Xtra-Ordinary Opportunities

WEEKLY UPDATE

13th MARCH 2023

	Price	5 Day % Change	3 Month % Change	1yr % Change
S&P/ASX300	86,555	-1.21%	0.62%	5.12%
MSCI World Ex-Aus. (Unhedged)	13,917	-1.97%	1.92%	4.96%
MSCI World Ex-Aus. (Hedged)	2,202	-3.91%	-2.06%	-5.41%
Bloomberg AusBond 0+ Composite	9,654	1.60%	-0.39%	-3.74%
BloombergBarclays Global Agg. (Hedged)	972	1.08%	-1.07%	-7.53%
S&P/ASX300 Property	59,296	-0.15%	2.83%	-5.95%
FTSE EPRA Nareit Global Real Estate (Hedged)	2,461	-5.77%	-5.43%	-19.18%
S&P Global Infrastructure (Hedged)	5,857	-1.81%	-2.15%	1.62%
Bloomberg All Hedge Fund Index	2,049	N/A	1.40%	5.63%
VIX	24.8	34.13%	9.98%	-19.35%
Bloomberg Commodity Index (USD)	104.55	-3.47%	-9.05%	-17.28%
Iron Ore Index (62% Fe Aus. Off. China, USD)	131.00	1.16%	16.96%	-17.35%
LME Copper Spot (USD)	8,755.00	-2.12%	3.12%	-13.69%
Coal 1st Future (Newcastle Export, USD)	185.25	-1.93%	-53.98%	-50.38%
Brent Crude 1st Future (USD)	82.78	-3.55%	8.78%	-24.28%
LNG 1st Future (Japan/Korea)	14.16	-1.19%	-57.58%	-63.07%
Gold in AUD	2,839	3.54%	7.50%	4.62%
AUDUSD	0.6580	-2.81%	-2.45%	-10.57%
AUDEUR	0.6186	-2.89%	-3.48%	-8.23%
AUDNZD	1.0733	-1.36%	1.53%	0.13%
AUDGBP	0.5470	-2.77%	-0.52%	-2.80%
AUDJPY	88.8220	-3.52%	-4.56%	3.79%

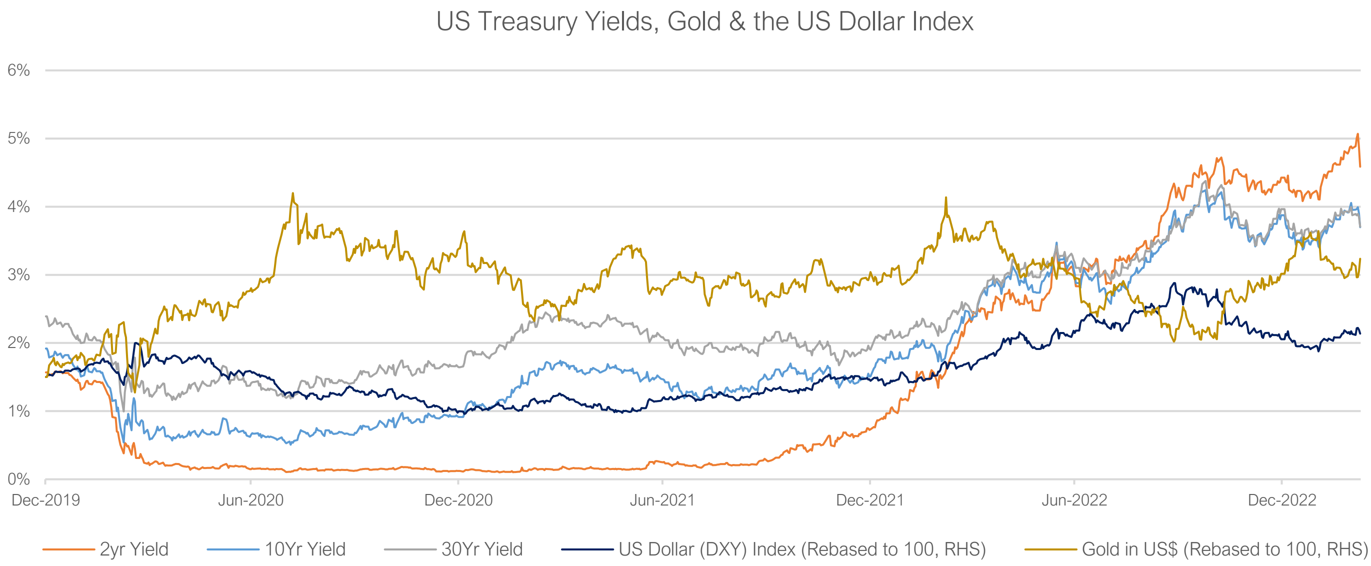
Source: Bloomberg, S&P Dow Jones, MSCI, FTSE Russell, 11th March 2023

Last week's US jobs report, possible pause in rate rises signalled by the RBA, and Jerome Powell's congressional testimony were completely overshadowed on Friday by America's second-largest bank failure in history. Bond yields dropped sharply as investors scrambled for safe havens, and the S&P500 broke below critical technical support levels, suggesting further equity weakness is very likely. Global REITs fell by nearly -6% on mounting fears of defaults.

Volatility looks set to continue this week, with immediate policy responses likely to try and maintain faith in American banks.

American CPI figures will be the data highlight on Tuesday night, followed by Chinese activity data on Wednesday. The ECB is expected to continue with a rate rise on Thursday.

Australian business and consumer confidence surveys will also be released on Tuesday, with employment following on Thursday morning.



Source: Bloomberg, 11th March 2023

Last week's news was dominated by the US's 16th largest bank being put into receivership on Friday, sparking fears of a second financial crisis and driving investors into safe havens. New York based Signature Bank (SIVB) was also put into administration over the weekend with the FDIC appointed as receiver. Gold rallied, and bond indices were pushed higher as investors looked to cut risk and avoid bank deposits.

Before explaining what happened to Silicon Valley Bank (SVB) on Friday, we'll briefly recall some of the other significant developments of the week.

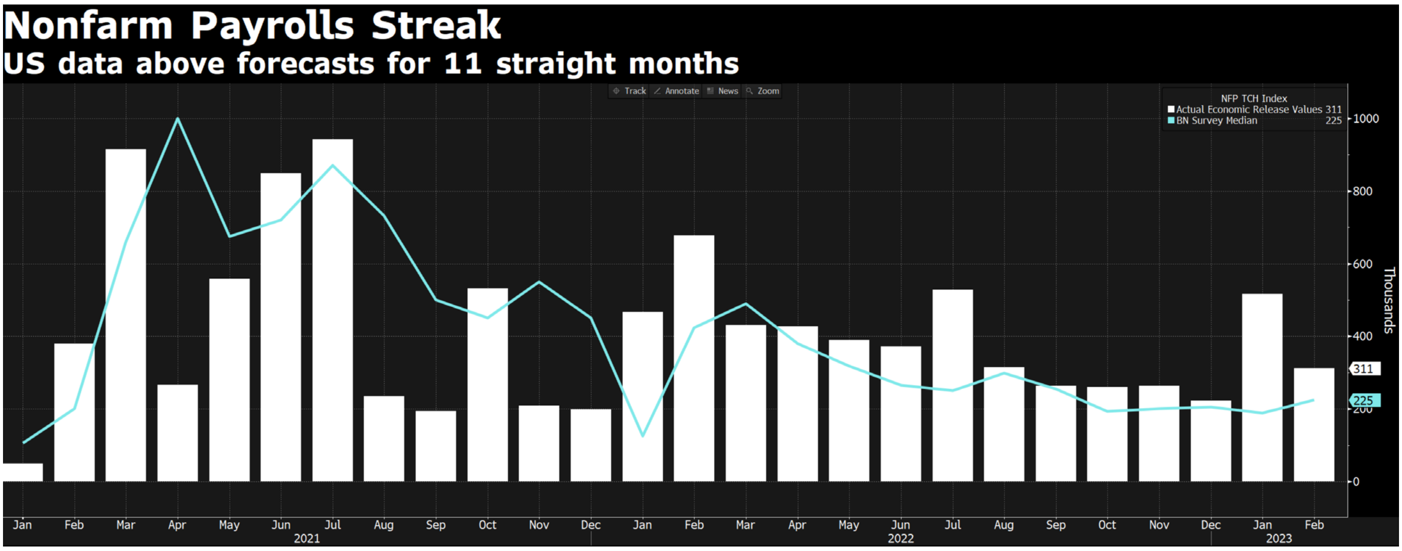
Xi Jinping was confirmed as China's president for an unprecedented third term on Friday, as widely anticipated. China's reopening has disappointed in terms of the growth boost to the global economy, despite a rebound in the recent PMI surveys. Chinese CPI (+1.0% yoy) and PPI (-1.4% yoy) undershot expectations and may provide room for more stimulus. Meanwhile, the Biden government is expected soon to announce further restrictions on investment in Chinese technology.

The White House unveiled a $6.9 trillion budget proposal. The plan includes an additional +$77 billion in spending and +$5.5 trillion in tax increases over the next decade, in contrast to Republican requests for -$150 billion in spending cuts. The proposals are the opening salvos in debt ceiling negotiations that will likely last several months and continue to see the deficit expand. In the Congressional Budget Office's 2023 projections, the federal deficit totals $1.4 trillion in 2023 and averages $2.0 trillion per year from 2024 to 2033. Real GDP growth comes to a halt in 2023 and then rebounds, averaging +2.4% from 2024 to 2027.

The Australian dollar fell following the RBA's Tuesday meeting, where the cash rate was increased by +0.25% to 3.6%. The statement suggested that the RBA may pause rate rises as soon as next month, a message that was reinforced by Governor Lowe in a speech at the Financial Review Business Summit the following day.

In contrast to the tone adopted by the Australian central bank, Fed Chair Jerome Powell spoke in congressional testimony of the unexpectedly strong US data. He suggested that the FOMC may return to +0.50% interest rate rises later this month before adding that no decision had yet been made.

On Friday, February's non-farm payrolls (+311k) exceeded forecasts, but unemployment rose from 3.4% to 3.6% as labour force participation increased by +0.1% to 62.5%, still below pre-pandemic levels. There were some signs of softening in the jobs market, with hours worked and earnings falling more than expected. Weekly initial claims also jumped unexpectedly from 190k to 215k, although the number of JOLTS job openings remains higher than expected. The ratio of 1.9 positions for every unemployed person is well above the longer-term average of around 1.2 and was widely interpreted as keeping the Fed in tightening mode.

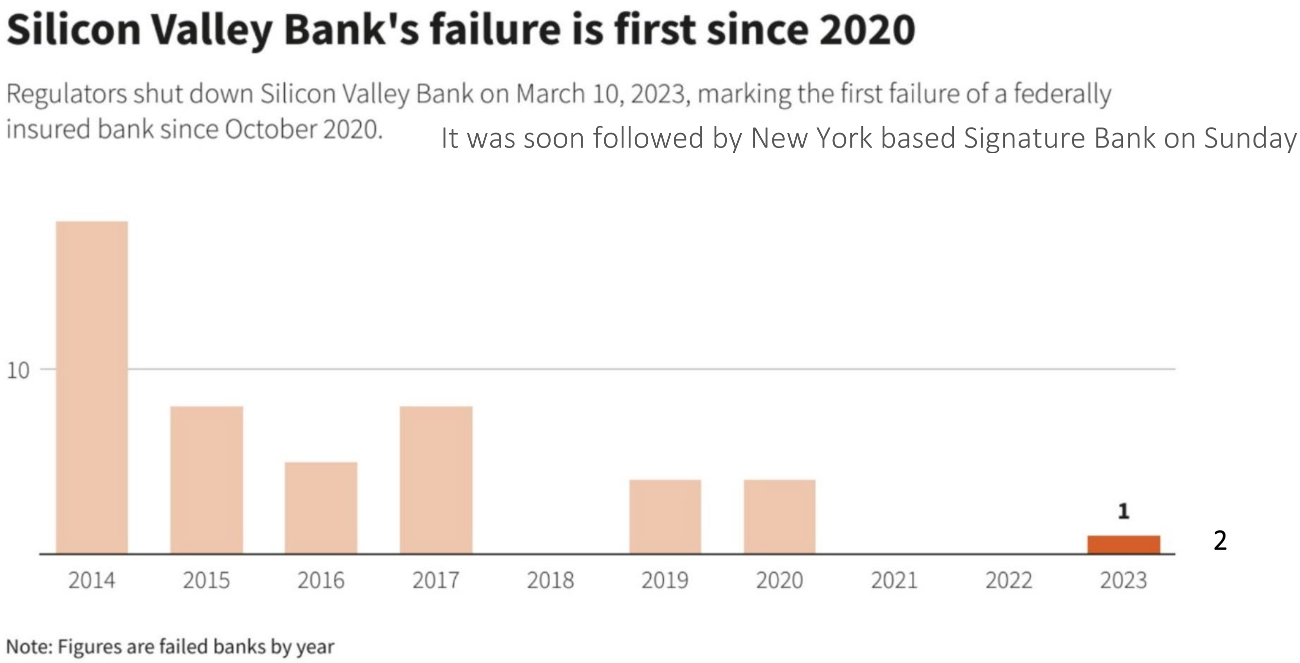


Source: Bloomberg

Those plans to raise rates further may now be questioned since Fed tightening contributed to the circumstances that pushed SVB into receivership overseen by the Federal Deposit Insurance Corporation (FDIC).

Banks are required to hold some of their capital in high-quality liquid assets, which are usually Treasuries and highly rated bonds. As interest rates and yields rise, those bonds fall in value, and the bank accumulates unrealised losses. Under accounting rules, if the bank intends to hold those securities until maturity, they are not required to mark-to-market or write down the value of their capital base, which would affect their solvency ratios. However, if the bank suffers an outflow of deposits, it may need to sell the securities to fund the withdrawals, crystallising losses and lowering measures of capital adequacy.

SVB was in a somewhat unusual set of circumstances. As a result of IPOs and other VC capital raisings in 2020 and 2021, the bank had taken in a high volume of deposits from the technology industry. With relatively little loan demand, the bank invested in high-quality bonds but appears to have made the mistake of not hedging the interest rate risk. As rates rose, the capital base reduced in value. The bond losses were accumulated over time and were very large compared to peers. When the bank announced a plan to raise more capital by issuing stock, fearful depositors quickly withdrew billions of dollars in deposits. The bank appears to have been forced to sell its bonds to fund the withdrawals, thereby crystallising the losses and making the bank insolvent before it could raise capital.



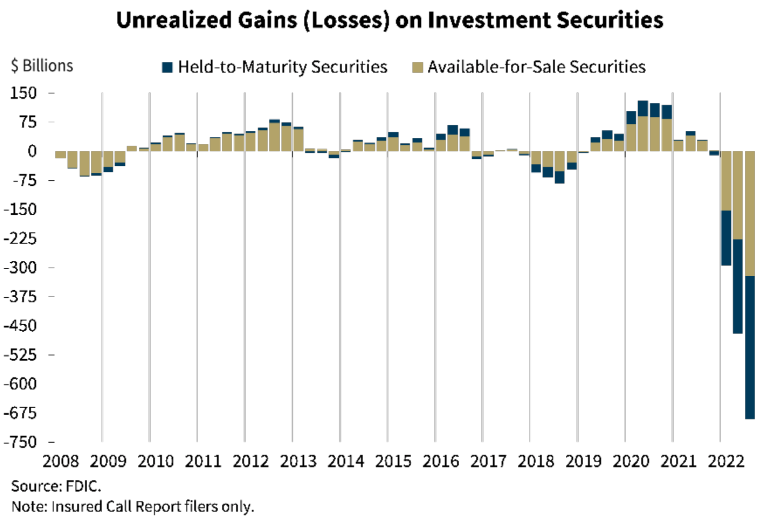
Source: Marketwatch.com

The direct consequences seem confined mainly to the Californian technology sector. Several companies are said to be struggling to pay staff. Even the relatively large cap Roku is reported to have 26% of reserves held in the bank, although it has said it can continue to operate without access to the funds. But there are less obvious consequences too. For example, the Wall Street Journal reported that the second-largest dollar-pegged cryptocurrency slipped below $1 over concerns that part of the reserves backing USD Coin could be tied up in SVB.

The high value of bonds in the capital base and lack of hedging distinguishes SVB from what you would generally expect to see with responsible risk management. However, the size of the bank was just under the threshold requiring regulatory oversight, which would likely have helped ensure that the interest rate risk was adequately hedged.

Nevertheless, the conditions that increased insolvency risks were not entirely unique. As FDIC Acting Chairman Martin Gruenberg said in December in the Third Quarter 2022 Quarterly Banking Profile:

"*Despite several favourable performance metrics in the third quarter, the banking industry continues to face significant downside risks. These risks include the effects of inflation, rising market interest rates, and continued geopolitical uncertainty. Taken together, these risks may reduce profitability, weaken credit quality and capital, and limit loan growth in coming quarters. Furthermore, higher market interest rates have led to continued growth in unrealized losses in the banking industry's securities portfolios. Higher market interest rates may also erode real estate and other asset values as well as hamper borrowers' loan repayment ability. These will be matters of ongoing supervisory attention by the FDIC.*"



Some, but not all, deposits are insured by the FDIC. The FDIC and the Federal Reserve were said to be in talks over the weekend to create a fund that could backstop and guarantee all bank deposits. The move is designed to restore faith in the system and prevent a general run on the banks that would force the banks to recognise losses, and possibly more would enter receivership. However, banks are also likely to be under pressure to increase deposit rates to deter withdrawals. Moreover, the appetite to make loans is also likely to drop sharply. At best, this would represent a more direct monetary policy transmission to the real economy and a rapid tightening of financial conditions. At worst, there is a rising risk of a second GFC-like credit crunch. It had become widely said that the Federal Reserve would continue to tighten monetary policy until it "broke something". That may now have happened.

Historically, the Federal Reserve would respond with liquidity injections to offset a undesirable tightening of financial conditions. This time, given the inflation backdrop, there is a much higher bar before the Fed would consider suspending quantitative tightening or even relaunching quantitative easing. If there is no run on the banks, that might not be an issue. But the capital adequacy of the banking system is in question, and the ability to absorb defaults is not unlimited. Unfortunately, with the economy slowing, the risk of defaults is rising.

The falls in asset values that sparked the 2008 financial crisis were in residential property. Today, it is the commercial sector that is causing concern. Earlier this month, Blackstone defaulted on a CMBS backed by a portfolio of offices and stores owned by Finnish company Sponda Oy. The reasons for the default were lower rent revenue and a write-down in property values caused by higher interest rates and lower occupancy rates. These issues are far from constrained to Finland. There are growing fears of widespread defaults linked to CBD offices that haven't returned to sufficiently high occupancy levels after the pandemic. As a consequence, global REITs were the worst-performing sector last week, down nearly -6%.

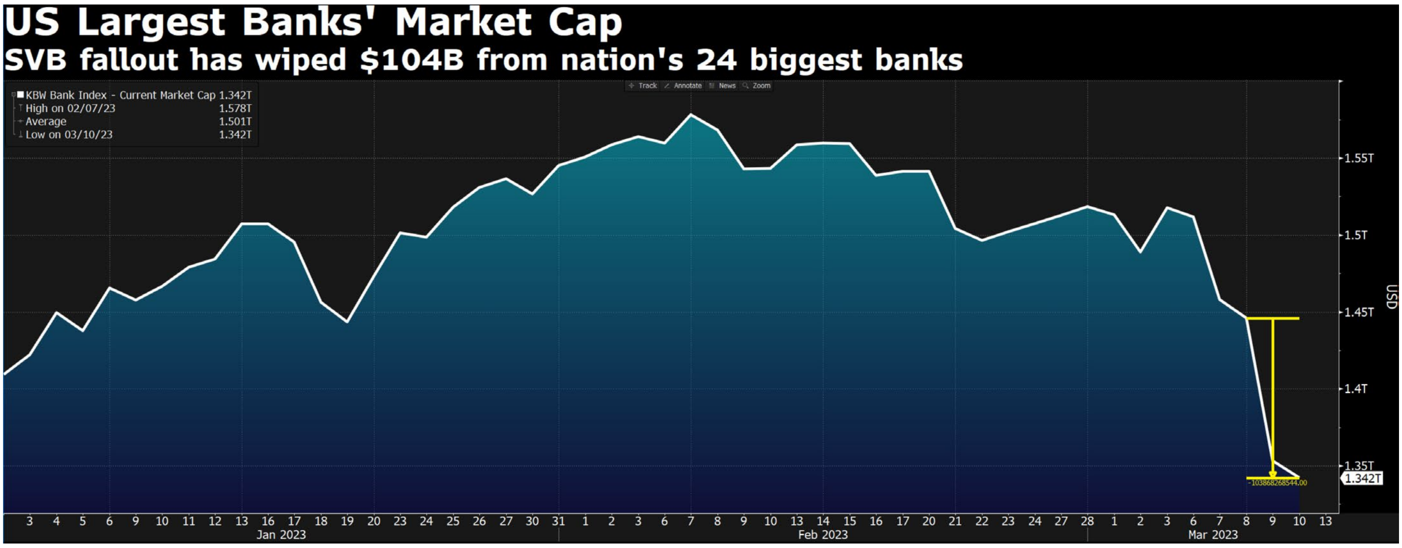
In the short run, assuming the Fed does nothing besides jointly guaranteeing deposits, credit spreads are likely to widen, equities and global REITs seem likely to experience further losses, and the US dollar will probably rally as demand for dollars rises.

What happens after that depends on how the Federal Reserve responds. Since Wednesday's testimony, when the market priced a roughly 85% chance of a 0.5% hike on 22nd March, the pricing has dropped to an approximately 60% chance. That figure will likely move again this week as American CPI figures will be published on Tuesday, followed by PPI on Wednesday night.

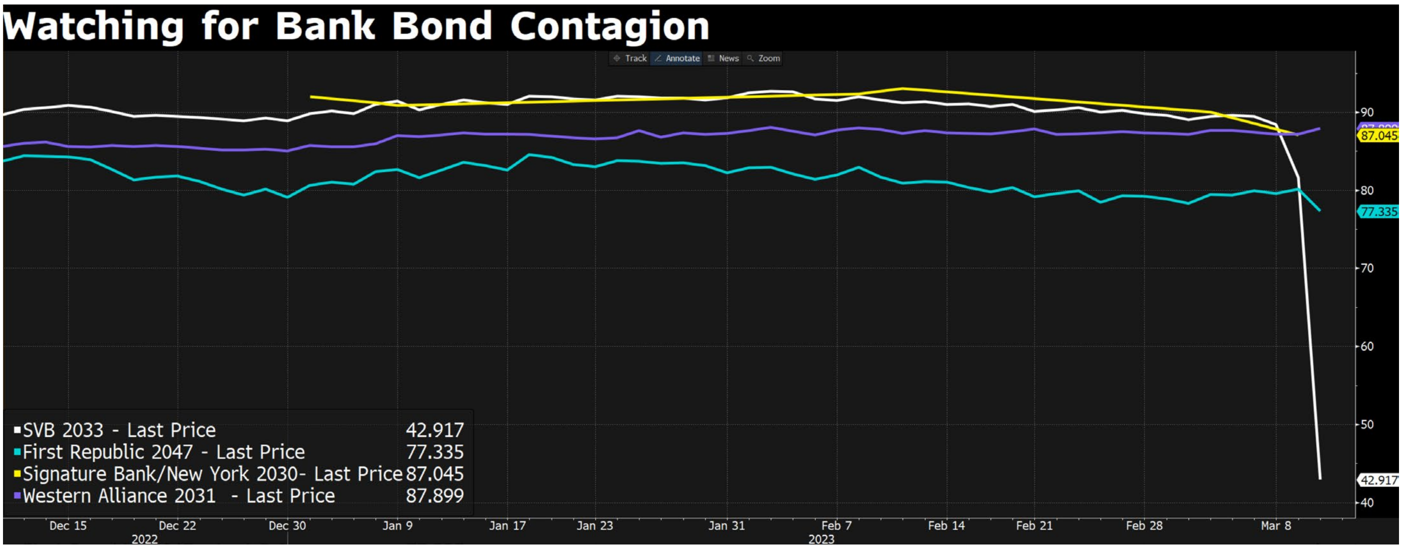
The ECB is expected to proceed with a +0.50% rate increase on Thursday. Australian data will include Tuesday's monthly business and consumer confidence surveys and the February employment data on Thursday. Important Chinese activity data will also be published on Wednesday.

The S&P 500 regional bank index (.SPLRBNKS) had the worst week since 2009. dropping 4% on Friday resulting in a 18% overall fall for the week. The S&P 500 bank index (.SPXBK) which is a composite of both large and medium banks was down 11% for the week.

With two banks now being put into receivership over the last week expect market volatility and uncertainty to ensue, as others the concern is others may follow.

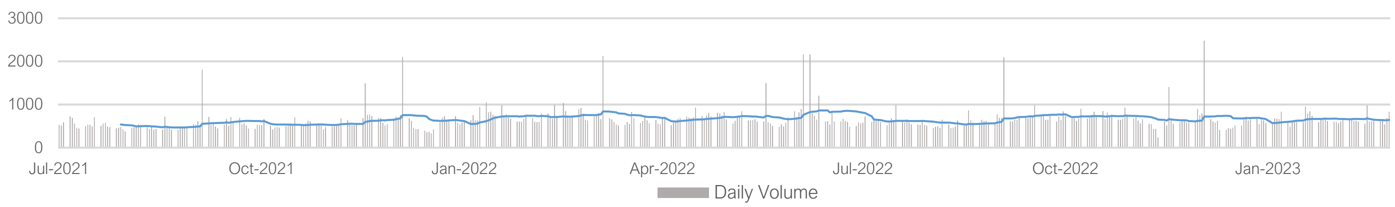


Source: Bloomberg

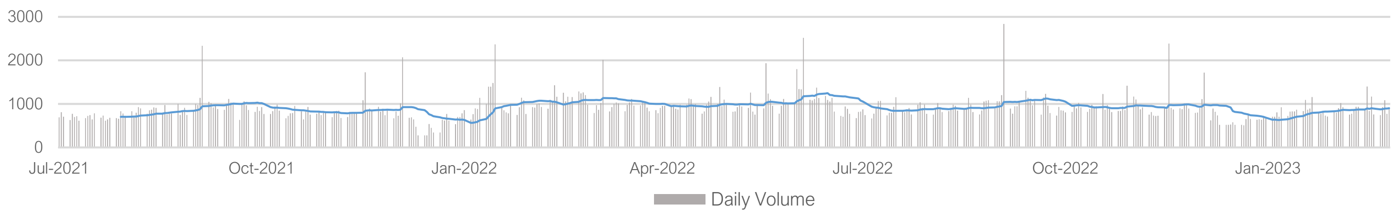


Source: Bloomberg

S&P500 Index



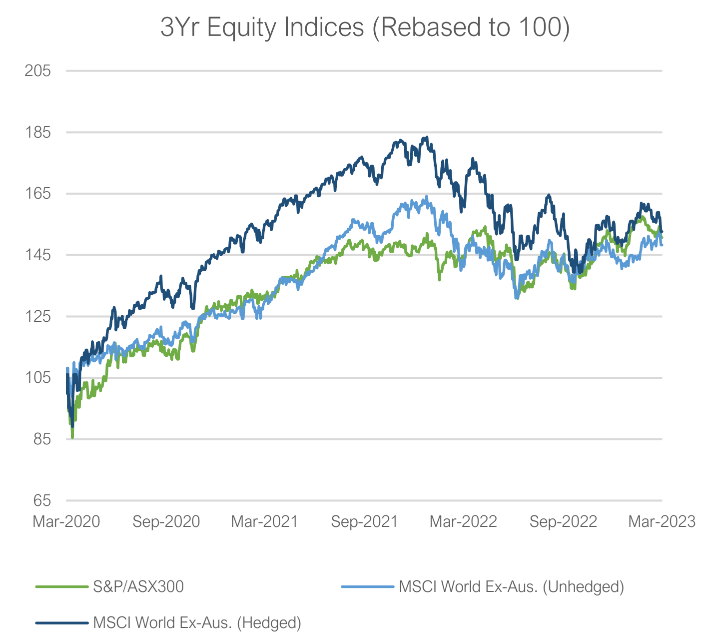
S&P/ASX 300 Index

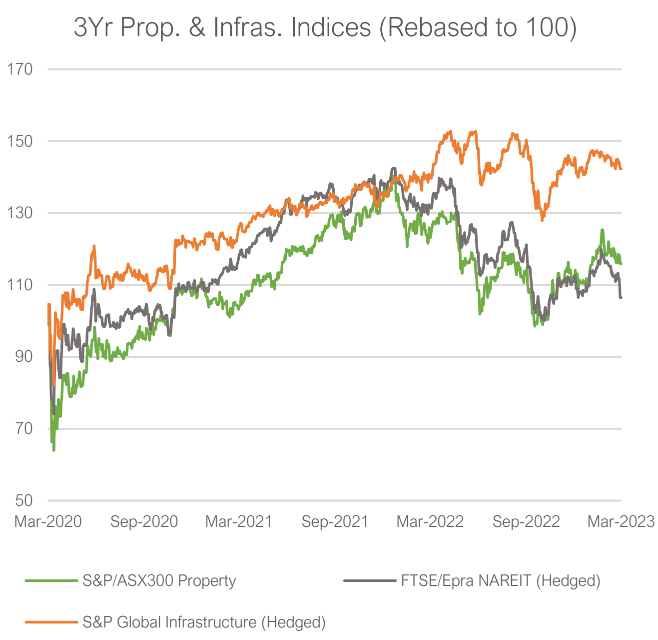


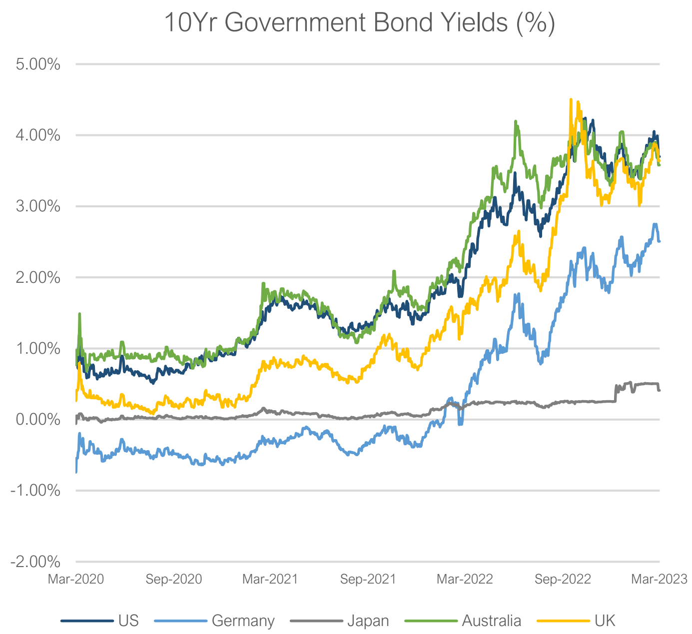
Source: Bloomberg, S&P Dow Jones, 11th March 2023

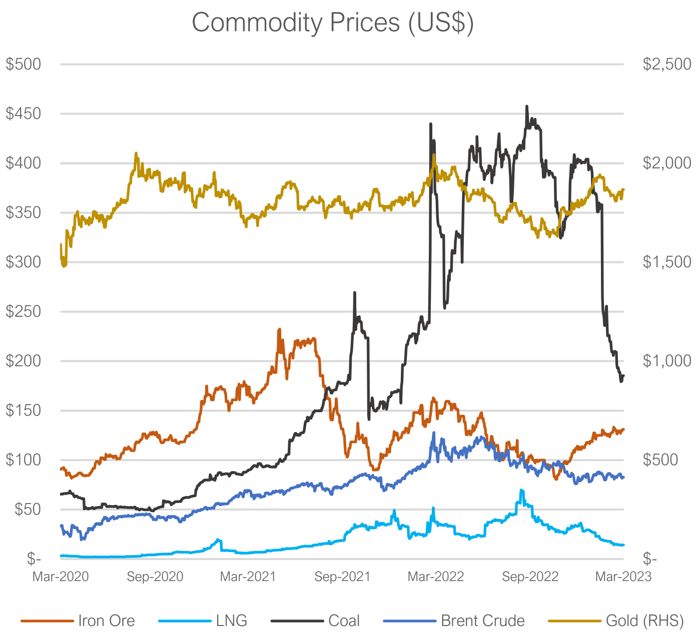
Significant Upcoming Data:

	Monday	Tuesday	Wednesday	Thursday	Friday
Australia		**NAB Bus. Conf.;** **Westpac Cons. Conf.;** **CBA Household Spending**		**Employment;** Cons. Infl. Expectations	
US		**CPI;** **NFIB Small Bus. Opt.** **Real Ave. Earnings**	**PPI;** **Ret. Sales;** **Business Inventories;** **Empire Manuf. Survey;** TIC Flows; MBA Mortgage Apps	**Philly Fed. Survey;** **Housing Starts;** **Building Permits;** NTY Fed Serv. Survey; Imp. & Exp. Prices; Weekly Jobless Claims	**Leading Index;** **Ind. Production;** **U Mich. Cons. Sent.**
Europe	**Danish Curr. Acc.;** **Irish Ind. Prod.;** Swedish House Prices; [German Wsale Prices]	**Spanish, Dutch & Finnish CPI;** **UK & Swedish PES Unempl.;** **Italian Ind. Prod.;** Swiss Producer & Import Prices; New Irish Vehicle Licences	**EZ Ind. Prod.;** **Swedish & French CPI;** **Danish PPI;** **German Curr. Acc. Ind.;** **Norwegian & Irish Trade;** Irish Property Prices;	**ECB Meeting;** **Italian & Irish CPI;** **Norwegian Monthly GDP Ind.;** Dutch & Spanish Trade; Dutch Unempl.; Spanish Labour Costs; SECO Swiss Eco FCasts;	**OECD Econ. Outlook;** **EZ Labour Costs & CPI (Final);** **Swedish Unempl.;** **Italian Trade**
Japan	BSI Surveys			**Ind. Prod.;** **Trade;** **Core Machine Orders;** Tokyo Condos. for Sale	**Tertiary Ind. Index;**
China	**[FDI]**		**Ind. Prod.;** **Ret. Sales;** **Surveyed Jobless Rate;** **Fixed Asset. Inv.;** **Property Inv.;** **Res. Property Sales;** **1yr Med. Term Lending Facility**	**New Home Prices**	









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