RICHMOND HOUSE
INVESTMENT MANAGEMENT

Investment commentary

March 2023

Market overview

March proved ultimately to be a positive month for equities as global economic data generally continues to surprise on the upside, helped by falling commodity prices and a strong recovery in China. Developed markets rose nearly 3% in local currency terms with returns from emerging markets just slightly lower.

The month did not pass without incident and some significant concerns however as the collapse of Silicon Valley Bank in the US and the subsequent, largely unrelated, failure of Credit Suisse stoked fears of a financial crisis, sending bank shares sharply lower. Bond markets were then further spooked by the surprising decision from Swiss authorities to rank equity holders above certain (AT1) bond holders in relation to the Credit Suisse collapse, prompting key central banks across the globe to step in and reiterate that the 'old order' of bonds ranking above equity in the payout order still stands. Subsequent reassurances from central banks about the health of the financial sector and a general belief (which we share) that the banking sector is well capitalised post the reforms after the 2008 financial crisis have since led to a recovery in the sector.

One likely consequence of the pressures within the financial sector is a further tightening in bank lending standards. The belief that this might provide a further brake to growth and inflation, and therefore reduce the need for further rate rises, added to the already increasingly dovish stance of central banks and led to a fall in bond yields (and rise in bond values) over the month – global bonds gained 3% in US dollar terms.

This decline in rate expectations benefited growth stocks in particular with sectors such as technology particularly strong in March. In contrast, the pressure on banking shares weighed heavily on markets such as the UK with significant exposure to the sector.

While sentiment became more dovish over the month, key central banks did go ahead with further rate rises, citing areas of stubborn core inflation and tight labour markets driving wage pressures within the services sector. The Bank of England and US Federal Reserve raised rates by 25 basis points while the European Central Bank went ahead with a 50 basis point rate rise with President Christine Lagarde holding back from further guidance on likely policy and reasserting a willingness to sure up stability in the banking sector if needed.

UK inflation remains problematic, standing at 10.4% after a slight increase in February. The Bank of England does, however, expect this rate to fall quite sharply by the year end driven by lower commodity prices, a fall in the price of imported goods and a slowdown in demand due to the squeeze on real earnings. Bond markets are now pricing in one further 25 basis point rise in the UK before a potential pause in the tightening cycle.

Sterling strengthened against the US dollar over the month, rising from 1.20 to 1.23, dampening returns on non-sterling denominated assets to a degree.

Strategy positioning

The prospects for the global economy have generally improved since the start of the year, helped by lower commodity prices and the re-opening of China. COVID influences are diminishing: the shortage of goods has reduced and delivery times have improved. Fears of a global recession have therefore abated although some countries may still flirt with a technical recession in 2023. This is most likely in Europe, where strikes and civil unrest are not helping the economic situation.

Headline inflation continues to ease in most areas, largely due to lower energy and food prices, however core inflation is proving to be stickier than initially expected, held up by strong service sector price rises and very tight labour markets. We still believe that the inflation picture should look very different by 2024.

We are encouraged by the improving economic backdrop and the positive outlook for corporate earnings, which suggests valuations in many sectors are attractive. This leads us to maintain a full exposure to equities where we are positioned more towards those parts of the world where inflationary pressures are either fundamentally weaker or showing good signs of diminishing – this backdrop continues to direct us towards Asia and the USA where superior rates of medium and longer-term growth are also expected.

We are alert to the concerns within the banking sector and accept that this adds another layer of potential risk for equity investment, but we do not believe the risk of contagion is sufficient to derail our positive view on equities versus other asset classes. Central banks should soon be in a position to stimulate growth once more and are ready to step in if needed to sure up the financial system.

We have been active in fixed income markets in recent months, adding targeted exposure where we see opportunities. Where appropriate for the investment mandate we also continue to hold low risk, uncorrelated strategies in the alternatives space, which reduce overall portfolio volatility and can provide absolute returns regardless of market direction.

Risk warnings