Macroeconomic Commentary[1]

Global equity and bond markets had a strong start to the year despite the continuing geo-political tensions. The strong economic data and persistent core inflation reported in February weighed on equity and bond markets, compelling investors to re-evaluate their rate forecasts, but the quarter still concluded positively for both markets. The collapse of Silicon Valley Bank in March caused a decline in government bond yields which in turn led to a resurgence in Growth stocks and saw the Nasdaq (USD) gain 17% during the quarter. The MSCI World Index (GBP) concluded the quarter with a gain of 5.5%, alongside the S&P 500, Euro STOXX 50 and FTSE 100 which finished up by 7.5%, 14.3% and 3.6% respectively, in their local currencies. In fixed income markets, yields on the US, UK and German 10-year government bonds fell by 41, 18 and 28 basis points respectively. Positive sentiment continued to grow in the face of declining energy prices, reflected in the 5.4% decline of the Bloomberg Commodity Index during the period. The pound gained 2.1% against the US dollar and 0.7% against the euro.

Fund Commentary

During the first quarter of 2023, the Credo Global Equity Fund (CGEF) returned 8.2%, slightly underperforming the MSCI World Index by 0.5% in USD terms[2].

Q1 of 2023 was another volatile quarter for global fund managers. The year started in the same vein as how it had ended in 2022. The main themes continued to focus on inflation, interest rates, recessions, and geo-politics. The market had been eagerly awaiting confirmation that inflation was back under control, allowing central banks to pivot and start slowing the pace of interest rate hikes or even start cutting interest rates. However, in early March, attention shifted to the potential for a banking crisis as a run-on deposits at Silicon Valley Bank, based in California, caused it to collapse. This spurred a mini-crisis across all regional banks in the US, forcing the Federal Reserve Bank to step in and guarantee depositors' money to avoid it developing into a full-blown crisis. Across the Atlantic, the nervousness within financial markets led to a questioning of the stability of Credit Suisse, which itself then faced a run-on its deposits and was ultimately forced to submit to being acquired by UBS at the insistence of the Swiss government and the Swiss Financial Market Supervisory Authority. The effect of this mini-banking crisis was two-fold: first, it accelerated the view that the Federal Reserve Bank will be forced to cut interest rates sooner than expected, sparking a rally in Growth-orientated stocks, and second, it prompted a massive rotation out of financial stocks, particularly banks, insurance companies and brokers, in favour of mega-cap, technology names, which were perceived as a safe haven.

The largest positive contributions to the performance of the CGEF came from higher beta stocks. Meta Platforms, Flutter Entertainment and Microsoft were part of that basket. We also saw continued strength in the retail sector, with strong contributions from JD Sports Fashion and Adidas. The largest detractors from performance were a combination of Value-orientated defensive stocks like The Cigna Corporation and British American Tobacco, which suffered from the so-called pivot trade. Financials were also negatively impacted by the mini-banking crisis which we saw in March, as mentioned above, as stocks like Wells Fargo & Co, Prudential, AIA Group, Chubb and JP Morgan Chase & Co all sold off.

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(1) Source: Bloomberg.
(2) Performance of the Credo Global Equity Fund Class A Retail Shares over the period 31/12/2022 to 31/03/2023.

Positions in Alphabet, Apple, AutoZone, Dollar General, Humana, Phillip Morris International and Ryanair Holdings were introduced into the portfolio, while our positions in JP Morgan Chase & Co and Moncler were sold.

Looking Forward

The first quarter of 2023 proved to be eventful, with the mini-banking crisis throwing up sombre questions about the risks potentially hiding in the financial system. These will continue to linger in the background until the market is satisfied that the moment has passed. In the meantime, the dominant narrative we are hearing has a familiar ring to it - economic data is lagging the true state of the underlying economy, inflation has peaked, and central banks will soon be able to start bringing interest rates down, or at least stop raising them. This will allow the party to restart.

Our view is a little less sanguine. We believe that the cost of capital will remain considerably higher than it was during the recent Growth stock bubble irrespective of what happens to interest rates. The Growth stock rally that we saw during the first quarter was a knee-jerk reaction (particularly more recently), as investors sought out safe haven, cash rich, mega-cap, technology stocks. However, valuations in that space appear stretched and we question how one will outperform the market by investing there at these levels.

We are of the belief more so now than before, that the current environment will favour stock pickers. Investors need to focus more attention on the quality of businesses, emphasising profitability, balance sheet strength and cash-flow. This should favour high quality stocks, which we hope to identify and acquire at attractive valuations.

As always, we remain patient and true to our investment philosophy.

Jarrod Cahn, Co-Portfolio Manager

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