also deteriorating, for example, order books are falling very quickly. Current levels are consistent with a moderate decline in activity in the euro area over the last quarter of this year. The contraction would be of the order of a quarter of a point.



However, some indicators are much darker. For example, the German IFO index is composed of several questions, including one on present conditions and one on future conditions. The difference between these two questions (called the “IFO gap” in economist jargon) usually gives the medium-term trend. The graph below shows the variation of this "IFO gap". The message would then be that the collapse to be expected is considerably worse than what we experienced during the great crisis of 2009 or during the Covid period! Prepare to suffer.

The situation in the United States is less extreme than in the Eurozone. There is really no equivalent to the IFO gap. But the PMIs are also clearly below 50: if the manufacturer is still at 51.1, the service component is at 46.6 and 47.3 for the composite. Again, levels that suggest a quarter-point recession in Q4.
It should also be noted that the manufacturing ISM holds up well while it is an indicator that the Fed looks at, unlike the PMI.

It should be noted, however, that investor sentiment has turned quite strongly over the past two weeks. We had 61% bears at the end of September, a historic high, and 56% on October 20. We went down to 33%, which is close to the median.



While not all sentiment indicators are as catastrophic as IFO, there is undoubtedly a very strong drop in confidence which should make us anticipate a more than complicated scenario at the end of the year.

Real life is different

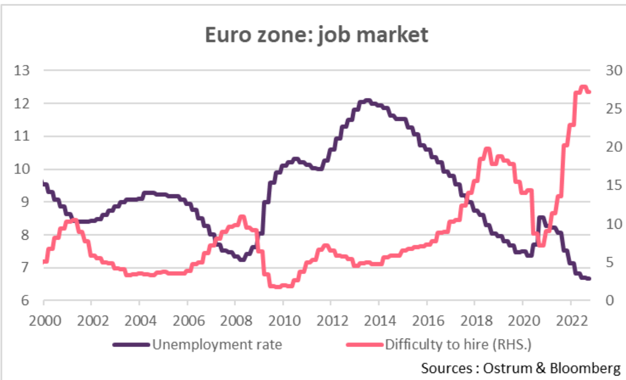
Conversely, ”hard” data, remain well oriented. The GDP that grew by 0.2% in Q3 in the Eurozone is one of the last examples.

We can nevertheless argue that these figures are very late and that the surveys, precisely, give the direction on the future.

Job market

More disturbing, labor market data remain well oriented. The unemployment rate in the Eurozone was 6.6% in September, an all-time low. Another point worth noting is that the recently released quarterly Eurostat survey shows that a very high proportion of enterprises are experiencing difficulties in hiring. More than a quarter of European companies surveyed say that the reason they do not increase their production is lack of labor!

So there is still the willingness to create jobs.



Job creation is, by definition, a bet on the future for the company. And so it is strange (inconsistent?) to have such a resilient labor market with such low confidence.

Capex

In the same vein, we can look at the capex decisions. Once again, such a decision is a bet on the future, hence it is partly a function of the level of optimism from companies. Unfortunately, we do not have detailed information in Europe on the very recent trend, there's no details of the Q3 GDP and no survey directly addressing this question.

However, we have an interesting data point from the US, the durable goods orders. The data is published in variation (month-on-month and year-on-year) but it is more instructive to look at the data in level as we do in that chart below.

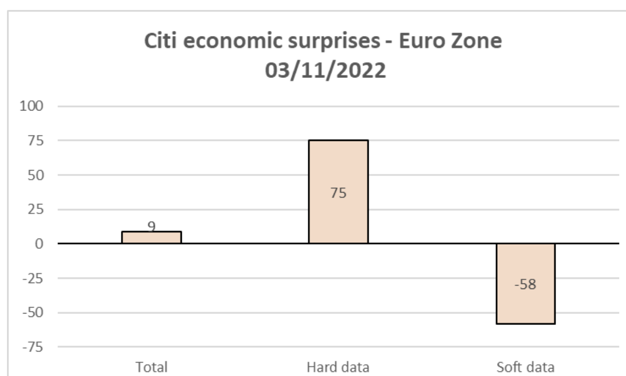
The message is very unambiguous with a record high level of orders. This is a signal that investment, just like job creation, is still quite resilient.

Can we extrapolate this finding to Europe? We think the answer is yes for two reasons. First the capex cycle is largely driven by common global factor. So having European capex collapsing while the US are at an all time high would be very peculiar indeed. Second, capex decisions are usually very correlated with job creation decisions, they have the same drivers and the same purpose: increase production. So here too, it would be odd to have European firms creating jobs and cutting capex aggressively at the same time.

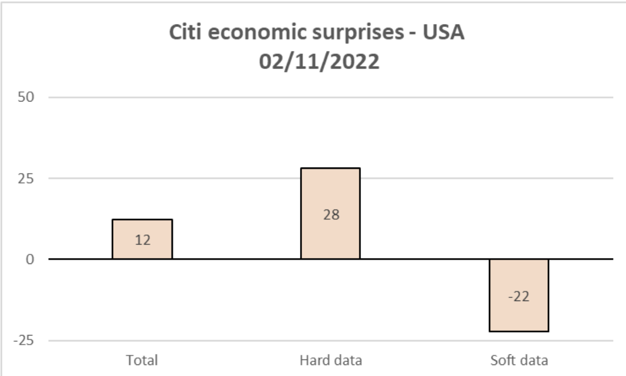
Surprise surprises

Another way to look at this is to look at economic surprises. Citi compiles the difference between the level of published data and the expectations of economists. The indicator for the Eurozone is currently 8.9, a very slightly positive level. But what is more interesting is the breakdown between the surprises on the "soft" data (understanding the surveys) and the surprises on the "hard" data (understanding the real data, GDP, industrial production, employment, etc.).

The current situation is very paradoxical. Soft data has provided a lot of bad surprises, the indicator is at -58 which places it in the second lowest decile of its historical distribution. So a very bad figure.
On the other hand, "hard data" surprises are at +75 in the best decile of the historical distribution. So the "hard" data has been very clearly surprising on the rise recently.



Here too the situation is less extreme in the US. But the inconsistency between the two is clearly apparent too.



It can also be noted that this “soft”/“hard” gap is very unusual. The data flow tends to move in sync and the two components move in the same direction. Such a large gap is very rare historically.

Here too there is a divergence between perception and reality.

Conclusion

The current divergence between economic sentiment and reality is very unusual. While some surveys can send an extremely anxious signal, the reality seems more measured, especially companies continue to make decisions that commit them to the future, job creation or investment.

Paul Samuelson proposed the “theory of revealed preferences”: rather than asking economic agents their preferences, we look at their concrete choices. For example, you say loud and clear that you are on a diet but your shopping cart at the supermarket is full of cassoulet and chocolate bars. You revealed your preferences…

At the same time, companies are now saying that they are pessimistic or even very pessimistic about the future, but they are not acting accordingly. On the contrary, they take bets that commit the future. By the end of the year, a recession seems very difficult to avoid. The question is about its magnitude: if we believe the current behavior of companies, it could remain moderate.

Stéphane Déo

Market review

Powell prolongs the monetary cycle

Stocks rebound on hopes of a recovery in China despite Fed tightening.

The hope of a relaxation of the zero-covid policy in China erased the decline in stock market indices caused by the hawkish communication from the FOMC. The 75bp hike is likely the last of this unusual magnitude. The next interest rate increase should be limited to 50 bps in December before the final adjustments in 2023. The peak of the interest rate cycle is now seen above 5%. The yield curve inverted further in the United States. Conversely, the BoE's monetary policy remains an enigma for many market participants resulting in renewed selling pressure on the pound Sterling. According to BoE forecasts, the status quo on interest rates at 3% will lead to a prolonged recession and a rapid decline in inflation. Global bond yields are rising without prejudice to risky assets. Credit spreads are narrowing in the euro area with the exception of covered bonds which remain sensitive to changes in swap spreads. The outperformance of high yield reflects a clear resurgence of interest in the asset class in the United States. Emerging debt is also attracting good demand. The greenback despite support from the Fed’s monetary policy declined somewhat as equities rallied towards the end of last week. However, daily volatility remains very elevated. The Chinese yuan is showing a rebound, as market participants bet on a reopening of the economy and a rapprochement with Germany. The technology sector in China’s stock market is recovering to price levels not seen since last March.

The Federal Reserve raised its rate by 75 bps to 4% last week. Jerome Powell spared the markets by suggesting that the next rate hikes would be smaller but recognizes that the available data argue for higher interest rates into 2023. An increase of 50bp seems certain at the December FOMC but the projections for next year will include further tightening. The market foresees a ceiling in rates at 5.25% for the upper bound of the Fed funds range. The latest employment release is still upbeat despite the brake on hiring announced by several large US companies. Vacancies have actually increased again despite signs of a moderation in economic growth. US employment increased by 261k in October after a 315k gain in the previous month. However, the unemployment rate rose by 0.2pp to 3.7%. Average hourly wages increased by 4.7% over one year. In the UK, after a tumultuous month, the BoE raised interest rates by 75 bps. The lack of an unanimous decision with two dissenting votes in favour of increases of 50 and 25 bps respectively immediately weighed on sterling exchange rate, especially as Andrew Bailey suggested that a status quo of 3% would allow a rapid decline in inflation (under 2% by 2024) at the cost of a long recession. Pressure from the new government raises fears of a return of fiscal dominance. The BoE, by raising rates and selling gilts (up to £6 billion this year), is crystallizing losses absorbed to the tune of £11 billion via a transfer from the UK Treasury. The independence of the Central Bank is at stake, and, in this context, it is the Pound that appears the weakest link.

The fixed income markets remain dominated by monetary tightening. The US 2-10yr spread traded below -60bps ahead of Friday's payroll release, a level not seen in over 40 years. The 2-year yield trades around 4.70%, attracting to money market fund flows. Total assets of money market funds exceed the $4,500 billion threshold, i.e. the level that prevailed at the height of the pandemic. The recovery in risky assets should encourage a steepening of yield curves. Inflation remains under pressure given the Fed stance. The 10-year is around 4.20%. Quarterly Treasury refinancing emphasized market liquidity issues. The Treasury is studying a securities buyback program in order to correct the liquidity gaps in US bond markets and will top up the maturities issued each month by more than expected. In the euro area, Christine Lagarde reiterates the need to act on inflation. The Bund fell again this week as 10-year yield closed near 2.30%. Sovereign spreads trade sideways despite the relative high richness of Italian BTPs and French OATs. The early repayment of TLTROs (to be announced on November 16) should not have an impact on spreads. The covered bond market could be more impacted.

On credit markets, improving sentiment sparked a week of spread tightening of around 6-7 bp. The primary market is very quiet (40% below average in October) with only €3 billion issued this week. The end of the earnings season blackout could spur issuance, in particular from US corporate borrowers. The balance of flows to funds has also stabilized. There was decent outperformance of good quality hybrid debt. The level of spreads on the euro IG now stands 14 bps below the highs of the year (140 bps against swap).

The rebound in equities is undoubtedly fueled by the short covering which reduces the equity risk premium and hopes for a recovery in Chinese growth. Flows to European equity funds suggest investors begin to see light at the end of the tunnel. Valuations are in line with long-term averages with, however, some risk of downward revisions to earnings. European luxury stocks are benefiting from improved sentiment towards China. Earnings releases from the US technology sector nevertheless weigh on markets, in the context of higher rates. The European, and even more so US, high yield market is once again attracting investors. US ratings projections are favorable to the speculative-grade market and spreads imply a sizeable risk premium in an environment of low default rates.

Axel Botte
Global strategist

Main market indicators

G4 Government Bonds	07-Nov-22	1wk (bp)	1m (bp)	2022 (bp)
EUR Bunds 2y	2.15%	+21	+28	+277
EUR Bunds 10y	2.28%	+13	+8	+245
EUR Bunds 2s10s	12.2bp	-8	-20	-31
USD Treasuries 2y	4.7%	+22	+40	+397
USD Treasuries 10y	4.16%	+12	+28	+265
USD Treasuries 2s10s	-54.6bp	-11	-11	-132
GBP Gilt 10y	3.54%	+3	-70	+257
JPY JGB 10y	0.26%	+1	-5	-7
€ Sovereign Spreads (10y)	07-Nov-22	1wk (bp)	1m (bp)	2022 (bp)
France	52.77bp	-1	-1	+15
Italy	215.27bp	0	0	+80
Spain	104.84bp	-3	-3	+30
Inflation Break-evens (10y)	07-Nov-22	1wk (bp)	1m (bp)	2022 (bp)
EUR 10y Inflation Swap	2.69%	+8	+28	+63
USD 10y Inflation Swap	2.75%	-1	+24	-2
GBP 10y Inflation Swap	4.2%	+7	+15	+2
EUR Credit Indices	07-Nov-22	1wk (bp)	1m (bp)	2022 (bp)
EUR Corporate Credit OAS	214bp	-9	-6	+119
EUR Agencies OAS	90bp	+2	+1	+41
EUR Securitized - Covered OAS	100bp	+2	-7	+54
EUR Pan-European High Yield OAS	602bp	-17	-21	+284
EUR/USD CDS Indices 5y	07-Nov-22	1wk (bp)	1m (bp)	2022 (bp)
iTraxx IG	107bp	-7	-25	+59
iTraxx Crossover	518bp	-34	-114	+276
CDX IG	89bp	-1	-12	+39
CDX High Yield	515bp	-2	-64	+222
Emerging Markets	07-Nov-22	1wk (bp)	1m (bp)	2022 (bp)
JPM EMBI Global Div. Spread	525bp	-15	-18	+156
Currencies	07-Nov-22	1wk (%)	1m (%)	2022 (%)
EUR/USD	$0.999	1.103	2.535	-12.1
GBP/USD	$1.147	0.009	3.464	-15.2
USD/JPY	JPY 146	1.613	-0.752	-21.4
Commodity Futures	07-Nov-22	-1wk ($)	-1m ($)	2022 (%)
Crude Brent	$98.1	$5.3	$2.2	34.55
Gold	$1 678.0	$44.5	-$16.8	-8.26
Equity Market Indices	07-Nov-22	-1wk (%)	-1m (%)	2022 (%)
S&P 500	3 771	-3.35	3.60	-20.9
EuroStoxx 50	3 711	2.59	9.95	-13.7
CAC 40	6 427	2.56	9.55	-10.1
Nikkei 225	27 528	1.56	1.52	-4.4
Shanghai Composite	3 078	6.37	1.77	-15.4
VIX - Implied Volatility Index	25.39	-1.89	-19.04	47.4

Source: Bloomberg, Ostrum AM

Additional notes

Ostrum Asset Management

Natixis Investment Managers

and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other Person should act upon this material. Registered office: Unit L10-02, Level 10 ,ICD Brookfield Place, DIFC, PO Box 506752, Dubai, United Arab Emirates

In Japan: Provided by Natixis Investment Managers Japan Co., Ltd., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 1-4-5, Roppongi, Minato-ku, Tokyo.

In Taiwan: Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2020 FSC SICE No. 025, Tel. +886 2 8789 2788.

In Singapore: Provided by Natixis Investment Managers Singapore Limited (company registration no. 199801044D) to distributors and institutional investors for informational purposes only.

In Hong Kong: Provided by Natixis Investment Managers Hong Kong Limited to institutional/ corporate professional investors only.

In Australia: Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only .

In New Zealand: This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand.

In Latin America: Provided by Natixis Investment Managers S.A.

In Uruguay: Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627.

In Colombia: Provided by Natixis Investment Managers S.A. Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors.

In Mexico Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity, securities intermediary, or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. While shares of certain ETFs may be listed in the Sistema Internacional de Cotizaciones (SIC), such listing does not represent a public offering of securities in Mexico, and therefore the accuracy of this information has not been confirmed by the CNBV. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority. Any reference contained herein to "Investment Managers" is made to Natixis Investment Managers and/or any of its investment management subsidiaries, which are also not authorized by or registered with the CNBV or any other Mexican authority.

The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.

The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. Past performance information presented is not indicative of future performance.

Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.

www.ostrum.com