INVESTMENT COMMENT March 2023

- **“There is Never Just One Cockroach in the Kitchen” (Warren Buffett)**

The classic bank-run last week at Silicon Valley Bank (SVB) – the 16th largest bank in the U.S. – is the second largest bank failure in U.S. history. SVB’s main clientele is venture capital firms as well as technology and life science startup companies. Each customer account is insured up to $250K but over 90% of the accounts have assets above that level. The U.S. government has stepped in to guarantee all deposits. Despite this “quick fix”, we do not think that this problem is over just yet, since the contagion could spread to more than some smaller regional banks.

- **A Pause in Rate Hikes?**

Fed Chair Jerome Powell keeps reminding investors of his intention to raise rates “until the job is done” in order to avoid the same mistake made by Paul Volcker in the late 1970’s / early 1980’s when he stopped rate hikes too soon.

However, on the heels of the SVB collapse bonds rallied over the past few days as investors flocked to the safety of bonds and speculated that the Fed may not raise rates at the same pace for the time being. One week ago, the market expected a 50bp rate hike with a 70% probability. And now, the market expects a 25bp rate hike with a 73% probability - with the balance expecting no rate hike at all. This could be supportive for equities, if fears of additional bank blow-ups subsides.

- **Is it Time for Bonds?**

The US yield curve is currently inverted: the 2-year US treasury yield is above 4% - higher than the yield on 10-year U.S. treasuries. German bunds trade at 3.2%, yields not seen in 16 years. Investing in short-term bonds is currently a viable alternative to equities.

- **Winners and Losers of China’s Reopening**

China’s faster than expected pace of reopening will allow it to grow significantly faster than previously anticipated with strong knock-on effects on the rest of the world. First, it will raise global demand. Second, it will relieve some of the pressure on global supply chains. Third, it will benefit in particular China’s domestic economy, traditional tourist destinations as well as exporters of commodities and manufactured goods.

On the flipside, a surge in Chinese demand could add to global inflationary pressures and make it more difficult for central banks to lower interest rates. This, in turn, makes emerging and developing countries more vulnerable to higher financing costs.

- **Asset Allocation**

Gold remains attractive. Last year, central banks bought a record of 1,146 tons of physical gold. While developed countries were net sellers, Russia, China, India, Turkey and Kazakhstan have been large buyers partly to de-dollarize their reserves.

We remain slightly underweight equities and continue to hold predominantly short duration fixed income. We are holding more cash than usual, enjoying the fact that negative interest rates are gone. In uncertain times like these, it is best not to try to be smart but wait and prepare for opportunities that will come our way again.