Markets
& Convictions

April 2023

RJ Management

The recent decline of American and Swiss banks, SVB and Credit Suisse, highlights the potential impact of rising interest rates on indebted actors and the possibility of a credit contraction cycle. Central banks are faced with the challenge of maintaining confidence in the financial system while grappling with persistent inflation. Moreover, the change in attitude of OPEC+ reinforces our investments in the energy sector. The mix of inflation, wage increases, and declining corporate profits lead us to anticipate a recession. On the geopolitical front, the polarization between the United States and China will also impact the global economy. As a result, we maintain a cautious approach with a modest allocation in equities.

Macro

- Stock market performance as of April 6, 2023, all in the green! S&P 500 +7.02% / Nasdaq +15.46% / Stoxx Europe 600 +8.01% / CAC 40 +13.15% / SMI +4.67% / DAX +12.02% / Nikkei +7.01% / CSI 300 +5.61%.
- The US economy continues to create a significant number of jobs while average wage inflation stands at +4.2%.
- In Europe, the inflation issue is also intensifying with a CPI of +8.5%, while in the US, inflation pressure is decreasing with a CPI of +6%.
- Despite the historic tightening of monetary policy by the Federal Reserve, which has raised its benchmark interest rate from 0.25% in March 2022 to 5% today, inflationary pressures appear to be more "persistent" (see graph below).
- It is true that inflation has decreased from 9.1% to 6%, but upon closer examination, pressure on services is increasing, while the main factors driving the decrease are energy and raw materials.
- As for Europe, the European Central Bank (ECB) has gone from 0% in July last year to 3.50% today, adopting a more "accommodative" stance than the Americans, but this has led to a more complex inflation situation.
- In the meantime, during the month of March, we have seen the first very visible signs of monetary tightening: the increase in the cost of credit is impacting fragile financial intermediaries (i.e. the banks!).
- Our central bankers are thus "caught" between persistent inflation that requires a restrictive monetary policy and a fragile financial sector that demands liquidity.
- The fall of the American bank SVB (and its counterparts) and Credit Suisse has caused a lot of concern...the increase in the cost of borrowing will put many economic players in difficult situations.
- The US and Swiss authorities have saved and will do everything to save the banking financial system.

Convictions

- The fall of these American and Swiss banks is another sign that the impact of interest rates will be profound.
- The pattern that seems to be emerging is a classic credit contraction cycle.
- The past 10 years have allowed many actors to take on debt and leverage themselves.
- The financial world has thus financed itself short-term at 0% to invest in long-term projects that offer "on paper" return prospects (the famous VC / PE / Real Estate).
- The decline in valuations caused by rising interest rates will require many leveraged actors to sell financial assets to cover their debts.
- This movement will accelerate the decline and create a domino effect.
- A poorly managed bank can thus be one of the first actors affected by this contraction.
- We believe that we are at the beginning of this contraction cycle and that there will be other actors more severely affected.
- We have just been confirmed once again that states and central banks will do everything to preserve confidence in the banking system.

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- One can certainly criticize the rescue methods (and their medium-term impacts), but depositors of Credit Suisse or SVB have suffered no losses.
- This will not be the case for different actors: PE / VC / Real Estate...
- The recent publication of the ECB on commercial real estate is an excellent example, as are the requests for reimbursements that continue to flow in for the largest real estate fund of the giant Blackstone (already mentioned frequently in these lines).
- During this recent crisis of confidence in banks, the US and Switzerland have shown that they are capable of putting hundreds of billions on the table.
- Everything seems to indicate that banks are just the visible tip of the iceberg in this potential deep credit crisis.
- On its side, OPEC+ is undergoing a significant shift in its attitude towards the markets.
- As we have often discussed before, the lack of massive investment in new oil resources has propelled OPEC+ as the new marginal oil producer.
- Since the mid-2000s, this position was largely held by the US, which had invested abundantly and produced shale oil.
- They had thus brought a new source of supply to the market while OPEC+ struggled to keep up with the pace.
- The ESG pressures of the past 10 years have amplified the disinterest in this sector (in favor of tech), resulting in new oil projects becoming very rare.
- With its natural (but weak) production growth, OPEC+ has naturally regained its power to bring a new source of supply to the market and thus set oil prices.
- OPEC+ has recently confirmed this new position, which strongly reinforces our convictions in this theme with our direct holdings (TotalEnergies - Shell - BP - ENI) and the Westbeck Energy hedge fund, which has managed this volatile period very well.
- Our central bankers are therefore forced on one hand to support the banking system and on the other hand to combat inflation that is much more persistent than they anticipated.
- This could lead them to slow down the pace of interest rate hikes (not necessarily lowering them), especially in the US where inflation is slowing down faster than in Europe.
- We still believe that a significant economic slowdown is ahead of us, in other words, a recession...
- The upcoming quarterly earnings releases of companies should confirm this conviction.
- Their historically high profit margins should undergo a significantly negative scissor effect.
- Continued cost increases (wages + credit costs + raw materials) and a likely inability to pass on these additional charges to the selling prices of their finished products.
- Indeed, consumers have been able to tolerate this inflation for now by dipping into their reserves, but this is unlikely to last.
- Not to mention the geopolitical risk with a growing divide between the US and China, which will force Europe to take a position ➔ Macron in China.
- We remain very cautious in this context with a modest equity allocation (<30%), a very short duration fixed income allocation (<2 years), and hedge fund investments (20%) capable of profiting from this volatility.

The main unknown is not whether the markets will decline but when. Ultimately, it is a question of timing! However, our investment philosophy is primarily based on fundamentals rather than timing.

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Chart of the Month: The phenomenon of widespread inflation

Headline inflation
% change year on year

		2021										2022												2023	
		Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Eurozone	Eurozone	1.3	1.6	2.0	1.9	2.2	3.0	3.4	4.1	4.9	5.0	5.1	5.9	7.4	7.4	8.1	8.6	8.9	9.1	9.9	10.6	10.1	9.2	8.6	8.5
	France	1.4	1.6	1.8	1.9	1.5	2.4	2.7	3.2	3.4	3.4	3.3	4.2	5.1	5.4	5.8	6.5	6.8	6.6	6.2	7.1	7.1	6.7	7.0	7.3
	Germany	1.8	2.0	2.2	2.4	3.7	3.8	4.1	4.4	4.8	4.9	4.2	4.3	5.9	6.3	7.0	6.7	6.7	7.0	8.6	8.8	8.8	8.1	8.7	8.7
	Italy	0.6	1.0	1.2	1.3	1.0	2.5	2.9	3.2	3.9	4.2	5.1	6.2	6.8	6.3	7.3	8.5	8.4	9.1	9.4	12.6	12.6	12.3	10.7	9.8
	Spain	1.2	2.0	2.4	2.5	2.9	3.3	4.0	5.4	5.5	6.6	6.2	7.6	9.8	8.3	8.5	10.0	10.7	10.5	9.0	7.3	6.7	5.5	5.9	6.0
	Greece	-2.0	-1.1	-1.2	0.6	0.7	1.2	1.9	2.8	4.0	4.4	5.5	6.3	8.0	9.1	10.5	11.6	11.3	11.2	12.1	9.5	8.8	7.6	7.3	6.5
	Ireland	0.1	1.1	1.9	1.6	2.2	3.0	3.8	5.1	5.4	5.7	5.0	5.7	6.9	7.3	8.3	9.6	9.6	9.0	8.6	9.4	9.0	8.2	7.5	8.1
Developed	Sweden	2.1	2.8	2.4	1.8	1.8	2.5	3.0	3.3	3.9	4.5	3.9	4.4	6.3	6.6	7.5	8.9	8.3	9.5	10.3	9.8	10.1	10.8	9.6	9.7
	Switzerland	-0.2	-0.1	0.3	0.5	0.5	0.8	0.8	1.3	1.5	1.3	1.4	1.9	2.2	2.3	2.7	3.2	3.3	3.3	3.2	2.9	2.9	2.7	3.2	3.2
	UK	0.7	1.5	2.1	2.5	2.0	3.2	3.1	4.2	5.1	5.4	5.5	6.2	7.0	9.0	9.1	9.4	10.1	9.9	10.1	11.1	10.7	10.5	10.1	10.4
	US	2.6	4.2	5.0	5.4	5.4	5.3	5.4	6.2	6.8	7.0	7.5	7.9	8.5	8.3	8.6	9.1	8.5	8.3	8.2	7.7	7.1	6.5	6.4	6.0
	Japan	-0.4	-1.1	-0.8	-0.5	-0.3	-0.4	0.2	0.1	0.6	0.8	0.5	0.9	1.2	2.5	2.5	2.4	2.6	3.0	3.0	3.7	3.8	4.0	4.3	3.3
Emerging	China	0.4	0.9	1.3	1.1	1.0	0.8	0.7	1.5	2.3	1.5	0.9	0.9	1.5	2.1	2.1	2.5	2.7	2.5	2.8	2.1	1.6	1.8	2.1	1.0
	Indonesia	1.4	1.4	1.7	1.3	1.5	1.6	1.6	1.7	1.7	1.9	2.2	2.1	2.6	3.5	3.6	4.3	4.9	4.7	6.0	5.7	5.4	5.5	5.3	5.5
	Korea	1.9	2.5	2.6	2.3	2.6	2.6	2.4	3.2	3.8	3.7	3.6	3.7	4.1	4.8	5.4	6.0	6.3	5.7	5.6	5.7	5.0	5.0	5.2	4.8
	Taiwan	1.2	2.1	2.4	1.8	1.9	2.3	2.6	2.5	2.8	2.6	2.8	2.3	3.3	3.4	3.4	3.6	3.4	2.7	2.8	2.7	2.4	2.7	3.1	2.4
	India	5.5	4.2	6.3	6.3	5.6	5.3	4.3	4.5	4.9	5.7	6.0	6.1	7.0	7.8	7.0	7.0	6.7	7.0	7.4	6.8	5.9	5.7	6.5	6.4
	Brazil	6.1	6.8	8.1	8.3	9.0	9.7	10.2	10.7	10.7	10.1	10.4	10.5	11.3	12.1	11.7	11.9	10.1	8.7	7.2	6.5	5.9	5.8	5.8	5.6
	Mexico	4.7	6.1	5.9	5.9	5.8	5.6	6.0	6.2	7.4	7.4	7.1	7.3	7.5	7.7	7.7	8.0	8.2	8.7	8.7	8.4	7.8	7.8	7.9	7.6
	South Africa	3.2	4.4	5.2	4.9	4.7	4.9	5.0	5.0	5.4	5.9	5.7	5.7	5.9	5.9	6.5	7.4	7.8	7.6	7.5	7.6	7.4	7.2	6.9	7.0

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