Letter from the CIO

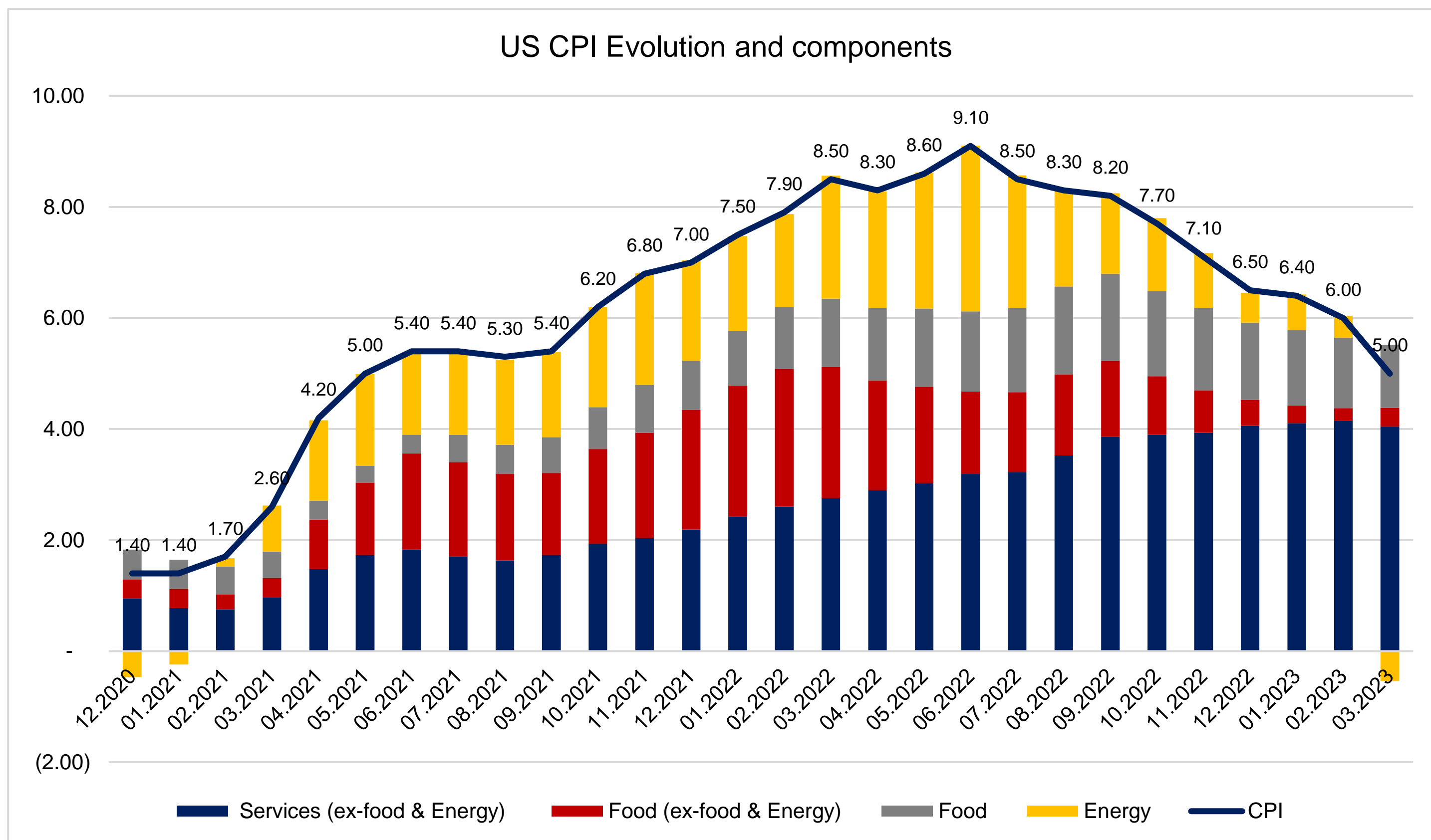
BANQUE HERITAGE

May 2023

Does May mean "stay" this time?

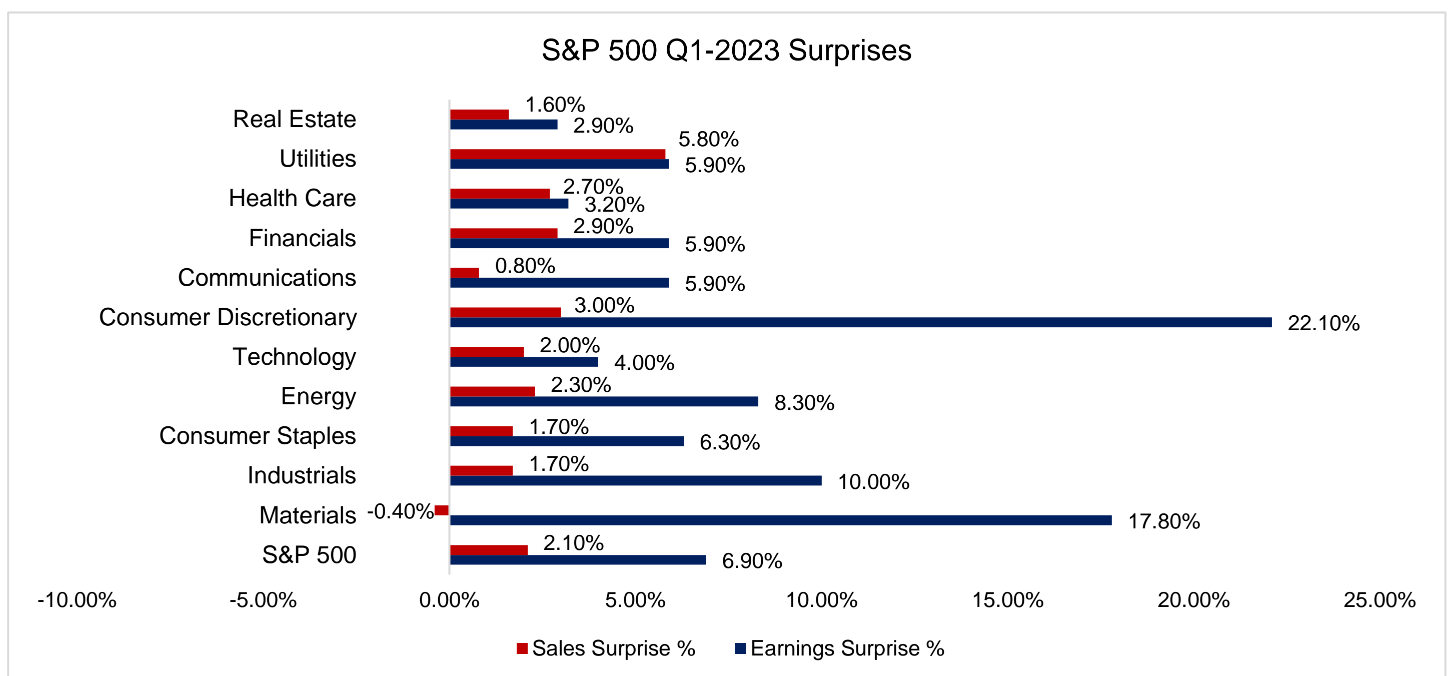
After the collapse of Silicon Valley Bank (SVB) a month ago, which after increasing concern and loss of trust led to the forced takeover of Credit Suisse by UBS, it's another Californian regional bank, First Republic Bank, that has been in the spotlight in recent days. Indeed, it is the same scenario that impacted the SVB that has just hit First Republican Bank as one of its main competitors. The publication of its results on 24th April showed a massive drop in deposits in the first quarter ($100 billion), which immediately caused its share price to plummet by 50%, following a fall of more than 80% since March. On the verge of bankruptcy, the US regulator intervened this weekend to save the bank, taking immediate control and selling most of its assets to JP Morgan Chase after a lightning bid. Will this be the end of the banking crisis that began a month ago? Only time will tell! Despite this threat, markets performed reasonably well in April, reassured by US and Swiss interventions to stabilise the financial sector and buoyed by a US Q1 earnings season that, at the halfway point, does not appear to be as bad as expected. The S&P 500 closed April up by 1.5%. On closer inspection, the three technology titans, Apple, Microsoft and Meta, were responsible for more than half of the month's performance! Record Q1 results and US interest rates showing signs of easing are the main catalysts for this rally. Growth continues to lead the way this year, with the MSCI US Growth Index up 18% in the first four months, while the Value Index remains stuck at 0%! In Europe, the Euro Stoxx 50 index rose by 1.9% over the month, while the Swiss Market Index rose by almost 3%, driven by strong gains from its two largest pharmaceutical companies (Novartis +8.8% and Roche +7.4%). The MSCI Emerging Markets Index fell by 1.2% over the same period. With no major announcements from the FED or ECB in April, sovereign bond yields on both sides of the Atlantic remained relatively stable. The US 10-year Treasury yield closed at 3.46% (+4bps), while the German 10-year yield stabilised at 2.30% (+6bps). Finally, dollar against euro continued its slide (-1.6%), while the Swiss franc appreciated +0.6% against the European currency over the same period. Gold remained flat this month (+0.6%), after having risen by almost 8% last month.

Earnings season is in full swing in the US, with 50% of companies having already reported their first-quarter results. On the face of it, the business models of these companies have been quite resilient, as S&P 500 earnings per share are on track to fall 4.2% year-on-year, better than the consensus forecast of a 6.7% decline at the end of the quarter (FactSet). In addition, corporate profits beat forecasts at 6.9%, the highest rate since the third quarter. And revenue growth came in at 2.9% (YoY, down 3 points from Q4 2022. All in all, this is rather reassuring news, which certainly helped to stabilise markets in April. But a closer look reveals a slightly different picture. In Q4 2022, companies had struggled to beat earnings estimates (beating them by only 1.3%). The fact that companies were able to beat their Q1 forecasts by such a large scale now can therefore probably be explained by the fact that they were more cautious (overly cautious?) in their forecasts for the first quarter of the year. The results are thus better than expected, but they do not point to an end of the economic crisis in the coming months, even if the momentum of earnings revisions for the coming quarters has improved across sectors since January.



Source: Bloomberg / Banque Heritage

From a macroeconomic point of view, the situation on the inflation front is improving but is still a concern for central banks. This week's decisions by the FED and the ECB will be closely watched. In the US, the CPI index published for March showed a drop in inflation to 5% year-on-year, the lowest since May 2021. It was the fall in energy prices (-3.5% over the month and -6.4% over the year) that helped bring down headline inflation. What worries our central bankers, however, is the evolution of core inflation (excluding food and energy), which remains high. While it slowed slightly in the US to 0.4% for the month from 0.55% in February, it is still up 5.6% for the year from 5.5% last month. The economy continues to slow down and there are risks of recession, although there is some resilience in the face of very tight monetary policy. According to a preliminary estimate, the US economy grew at an annualised rate of 1.1% in the first quarter of 2023. This represents a slowdown in the first three months of the year compared to the previous quarter, when the US economy had grown by 2.6%. In the eurozone, growth has proved to be more resilient than expected, while fears of a recession are mounting. According to a first estimate by Eurostat, gross domestic product grew by 0.1% in the first quarter. It had stagnated in the final quarter of last year. Over the year, growth reached 1.3%, compared to 1.8% on an annual basis in the last quarter of 2022. Inflation figures published at the beginning of the week show that inflation in the zone has started to rise again. After reaching 6.9% in March, Eurostat's first estimate is that it rose slightly to 7% in April. Encouragingly, however, core inflation (excluding energy, food, alcohol and tobacco) fell for the first time in many months, from 5.7% in March to 5.6% in April.



Source: Bloomberg / Banque Heritage

The combination of these micro/macro indicators seems to confirm that the worst has been avoided, but that there are still many hurdles to overcome. As a result, we have not made any major changes to our portfolios. We remain resolutely constructive, but cautious in the face of a global economy approaching the end of its cycle and a more moderate turn from central banks. Profits taken last month on our banking positions have been reinvested in US technology companies. Long time underweighted in our portfolios, the first quarter results of these tech giants have shown that they have been able to adjust their model to the bursting of the technology bubble and remain key players in an increasingly connected and digitalised world. More attractive valuation levels and a further easing of interest rates in the coming months are all catalysts that should benefit these tech giants.

This month of May, we don’t sell and go away!

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