London
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MONTHLY COMMENTARY

While the regional banking crisis in the US was unrelated to the travails of Swiss bank Credit Suisse (CS), it laid the foundations for an intriguing month of March for financial markets. Global equities as measured by the MSCI World rose 3.2% while global bonds as measured by the Bloomberg US Aggregate index also rose 2.5%.

During March the health of the global banking sector was brought into sharp focus. The collapse of Silicon Valley Bank (SVB), a US bank with strong ties to the US tech industry and two other regional banks Signature & First Republic was unexpected. It appears that while the larger systematically important banking institutions, since the global financial crisis are well capitalised with strong risk management, the regional banks' balance sheets were not under the same scrutiny.

This was further exacerbated, by the run-on bank deposits at Swiss bank Credit Suisse leading to its takeover by Union Bank of Switzerland (UBS). Astonishingly, the Swiss central bank forced CS to write down to zero value a type of debt called Additional Tier 1 (AT1) which shocked the market of this asset class. AT1s are a type of convertible debt which can be written down to provide the issuing bank emergency liquidity. It was surprising because while AT1 holders lost 100% of their position, equity holders – although paltry – were to receive some compensation. (Usually, equity holders bear the brunt of liquidity calls first then bond holders.) In CS's case the ranking of equity lower than debt was turned on its head, meaning the credibility of the asset class was brought into question!

Following this, on Monday March 20th markets in the AT1 asset class opened significantly down leading to worldwide reassurances from central banks. Investors not immediately, but eventually received the news positively.

The Federal Reserve (Fed) ploughed ahead unperturbed raising rates by a further 0.25% taking the deposit rate range to 4.75% - 5.0% and moved quickly to address the banking sector challenges by opening a Bank Term funding programme to enhance liquidity access for banks. US non-farm payrolls – a monthly measure of new workers excluding farm workers - for February came in slightly above expectations at 311,000 while the unemployment rate increased to 3.6%. Average hourly earnings rose 4.6% while the wider US inflation gauge came in at 6% continuing its downward trend from the highs of last June.

The Bank of England also raised short term rates by 0.25% to 4.25% as inflation remained stubborn at above 10% due to rising prices in food and non-alcoholic drinks. When stripping out volatile goods like food and energy the number is materially softer at 6.2%. The UK Spring budget focused on boosting growth through cost-of-living support, business tax incentives and levelling initiatives and was broadly well received by markets. In part due to higher-than-expected record tax receipts in January of £5.4 billion creating a budget surplus allowing more

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wiggle room in budget policy.

Global equities rose 3.2% for the month and within equities the key detractors were financials down 6.5% and real estate down 2% on the back of concerns around the commercial real estate sector and its ties to regional banks. Positively, the tech sector rallied hard rising above 11% for the month driven by a lower expectation of future interest rates and the valuation reset in the sector becoming more attractive (eg cutting workforce and improving operating margin, resilient cash flow generation during slowdowns).

Within fixed income short term 2-year US Government bond yields dropped aggressively by nearly 1% to 4%. The yield curve, which provides the yields across short to long maturities, has remained inverted. Meaning short maturity yields which are influenced by central bank policy – for example the 2yr yield is currently 4% - are higher than the longer dated bonds like the 10yr yield at 3.4% - which is influenced by inflation and growth expectations. An inverted yield curve implies investor concerns over growth.

Within commodities, energy prices declined, led by natural gas down 16% and oil down 4%. On the back of expected falling demand and lower interest rates precious metals like gold had a strong month rising 7%. While wheat prices slowed on ample supplies particularly from strong output in Australia.

Cable, the slang term used for the price of British pound (GBP) against the US Dollar, experienced GBP strength with appreciation of circa 4% over the month to close around 1.24. While the focus has now switched to growth over inflation, markets continued their bullish ascent, even during a major Swiss bank collapse and a US regional banking sector crisis. As we move into the next quarter the focus will be on earnings and guidance from companies, and in particular the banking sector.

London & Capital continue to remain cautious with a view that the performance in risk markets has been exaggerated. Therefore, an underweight to equities over fixed income remains with a focus in high quality names with resilient cash flow generation across defensive sectors and structural growth sectors.

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