Investment Outlook

A monthly round-up of global markets and trends

April 2023

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Investment outlook

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Banking concerns bring forward the end of the monetary tightening cycle

Equity and bond markets whipsawed in March. Global equities were down nearly 3%, in sterling total return terms, at their worst last month, but then recovered that loss.[1] In fixed-income markets, government bond yields fell sharply to discount an earlier end of the Federal Reserve's (Fed) tightening cycle – see market highlights. For instance, the US 2-year treasury bond yield declined a full percentage point from 5% to 4%, its biggest three-day fall since the early 1980s.[2]

The source of this market volatility came from the banking sector. Specifically, from growing concerns over the viability of some US regional banks and Credit Suisse as going concerns. We look at both issues below and the implications this has for interest rates and markets.

US regional banks

Silicon Valley Bank (SVB), the 16th largest US bank by assets, and the smaller Signature Bank both collapsed in March. The failure of these deposit-taking institutions is not entirely unusual: there have been 563 such failures in the US since 2001.[3] However, in the current uncertain financial environment, the US Federal Deposit Insurance Corporation (FDIC) took no chances and stepped in to protect all bank deposits at SVB and Signature Bank, including those previously uninsured. The US authorities hope that this unprecedented move is enough to shore-up public confidence in the overall banking system. Arguably, the collapse of SVB was driven by the bank's mismanagement of liquidity, and is not a systemic risk – see **our article:** Is Silicon Valley Bank a canary in the coal mine?

Nevertheless, the financial vulnerability of some US regional banks has been exposed by the biggest Fed interest rate hiking cycle for decades. One issue is that banks have been reluctant to raise the interest paid on bank accounts as it negatively impacts their profits. As a result, customers have switched their savings into money market funds, whose interest rates are in line with higher central bank rates. To meet customer demand for cash, some banks were forced to sell their holdings of 'safe assets' like treasury bonds to raise this cash. Given that bonds have fallen in value as the Fed has been increasing interest rates, these banks realised losses on the sale of these bonds. This eroded their capital position and in the case of SVB led to its insolvency.

To try and mitigate any further fallout, the Fed announced that it would provide additional funding to eligible banks to help them meet customers' deposit demands. This new 'Bank Term Funding Program' (BTFP) offers loans to banks who will pledge treasuries and other assets against the loan. In other words, the Fed will lend money to commercial banks based on collateral that if held to maturity will be worth more than it is today. Essentially, this buys time for the value of banks' fixed-income portfolios to recover. Banks can also borrow money directly from the Fed and have been doing so through emergency lending facilities.

Credit Suisse

Credit Suisse was founded in 1856 and is listed as one of 30 Global Systemically Important Banks by the Financial Stability Board. The failure of Credit Suisse is a concern for markets since its weakness could threaten the integrity of the wider financial system.

The problems at Credit Suisse are complex. In its delayed annual report, which was released in March, auditor PwC identified 'material weaknesses' in internal financial controls at the group.[4] The investment bank has been the subject of a series of scandals and poor management, particularly in its investment banking division, which a series of restructuring attempts have failed to address. To add to the firm's woes, Saudi National Bank, its largest shareholder, undermined market confidence by saying it would not commit more capital to the troubled bank. These events eventually led to UBS, another major Swiss bank, taking over Credit Suisse after being offered extensive government guarantees and liquidity provisions from the Swiss authorities.

On balance, these developments probably change the thinking of central bankers about raising interest rates: they are also a reminder that problems for individual banks and companies can quickly spread around the world. If the commercial banking sector becomes less inclined or able to lend money, there is a knock-on effect of reducing growth in the real economy, and possibly by more than central bank forecasts. Ironically, in their quest to raise interest rates to tackle high inflation, central banks (and governments) could ultimately end up having to provide more funding to the banking system in the event of a bailout than would otherwise be the case.

The bottom line is that central banks are coming to the end of the tightening cycle. Annual headline CPI inflation is down from the respective peaks in major economies. For instance, US inflation is down to 6.0% from a peak of 9.4% in June.[5] There is also some initial evidence of labour market softening, reducing the risk of wage inflation becoming ingrained in economies.

Although there is a fine balance between addressing elevated inflation and managing financial sector risks, the need to raise interest rates much further has lessened. Assuming this is the case, then government bonds look increasingly attractive at current yields. Easing interest rate headwinds are also an opportunity for equities if the global economy can avoid a recession, and the risks in the banking sector are brought under control.

Sources:

[1,5] Refinitiv, Evelyn Partners

[2] 10 charts from an unprecedented week in markets, Deutsche Bank, Henry Allen, March 2023

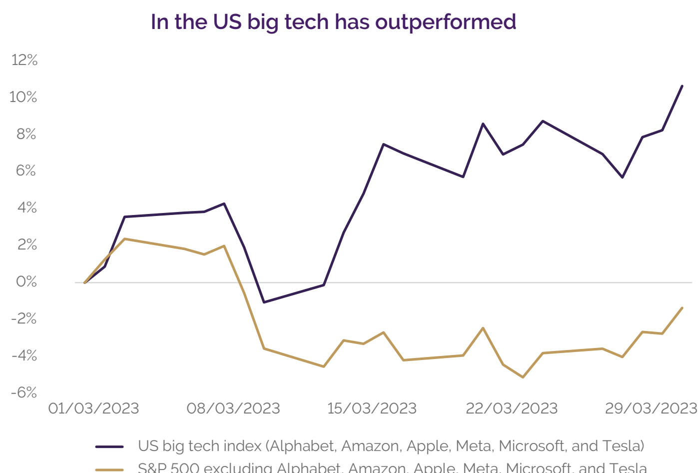
[3] Chart of the Day, Jim Reid, Deutsche Bank, 13 March 2023

[4] Credit Suisse finds 'material weaknesses' in financial reporting controls, Financial Times (ft.com)

Market highlights

Equities

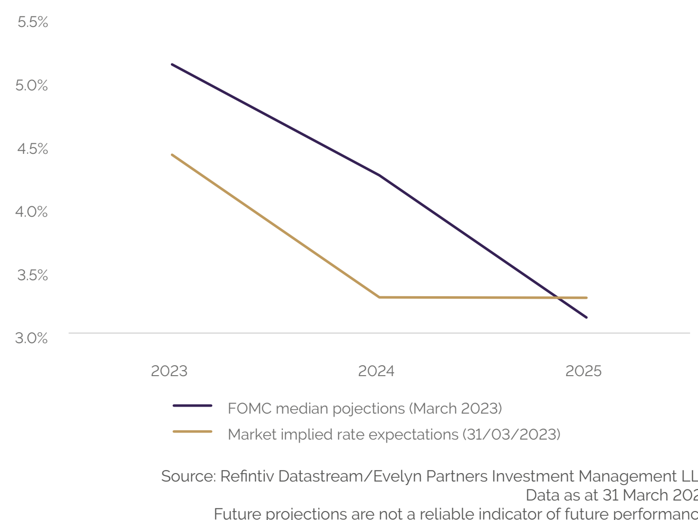
In March, the big tech names emerged as winners in a volatile US equity market. A market cap weighted index of six of the largest US technology companies (Amazon, Apple, Google, Meta, Microsoft, and Tesla) outperformed the rest of the S&P 500 by almost 12% during the month. Technology companies tend to be more sensitive to changes in interest rates compared to the broader equity market. So, when forward interest rate expectations began to fall, shares in these large technology companies rallied. Additionally, recent layoffs and other cost-cutting initiatives have improved efficiency, potentially increasing the attractiveness of these companies.



Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Performance is total return in pounds sterling as at 31 March 2023.
Past performance is not a guide to future performance.

Fixed income

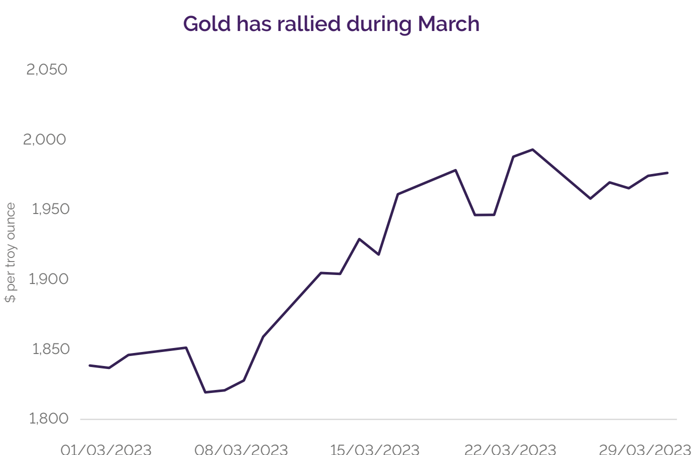
March saw significant volatility in fixed-income markets. At the beginning of the month, the expectation was that the US Central Bank would continue to hike interest rates in the coming months. However, following the collapse of several regional US banks, markets changed course and instead anticipated that the tightening cycle would end earlier. In another twist, the Federal Open Market Committee (FOMC), a committee responsible for setting interest-rate policy, voted in favour of a 25 basis-point (bps) hike and reiterated their commitment to reducing inflation. They also published an update to their 'dot plot' which shows where committee members expect rates to go. It suggests that there will be one more 25bps increase this year with cuts not expected until 2024. Market expectations differ, implying that the Fed may need to start cutting rates as soon as July. Only time will tell which one of these views will play out.



Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Data as at 31 March 2023
Future projections are not a reliable indicator of future performance.

Currencies / Commodities

Market turmoil, caused by fear in the banking sector, saw a swing in investor sentiment. Investors moved away from risky assets and turned towards traditional safe havens, such as gold. Falling US treasury bond yields also increased the relative attractiveness of gold, given that it is a non-yielding asset (i.e. it does not pay income to holders). The rally saw the spot value of gold peak at just over 2,000 US dollars per troy ounce during intraday trading, its highest value since August 2020. However, contagion risks in the banking sector now appear to have eased and bond yields have ticked up, prompting gold to give back some of its gains. Nonetheless, the gold price increased 7.5% over the month.



Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Gold spot price in USD, data as at 31 March 2023.
Past performance is not a guide to future performance.

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	1.0	4.5	-0.9	62.6
MSCI UK	-2.7	3.2	5.6	31.6
MSCI UK Broad	-3.1	3.0	3.0	26.1
MSCI USA	1.4	4.8	-2.5	91.9
MSCI Europe ex UK	1.3	9.1	9.5	49.1
MSCI Japan	2.0	3.5	1.3	23.1
MSCI Asia Pacific ex Japan	-1.5	-0.6	-1.3	34.8
MSCI Emerging Markets	0.9	1.2	-4.5	10.5
Bonds				
iBoxx GBP Gilts	3.0	2.4	-17.0	-14.8
iBoxx USD Treasuries	0.9	0.5	1.4	17.7
iBoxx GBP Corporate	0.8	2.3	-10.6	-3.2
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	-5.0	-6.1	-25.8	13.8
Gold ($/ounce)	8.2	8.9	1.8	49.4
GBP/USD	2.1	2.8	-6.1	-11.9
GBP/EUR	-0.3	1.0	-3.8	-0.2
EUR/USD	2.4	1.8	-2.4	-11.7
USD/JPY	-2.3	0.9	9.7	25.1

Market commentary

Despite a volatile month, the MSCI All-Country World Index, a benchmark for global equities, ended the month up 1% in sterling terms. This rounds off a strong start to the first quarter, with global equities up 4.5%. In contrast, the reopening of China led to a smaller demand boost for oil than had been expected, which contributed to a 5% decline in brent crude prices for the month. This impacted UK equity indices, which have a large weighting towards petroleum-producing companies, with MSCI UK falling 2.7% during March. Banking-sector turmoil led to bond yields falling, as markets now expect central banks to cut rates earlier than they had indicated. The magnitude of interest rate repricing was particularly notable in the US and caused the US dollar to lose value against other major currencies.

Key macro data	Latest	2023 Consensus forecast	Spot rates	31-March	Yields (%)	31-March
UK GDP (YoY%)	0.57	-0.40	GBP/USD	1.24	MSCI UK	4.30
UK CPI Inflation (YoY%)	10.40	6.50	GBP/Euro	1.14	MSCI UK broad	4.30
Bank of England Base	4.25	4.25	Euro/USD	1.09	10 Year Gilt	3.38

The market commentary, values and charts as at 31 March 2023. Total returns in sterling.
Returns are shown on a total return (TR) basis ie including dividends reinvested (unless otherwise stated).
Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.
Source: Refinitiv Datastream/Bloomberg

Important information

Please remember the value of investments and the income from them can fall as well as rise and investors may not receive back the original amount invested. Past performance is not a guide to future performance.

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