STRATEGY OUTLOOK

May 2023

Key takeaways-

- More banking issues in the US……another collapse.
- Yet markets seem resilient with nervous investors and a looming US debt ceiling. What do they say? - 'Sell in May and go away'!

Last month we discussed the collapse of several US regional banks one of which, Silicon Valley Bank, was then the 2nd largest bank failure in US history. Roll on another few weeks and First Republic Bank has snatched the spot as the 2nd largest bank failure in US history ($233bn with Washington Mutual at $386bn still the largest). **First republic's 84 branches will reopen on Monday as JP Morgan Chase**. Fear not, this was a good deal for JPM, and they seemed to be able to bypass the rule restricting any bank from controlling more than 10% of US deposits. The impact of these collapses however is seeing a distinct tightening in the availability of credit to consumers and business. As we write US regional banks continue to be under considerable pressure.

Commercial real estate is another area struggling and reliant on regional banks. San Francisco has hit a vacancy rate of 29.5%, the lowest on record. Office vacancies are up 7x since the start of 2020 across the country. This is an illiquid and opaque asset class and one to keep an eye on.

We're in an unusual cycle. Investors are bearish (and seem to be positioned that way) looking for a lower stock market. Indeed, the lack of any weakness given the banking issues on stock markets is impressive. Recession fears and evidence abound. **We've had an inflation shock, an interest rate shock (ongoing as per graph) and a bear market and the lead and lag times for these are frankly, anyone's guess.** Add in the lag from COVID, a Chinese economic system that only came back online this year and stimulatory US fiscal policy ($1.8trn deficit and counting which hits a debt ceiling soon) and there is a lot going on.

Liquidity is key. Central banks and in particular China and Japan have been turning the taps on so far this year but its also about oil, the dollar and volatility. From the UK Gilt crisis in September the reaction function of the authorities has been clear – more liquidity.

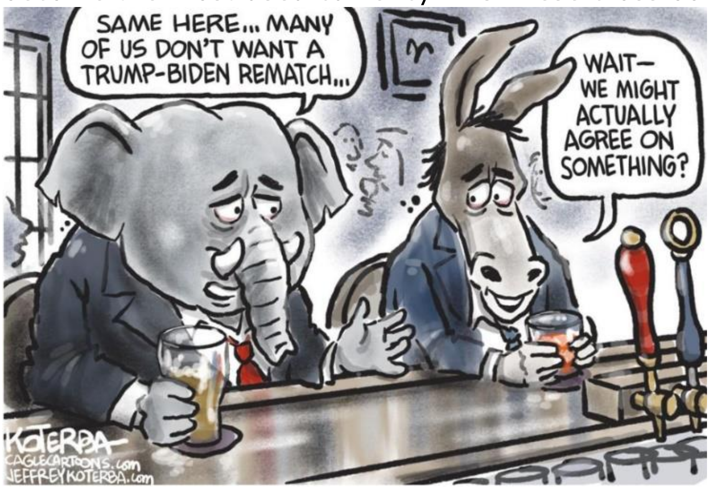
Earnings for Q1 have been strong led by Big Tech. Additionally, guidance for the rest of the year is robust. **These are lead indicators that haven't been sold the 'the recession is here' narrative.** However, the economic data in the West continues to price in weak growth but, again, markets remain robust given the weaker outlook.

Of interest to us was in the Glencore Q1 2023 production report. Copper (-5%), Zinc (-15%), Lead (-16%), Nickel (-32%), Gold (-1%) and Silver (-31%) all saw production cuts. Grades too have deteriorated. Glencore is just one supplier to the market but is an example of the deficit situation in many of these metals which, given the lack of investment, isn't going to get better anytime soon. **Little wonder Glencore want to buy Teck.** It's the same situation in oil. US shale production has been 90% of global oil production growth over the past decade. As of this year the big 4 US shale basins (Permian, Bakken, Eagle Ford and Niobrara) were declining at a 6.1% per month rate. Supply is being crushed but, for the time being, demand concerns perhaps via recessionary concerns are keeping a lid on price. This is an area of interest for us.

Latest data from the Monetary Authority of Singapore shows they have bought 68.7 tonnes of Gold this quarter or an amount 45% higher than at the end of December. Indeed, collectively central bank purchases of gold hit their highest level since 1967. **US Treasuries are the loser** from this as in the last 12 months China has sold almost 18% of its US Treasuries diversifying into real assets (it's just bought its first stake in a Qatari gas field). In a similar vein its perhaps interesting that both Chile and Mexico have, this year, nationalised their lithium industries.

The US is either going to have to slash their own spending or have the Fed finance them via QE. **The only palatable political choice**, out with a sea change in the political narrative **is for the Fed to finance**. Indeed, the Congressional Budget Office already, by 2033, forecast that the Fed's balance sheet will have expanded to $14trn (from $8trn). Ultimately this is bullish.

De-dollarisation is another thread of debate currently. The Yuan has overtaken the $ to become the most used currency in Chinese cross border transactions. Alipay, WeChat



etc offer global payments with huge processing and cost advantages over the traditional system Swift (maybe that's why Musk bought Twitter?). Additionally, the US has made it clear that it will decide who has access to Swift and who doesn't. Not surprisingly, given this, Argentina follows a host of other BRICS countries in using the Yuan to pay for imports rather than the $. **The $ wont collapse tomorrow** or the next day but the trend is in place. Over 50% of all people live in Asia with 500 cities in South-east Asia having over 200k inhabitants. **It's not about the West anymore.**

In politics, Robert F.Kennedy Jr has announced his candidacy for President. Alarmingly his views are still censored by TV networks (e.g., ABC) who think the viewing public is too timid to hear another view to their narrative. There is a lot that can be said about the state of politics at the current juncture. The lies, corruption and double standards seem to be getting worse with a lack of journalists able to hold anyone to account. **Voters aren't stupid** and however much the mainstream media tries to ignore it, change will happen. They've even stopped doing debates in the forthcoming US primaries, a move which clearly will aid the incumbent President

For investors the reaction function of 'authorities' (unelected and elected) is to do anything to create stability and a chance to keep power. Irrespective QE is more than likely to remain the favoured tool in the central banker's toolkit. The appetite to let the market clear is far, far, far from palatable at the current junction.

Broadly we remain **defensive** with an underweight in equity. The full effect of interest rate hikes is only beginning to develop. Ultimately, we believe stocks are bottoming and are looking for opportunities to get bullish. Going forward we have, and are, adding niche investments which fit our strategic themes, and which don't require as much of a binary bet on many of the issues discussed.

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