STRATEGY OUTLOOK

April 2023

Key takeaways-

- Bank stress, protests in France and the Swiss upset bond holders
- Yet global central banks just keep hiking interest rates AND increase QE!

Another banking crisis. The banks were the **Achilles heel** of markets back in 2008 but today there is an important distinction. In 2008 it was a solvency crisis, where banks lost money and couldn't meet their obligations. In **2023 it's a liquidity crisis** where banks simply can't sell their assets quick enough to meet outflows.

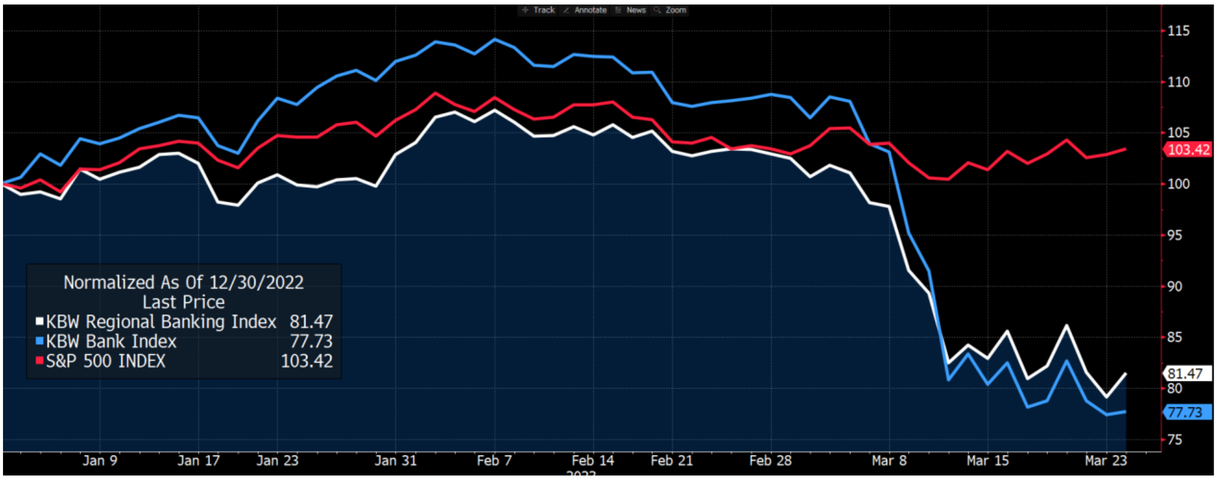
The month will almost certainly be remembered by Europeans for the collapse of Credit Suisse and, for across the pond, the **2nd biggest bank failure in US history** (Silicon Valley Bank or SVB). Also, some important geopolitical events occurred in March plus the reignition of stimulus (QE) by the Fed despite hiking interest rates to 5%.

As an example of March's volatility, the 2yr US Treasury posted several days in a row of 3-sigma moves. **According to Bloomberg this has a statistical probability of once every 50 million years.**

US Treasuries are deemed by regulators as "safe haven assets". This type of volatility destroys risk models for insurance companies, sovereign wealth funds, pension funds, group treasuries etc. The consequence may then become forced selling of any asset.

Negative or indeed vicious rumours were all that was required to set off a **self-perpetuating spiral** against the Banks. Endless scandals, losses, management shake-ups and restructuring didn't exactly help but it did feel, at times, that the market always just needed something to kick. The graph highlights the fall in regional bank equity indices vs. the S&P.

As an example of how liquidity was so important. Signature bank went to the authorities on March 10 to borrow $2bn around noon. By 1.30pm, customers were withdrawing money so fast that it had to go back for another $2.5bn. The Bank filed a second request close to 6pm. By then Signature customers had withdrawn $18bn – about 20% of the lender's total deposits. The bank inquired about further advances after the market closed but was told no. The bank closed on March 12.



Banks have been caught sleeping. You cant push everyone 'digital' and then be surprised that money moves fast. With interest rates at 5% you cannot pay <1% on accounts. Citigroup in March were paying 1bps (0.001%) on saving accounts. Customers have woken up (apparently its more likely you divorce than change your bank!) and the ensuing stress is yet another unintended consequence of hiking interest rates from 0% to 5% in the space of 12 months.

With the CS bailout the methods used by Swiss authorities to 'save' equity holders and wipe out a speciifc class of bondholders has created **ire and the start of legal action**. There is a great deal we could write on the subject but will save the reader. One author, we tend to agree with, put it like this –

" We are sympathetic to the plight of investors but we are surprised they are surprised. Afterall, in just the past 14 months, the UK froze Venezuela's gold, Canada froze protesting truckers' bank accounts, the US froze Russia's FX reserves, the LME broke nickel trades and most recently, the US is (for the moment at least) selectively backing uninsured bank deposits. Anyone surprised that contracts are not being honoured should not be, in our view ". We would note that Gold doesn't have a contract, a reason we like it.

Consequences of all this? - Banks will change but the availability of credit may contract, less lending particularly in commerical and industrial sectors and small business optimism may fall. **Small businesses create 2/3 of jobs in the US**. Deposit rates for savers will have to rise ultimately hitting bank margins too.

Following the trend of an end to dollar hegemony we saw the formal resumption of diplomatic ties between **Saudi and Iran**. Obama made Iran an economic pariah state which is now being welcomed back into the (new world) fold despite the significant religious divide between Sunni and Shia. As if by coincidence Xi Jinping was meeting Putin in Moscow in March with the result Putin announced that Russia will favour the Yuan for settlements. China will buy oil in Yuan and dramatically reduce its need to hold US Treasury reserves, **a negative for bond markets but, we believe, a positive for gold**.

Although getting pitiful exposure in the media France is a nation in strife. The media have tried to paint a picture of the French striking (again!) because Macron has dared to increase the pensionable age. The reality is more that Macron has enacted **Article 49.3** of the constitution which allows Government to unilaterally pass any law without a vote. Socio-political change in Europe is happening. In Holland, Israel, Germany, Ireland, and France the electorate are not happy.

Broadly we remain **defensive** with an underweight in equity and cash on the side-line. The full effect of interest rate hikes is only beginning to develop. Ultimately, we believe stocks are bottoming and are looking for opportunities to get bullish. We continue to be bullish on Gold and have added more exposure. Going forward we have and are adding niche investments which fit our strategic themes, and which don’t require as much of a binary bet on many of the issues discussed.

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