Panta Rhei

Nothing is permanent except change

« If one does not know to which port one is sailing, no wind is favourable. »
Seneca - A Stoic philosopher of Ancient Rome, a dramatist and statesman (around 4 BC - 65 AD)

No time to sit back !

Charles BOK
Chief Executive Officer

Dear readers,

There's no denying it, the financial markets have been spooked in recent days.
And we have most certainly not been taking it easy! But when it comes to love (of your job), you don't count the cost😊 !
What exactly has been going on? Are we seeing a repeat of 2008?
Let me reassure you right away: things are very different today.

The current banking crisis was sparked by the collapse of Silicon Valley Bank (SVB).
Founded in California in 1983 by former Bank of America executives, this bank had a solid reputation among tech companies, start-ups in particular, providing banking services to newly established companies and coordinating financial operations with local venture capital companies.
In 2020 and 2021, against the backdrop of the Covid crisis, many high-tech companies fared well out of the accelerated digitisation of the economy and made staggering profits.
The bank subsequently saw its customer deposits soar to nearly $200 billion by the end of 2022.
As long as short-term interest rates were low or at least lower than long-term rates, there was no problem - the bank paid deposit rates that were lower than its own investment rates. But the bank had invested very large amounts in US long-term Treasury bonds (highest quality).
It did not foresee the drastic rise in interest rates initiated by the Federal Reserve in March 2022 and the inversion of the yield curve (long-term rates temporarily falling below short-term rates).
When interest rates rise, the resale value of bonds decreases automatically.

Therein lay the problem! As long as it was not selling, the bank was fine. But when customers began to withdraw large amounts of cash from their accounts with it, SVB had no option but to sell bonds at a loss to provide the liquidity needed for these customers.
Thus began a vicious circle that was difficult to break: the market discovered that SVB was losing a lot of money after selling its bonds, which prompted other customers to also make significant withdrawals.
And so a bank run ensued leading to an irretrievable bankruptcy.
Fortunately for customers, the Fed guaranteed their deposits to maintain calm and avoid a domino effect on the markets.
At that point, Signature Bank and Silvergate (a cryptocurrency bank) joined the fray and also collapsed.
In a case of Murphy's Law, a few days later Credit Suisse collapsed after massive withdrawals by fearful customers and was hastily bought by UBS at the behest of the Swiss Confederation.
While the bank had made a series of management errors, if it were not for the current strains, it would probably have been able to claw back those losses within two or three years.

Banks today are much better capitalised and supervised than they were in 2008.
They no longer lend money to insolvent and unsecured customers.
Still, this did not prevent a (momentary and exaggerated) tumble in the share prices of Europe's main banks, more out of contagion of nerves than for objective reasons.
When a bank loses the trust of its customers and the market, even for the wrong reasons, it becomes very difficult to avoid a dramatic outcome.
UBS's bailout of Credit Suisse and the Fed's guarantee of SVB's customers ultimately extinguished the fire and averted an irrational

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spread to the entire banking sector.
There are some reassuring lessons we can draw from all of this.
Despite the panic that started to unfurl among the customers concerned, their bank assets were not in any way affected by the crisis.
And even if Credit Suisse had gone bankrupt without the intervention of the Swiss authorities and UBS, its clients' securities portfolios would not have been affected.
A guarantee fund is in place covering CHF100,000 per account holder.
Any other amounts can be placed in money market funds to avoid the slightest risk.
The coordinated actions of the main central banks (United States, European Union, Switzerland, United Kingdom, etc.) swiftly contained the damage.
So, while the stock markets were a little spooked, there was no meltdown.
And no, we are not seeing a repeat of 2008, but neither can we afford to rest on our laurels!
All eyes are once again on the central theme: controlling inflation.

Economy - Markets - Strategy: trends

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Contrary to all expectations, and despite fears of a recession in the world's major economies, 2023 got off to a good start, on both the stock markets and the bond markets. European stock markets led the way, even as war continued to rage in Ukraine.

However, this bull rally ground to a halt in March over concerns about the solidity of the banks. As a matter of fact, the sharp rate hikes introduced by the world's major central banks over the past year have caused a lot of damage. Last year, the various hikes by the US Federal Reserve (Fed) caused a tumble in technology stocks and listed real estate stocks and a severe cryptocurrency crisis that led to the collapse of the FTX platform and, more recently, Silvergate Bank. In March, we learned of the resounding collapse of Silicon Valley Bank. A few days later, Credit Suisse, a well-known lender founded 167 years ago, followed suit, having also fallen victim to the crisis of confidence, leading to a forced takeover by UBS. With the 2008 banking crisis still fresh in people's minds, investors began to fear contagion throughout the banking sector. At the end of March, Deutsche Bank became the subject of speculation but the German authorities quickly reassured the markets of the solidity of the country's leading bank. Despite all of these difficulties, it is clear that the banking sector is in a stronger position than it was in 2008. The crisis then was systemic. In 2008, toxic products were found in almost every bank and everything exploded at once. This is not the case today as the problems are more confined.

The latest loss of confidence in banks saw investors turn back to big-tech companies that are cash-rich. This unexpected sector rotation reversed the downward trend seen in the technology sector in 2022 and pushed the Nasdaq higher.

On top of this new banking crisis and the war in Ukraine, inflation is still a burning issue this year. To be sure, energy prices have fallen sharply. The price of natural gas in Europe, for instance, has fallen back below pre-Russian invasion levels. However, core inflation (excluding energy, food, alcohol and tobacco) continues to rise.

In order to further contain inflation in the United States, the Fed raised its key rates by 0.25% in early February and again at the end of March. The federal funds rate is now 5%, a level not seen since the summer of 2007.

On the other side of the Atlantic, as was expected, the European Central Bank (ECB) raised its key interest rates by 0.5% in early March and again in mid-March. These increases, on top of identical hikes in December, have raised European interest rates to 3%, their highest level since 2008. It generally takes 12 to 18 months before we see the effects of monetary tightening on the economy and inflation. It is now 12 months since the first rate hike in the United States (mid-March 2022). Some economists are asking if the Fed has gone too fast and too far in its monetary tightening policy. It has already caused significant turmoil in the banking sector and could lead to an unwelcome recession.

Overall, the economy is doing fairly well and the anticipated slowdown seems to be taking its time. Against this backdrop, we believe the equity markets could have a good year in 2023, especially as inflation and rising rates are likely to weigh on the physical real estate market.

In currencies, the US dollar fell slightly during the first quarter of the year and ended Q1 2023 down 1.3% against the euro.

The loss of confidence in the banking sector has obviously been good news for gold, a safe haven, which has risen by nearly 8% in 2023. Oil has fallen by 5.7% as a result of the economic slowdown. Like gas, oil is now below the level seen before the Russian-Ukrainian war.

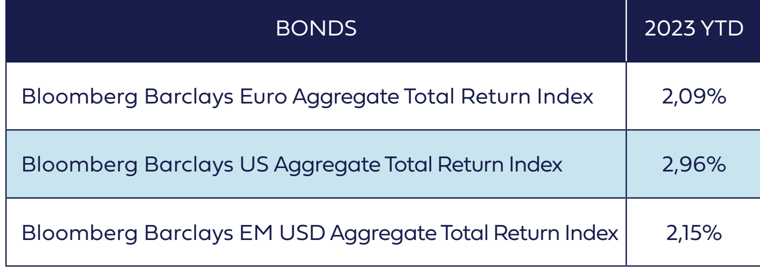
Drafting closed on 03/04/2023

Recommended asset allocation for a MEDIUM risk investor in EUR

Asset allocation		Currency exposure	
Total individual equities and equity funds (including real estate)	**40%**	**EUR**	**85%**
European equities	17%	**USD**	**12%**
US equities	20%	**Other**	**3%**
Emerging market and Japanese equities	3%		
Bonds and bond funds	**32%**		
AIFs	**10%**		
Miscellaneous (gold and other commodities)	**5%**		
Cash and money market funds	**13%**		
	100 %		**100 %**

Guidelines for our in-house policy. For many reasons, differences, sometimes substantial, may exist between different portfolios.

Drafting closed on 03/04/2023.



BONDS	2023 YTD
Bloomberg Barclays Euro Aggregate Total Return Index	2,09%
Bloomberg Barclays US Aggregate Total Return Index	2,96%
Bloomberg Barclays EM USD Aggregate Total Return Index	2,15%

EQUITIES	2023 YTD
EURO STOXX 50	13,74%
STOXX Europe 600	7,75%
CAC 40 (Paris)	13,11%
BEL 20 (Brussels)	2,49%
S&P 500 (New York)	7,03%
NASDAQ 100 (New York)	20,49%
NIKKEI 225 (Tokyo)	7,46%

COMMODITIES (IN USD)	Gold	Silver	Oil (WTI)	Bloomberg Agriculture
As at 31/12/22	1.824,02	23,95	80,26	68,82
As at 31/03/23	1.969,28	24,10	75,67	68,03
%	7,96%	0,60%	-5,72%	-1,15%

CURRENCIES	GBP	GBP	CHF	JPY
As at 31/12/22	1,0705	0,88534	0,98956	140,41
As at 31/03/23	1,0839	0,87902	0,99218	144,09
%	-1,25%	0,71%	-0,26%	-2,62%

The impact of rising interest rates on company valuations

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For almost a year now, central banks in many countries have started to raise interest rates. Their objective is clear: to fight inflation.

The effects of these rate hikes are numerous and complex. While for certain assets, such as bonds, the consequences are predictable and follow an almost mathematical logic, the effects on equities are more difficult to understand.

This can be examined from various angles, such as debt, pricing power (a company's ability to transfer additional costs to its customers) or elasticity (the sensitivity of customers to a rise in the price of a company's products). Here, I am going to look at how it affects a company's valuation, as calculated using the discounted cash flow method.

This method, well-known in the industry, involves calculating future cash flows and discounting them to their present value. A fraction is applied for each year, the numerator of which is the net cash flow for the year in question and the denominator of which is 1+ the interest rate (1+r). The power of n (number of the year) is applied to this factor, i.e. (1+r)n. Then, by adding each of the annual fractions, we obtain the company's theoretical value.

This can be illustrated using a simple example: imagine discounting a cash flow of €1,000,000 to be obtained in three years' time. If the reference interest rate is 2%, the discounted cash flow will have a value of 1,000,000/(1+0.02)3 i.e. €942,322.
If the interest rate changes to 5%, the discounted cash flow is €863,838.

Thanks to this formula, we can see that the further away a cash flow is in the future, the more it will be impacted by the interest rate and any increase in that rate.

Popular wisdom dictates that when equity markets come under stress, it is advisable to invest in so-called « value » stock rather than « growth » stock. This unwritten rule is supported by the discounted cash flow method I have just explained.

Indeed, a growth stock by definition represents a company whose future income is significantly higher than its current income. The negative impact of an interest rate hike on the valuation will therefore be greater for a « growth » company than for a « value » company.

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