ARIA | CAPITAL

INVESTMENT INSIGHT

A weekly look inside the investment world.

> *In five years, a number of banks will not be around because of blockchain technology.*
> ***Joseph DiPaolo, Signature Bank CEO, 2018***

Friday, 17 March 2023

In this week's Investment Insight

Gradually and then suddenly
In Ernest Hemingway's The Sun Also Rises, a group of young expats travel to Pamplona for the running of the bulls. One expat, Mike, is asked how he went bankrupt. His reply: "Gradually and then suddenly." As the sun now sets on 2023's first earnings season, are equity markets are heading for a Hemingway moment? In The Inside Track we share some thoughts on the matter from Ruffer's Jasmine Yeo.

Silicon sealed
One story has dominated financial markets over the past seven days: the demise of Silicon Valley Bank (SVB). Credit Suisse's woes have added to jitters, although yesterday's provision of a liquidity lifeline by the Swiss central bank has restored some calm. While the collapse of SVB wasn't caused by a single factor, it was interesting to note that its fate was sealed by the need to crytallise losses on investment assets to meet liquidity demands. Those loss-making investments weren't high-risk, esoteric deriviatives, they were US Treasury bonds. The US Fed and other central banks are coordinating efforts to prevent contagion effects from SVB's failure, but it hasn't been enough to avoid huge sell-offs of regional US banks. In *Pic of the Week* we take a look.

Newswire
Some interesting nuggets from this week's newswires.

Market view
A visual snapshot of recent market performance.

The Inside Track: Gradually and then suddenly

Jasmine Yeo is an Investment Manager at Ruffer where she co-manages the Ruffer Investment Trust. What follows are extracts from her rather sobering recent assessment of potential market developments.

Whichever way you cut it, [corporate] earnings are high. US companies have been enjoying such plump margins thanks to the disruption of the pandemic and the subsequent supply chain issues, as well as over a decade of zero interest rates. As a result, pricing power has been high and borrowing costs low.

But both these tailwinds are reversing, meaning US corporate profits will remain under downward pressure in 2023. This pressure could be exacerbated by macro factors such as higher energy costs, supply chain re-shoring, wages, labour hoarding and the energy transition. An earnings bear market where EPS just return to trend – never mind overshoot – would be brutal, with severe implications for equity markets.

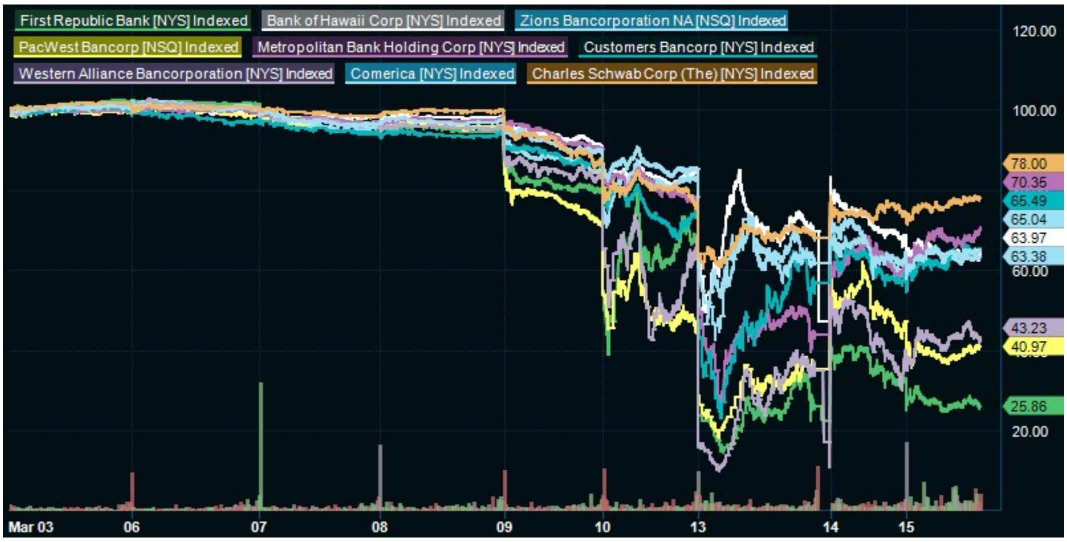
Crucially, investors are not being rewarded for taking on this uncertainty. Equity risk premiums are at a 15 year low. For example, a six month US T-bill offers roughly the same yield as the earnings yield, but without any earnings or duration risk. Whilst this is a measure of income and thus does not account for capital growth, it is a startling proposition nonetheless.

For the coming months, we see a tactical runway for equity markets thanks to a confluence of supportive factors, including China's re-opening, Europe's energy-driven rebound, US consumer resilience and underlying liquidity driven by central banks in China, Japan and Europe.

However, we expect both fundamental factors and liquidity conditions to be challenged in the second half of the year, particularly as consumers draw down their covid savings buffers. And we are already seeing evidence a global rebound is inconsistent with sustained disinflation. We remain defensively positioned in the expectation that this year's running of the bulls will end suddenly – and the unwary risk being gored.

Pic of the Week: Silicon sealed

Silicon Valley Bank's collapse this week triggered immediate and sharp falls in the values of other regional US banks. Even though SVB had a somewhat unique depositor base and an unsuitable investment strategy, investors were understandably spooked by the prospect of a drain in confidence triggering runs on other second tier banks. Assuming confidence is, ultimately, fully restored, many of these banks will see their share prices recover. Over the longer term, however, they may face growth challenges as both depositors and borrowers apply greater scrutiny to their choice of banking partner, with many likely favouring those systemic banks deemed 'too big to fail'.



Newswire

...on Monday
Joe Biden promises to do 'whatever needed' to support the US banking system following Silicon Bank's demise.

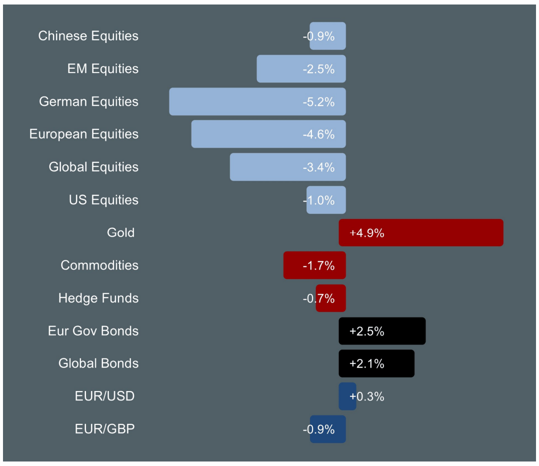
...on Tuesday
Bid/Ask spreads on US goverment bonds reach their greatest in over six months as liquidity in the world's largest bond market dries up.

...on Wednesday
European stock markets fall sharply with shares in Credit Suisse plummeting.

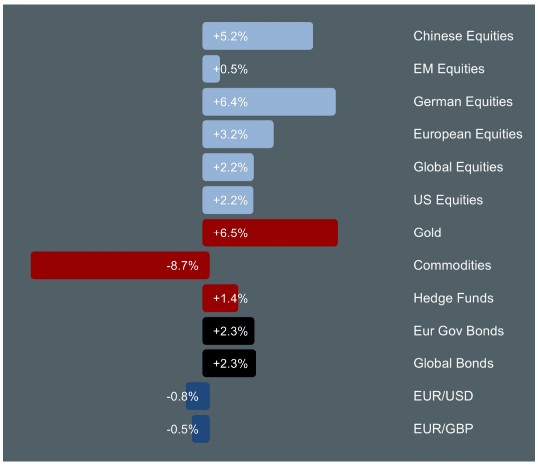
...on Thursday
Credit Suisse shares gain 40% on announcement of Central Bank support.

Market View

Last 7 days (€)



Year to date (€)



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