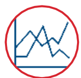
Ravenscroft

COMMENTARY

1st January to 31st March, 2023

For professionals and intermediaries

A growing belief that the interest rate hiking cycle is nearing its peak put investors in a positive mood that sticky core inflation data, hawkish central bank rhetoric, corporate earnings downgrades and even high-profile bank failures in the US and Europe failed to dampen.



EQUITIES

Equity Market Indices

Index	Q1-2023	2022
MSCI World ($)	+ 7.25%	-19.46%
MSCI World (€)	+ 5.69%	-14.39%
MSCI World (£)	+ 5.08%	- 9.90%
MSCI World (local ccy)	+ 6.96%	-17.40%
S&P 500 ($)	+ 7.03%	-19.44%
FTSE UK All Share (£)	+ 2.03%	- 3.16%
MSCI Europe Ex-UK (€)	+ 9.46%	-14.52%
Japan Topix (¥)	+ 5.91%	- 5.05%
MSCI Asia Ex-Japan ($)	+ 4.09%	-21.54%
MSCI Emerging Markets ($)	+ 3.54%	-22.37%
MSCI Emerging Markets (€)	+ 2.04%	-17.48%
MSCI Emerging Markets (£)	+ 1.45%	-13.15%

Slower US headline inflation, the fast pace of China's post-lockdown economic rebound and lower European energy prices combined to deliver the strongest start to a calendar year for equities since 2019 (and the second best in 22 years), which saw the bulk of the quarter's gains in global indices delivered in January. Reversing the pattern of the preceding six months, mega-cap growth stocks led the market higher, as hopes that interest rates would peak earlier than previously expected boosted demand for "long duration" assets. February brought an abrupt end to the rally and a change in direction after cautionary language in the statement that accompanied a 0.25% increase in the Federal Reserve ("Fed") policy rate was followed swiftly by the release of strong US jobs data, denting hopes of a central bank pivot.

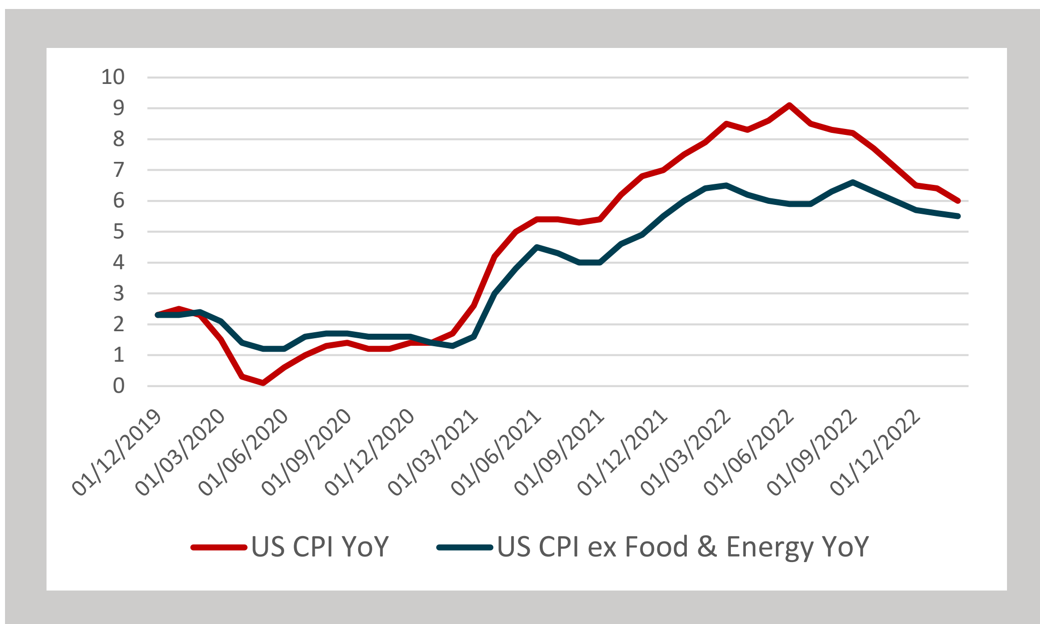
Sentiment took another hit in early March with the collapse of California-based Silicon Valley Bank ("SVB") – a key player in the technology venture capital sector. The sudden demise of America's sixteenth largest deposit- taker

triggered a series of bank runs and failures of both national and state entities, the size and speed of which were deemed sufficiently concerning for the Fed to announce an extension to its depositor insurance scheme in an effort to stop further contagion. Meanwhile on the other side of the Atlantic, the Swiss authorities were forced to step in when, propelled by large-scale depositor withdrawals, Credit Suisse entered its own equally rapid death spiral. After a frantic weekend of negotiations involving state-funded write-downs and guarantees, a hastily arranged "shotgun wedding" with its arch competitor UBS saw the 167-year-old institution consigned to the history books barely a week after SVB's demise.

Ordinarily, the second biggest US bank failure ever and the implosion of another designated as being of "global systematic importance*" in the space of ten days might reasonably be expected to spark a sizeable risk-off episode in equities. Instead, based on the assumption that the potentially negative impact on a fragile baking system made further US interest rate rises much less likely, markets headed higher. A steady ascent over the period's final fortnight, during which growth stocks again led, left the MSCI World (local currency) Index just 1.5% below its intra-quarter high.

As has been the case for some while, inflation reports remain the most keenly watched economic data and in terms of the quarter's releases, the picture was mixed. Whereas the latest headline readings for the US and Eurozone have fallen meaningfully from the levels recorded last year (6.0% vs 9.1% and 6.9% vs 10.6% respectively), the latest US core rate of 5.5% is only 1.1% below its peak (Fig.1), while the most recent Eurozone print of 5.7% represents a new high. In the UK, meanwhile, headline inflation rose unexpectedly to 10.4% in February, compared with a peak of 11.1%, as did the core rate, to 6.2% vs a 6.5% high.

Fig 1. US Composite PMI



Source: Bloomberg

In terms of other important metrics, Purchasing Managers' Indices ("PMIs"), which aim to measure corporates' future intentions for investment, procurement and hiring, recorded encouraging increases. In the US the latest reported composite (manufacturing + services) PMI crossed the threshold from contraction to expansion, climbing from 45.0 to 50.1 and the equivalent Eurozone measure from 49.3 to 52.7. Even more promising was the implied rise in business activity within China, with the composite PMI index surging from 42.6 to 57.0.

Thanks to a modest increase in reported aggregate earnings, broad market valuations were little changed: at its closing mark, the MSCI AC World Index ended the quarter priced at 16.1 times the previous twelve months' earnings. With consensus estimates suggesting only marginal growth in profits over the coming year – consistent with

expectations of (at worst) a mild global mild recession – the same forward price / earnings multiple of 16.1 compares with a ten-year average of 18.4. As we commented last quarter, while certainly not in bargain territory, that rating seems entirely reasonable to our way of thinking, given the likely outlook for the global economy and provides room for some upside should forecasts prove overly cautious.

Importantly, this should not prevent our preferred funds from delivering positive returns. Indeed, with the era of "free money" well and truly behind us, the rising cost of capital means that factors such as superior business models, competitive advantage and quality of management have become more important drivers of share price performance than has been the case for many years (the greater dispersion in individual companies' market behaviour supports this). In such an environment, we therefore see considerable scope for outperformance from the superior stock-picking that is the hallmark of the managers through whom we invest.

**Among the 33 banks included in that category as at the end of 2022, Credit Suisse was one of 23 required to maintain the lowest level of regulatory capital buffer. In addition, at the time of its emergency rescue, 16 of 27 brokerage analysts covering the company rated its shares a "buy" or "hold".*

BONDS

Bond Market Indices

Index	Q1-2023	2022
Bloomberg US Gov't >1yr ($)	+ 0.72%	-12.46%
Bloomberg German Gov't >1yr (€)	- 2.97%	-17.83%
Bloomberg UK Gov't >1yr (£)	+ 1.69%	-25.11%
Bloomberg Global Aggregate ($)	+ 4.55%	-16.25%
Bloomberg US Aggregate ($)	+ 1.87%	-13.01%
Bloomberg Euro Aggregate (€)	- 1.21%	-17.18%
Bloomberg Sterling Aggregate (£)	+ 2.81%	-23.15%
ICE BofA US Corporate ($)	+ 3.52%	-15.45%
ICE Bof A Euro Corporate (€)	+ 1.32%	-13.95%
ICE Bof A Sterling Corporate (£)	+ 7.56%	-19.88%
ICE BofA US High Yield ($)	+ 3.98%	-11.22%
ICE BofA Euro High Yield (€)	+ 4.67%	-11.48%
JPM EM Gov't Bond ($)	+ 7.44%	-16.45%

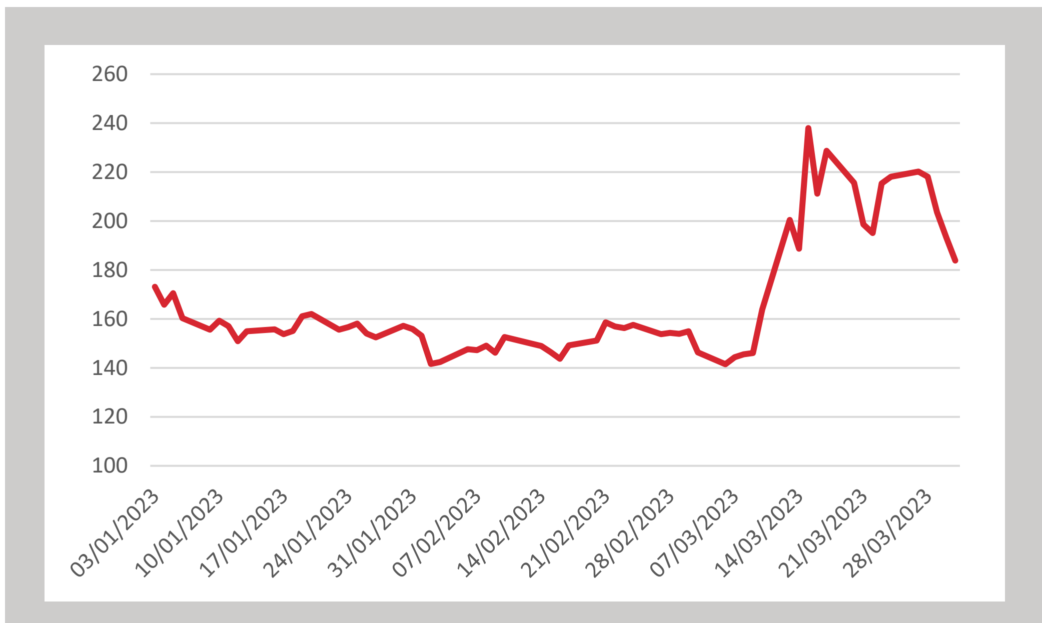
With interest rate expectations the main influence on markets' movements, sovereign bond price indices (the inverse of yields) followed a similar pattern to that of equities. Starting at, respectively, 3.88%, 2.57% and 3.67%, a strong start to the period saw the yields on 10-year US, German and UK benchmark bonds fall by more than 50 basis points ("bps") in the first three weeks, before a shift in direction sent them climbing back above those opening levels by early March. At that point, another change of path then took them back towards the lower end of the quarter's trading range and at the period-end their yields stood at 3.47%, 2.29% and 3.49%. In terms of index movements (per our table, above), these translated to the biggest Q1 gains for seven years in the case of the Bund and Gilt markets and eight years for Treasuries.

Though central banks continued to raise their policy rates over the quarter, both the declining number and size of the increases when compared with previous periods gave credence to the belief that an end to the current rate hiking cycle is almost upon us. In the US, the upper bound for Fed Funds was put up by 25bps on two occasions to 4

.75%, the European Central Bank ("ECB") raised the cost of funds to banks in two 50bps chunks to 3.5%, while the Bank of England's base rate ended 75bps higher (50bps+25bps) at 4.25%. If markets' current forward pricing is to be believed, further hikes of, respectively, just 25bps, 50bps and 25bps can be expected before official rates top out and then begin to head lower in the third quarter.

Events in the banking sector made for a volatile time within corporate bond markets. Adding to an already fragile environment caused by the collapse of SVB and others, a shock revelation that some USD 17 billion of Credit Suisse contingent convertible bonds were rendered worthless under the terms of its rescue triggered a sharp rise in the credit spreads of financial issuers that bled into the broader corporate space. Happily, thanks to the aforementioned swift intervention in the US and reassuring statements from European and UK authorities that the Swiss regulator's controversial actions were very much a one-off, the unwanted drama proved short-lived. By the quarter-end, average yield in the broad investment grade and high yield markets were little changed from their opening levels (plus or minus a few bps, depending on rating), while the index for European banks' subordinated debt ended only modestly higher (Fig.2).

Fig.2 – iTraxx EUR Sub Fin Index



Source: Bloomberg

Specific Credit Suisse issues notwithstanding, the resilience exhibited by corporate bonds in general and those of bank issuers in particular has served to reinforce our positive view of credit markets, where the compelling combination of attractive income yields and capital upside has not been on offer for many years.

CURRENCIES

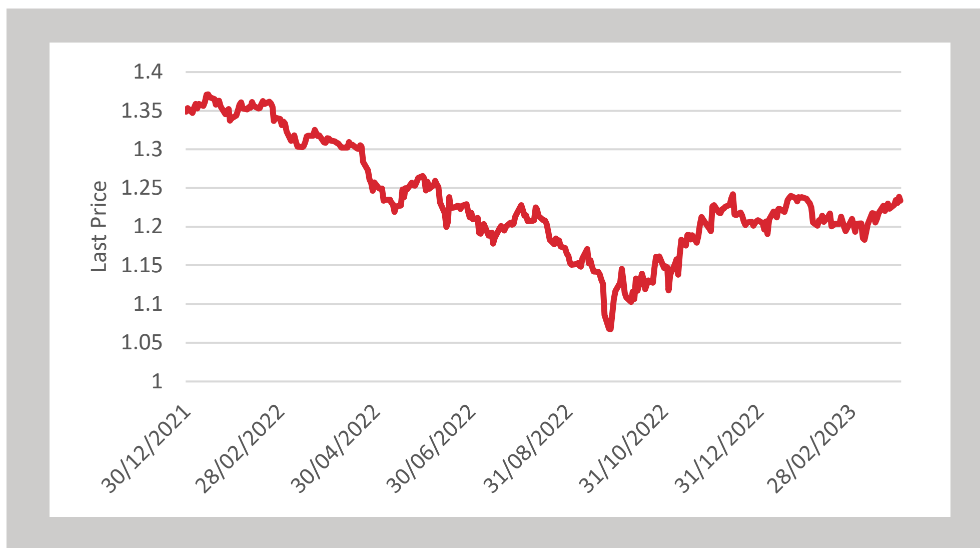
Though its safe-haven credentials and future status as the world's reserve currency are regularly called into question, the US Dollar behaved in textbook fashion over this particular period under review: its movements a mirror image of the risk-on, risk-off, risk-on pattern seen in equities and bonds. Measured by the DXY Spot Index, the Dollar ended the quarter down 0.98% on a trade-weighted basis.

Emerging market currencies featured prominently among the largest movers on the foreign exchanges, with the Mexican Peso (+8.06% in USD terms) and Brazilian Real (+4.29%) topping the league table of the 16 major

currencies listed by Bloomberg, while the South African Rand recorded the second biggest decline (-4.26%) behind the Norwegian Krone (-6.40%).

Extending its strong relative showing from the previous period, the Pound appreciated by a further 2.10% in US Dollar terms, having moved towards the top of its recent trading range to reach a close at USD/GBP 1.2337 (Fig.3). Defying the Bank of England's grim forecast of a recession that would last for up to two years, UK GDP grew by 0.1% in last year's final quarter and according to official data has continued to expand in January. With the IMF having recently upgraded its forecast for the UK economy by the largest margin among those of the G7, it would not be too much of a surprise if Sterling's positive momentum was to continue.

Fig.3 – USD GBP exchange rate



Source: Bloomberg

COMMODITIES

Despite rises in the prices of its underlying components outnumbering those that fell, the Refinitiv CRB Commodity Index recorded a decline of 3.61% in US Dollar terms over the quarter under review.

That was largely down to softness within the energy complex, most notably the 50.48% fall in the price of (US) Natural Gas (wholesale European gas prices were also down 35% QoQ). Crude Oil prices also declined: the "front month" future contract for West Texas Intermediate (the index's largest component by weight, at 23%) closed at USD 75.67 per barrel, down 7.09%.

At the top end of a huge range in price changes, meanwhile, Orange Juice was up 30.57%, Cocoa +12.81% and Sugar +11.03%, while Nickel (-20.67%), (US) Heating Oil (-20.40%), Lean Hogs (-14.20%) and Wheat (-12.59%) recorded double-digit drawdowns.

Though unremarkable within the context of these other movements, Gold's return to the top of its historic price range generated a fair degree of excitement, with the bullion price reaching its highest level for over a year and testing the USD 2,000 per troy ounce level, before closing at USD 1,969.28 (Fig. 4).

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Fig.4 - Spot Gold USD per troy ounce

Source: Bloomberg

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