NEWSLETTER

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IN THIS MONTH'S NEWSLETTER

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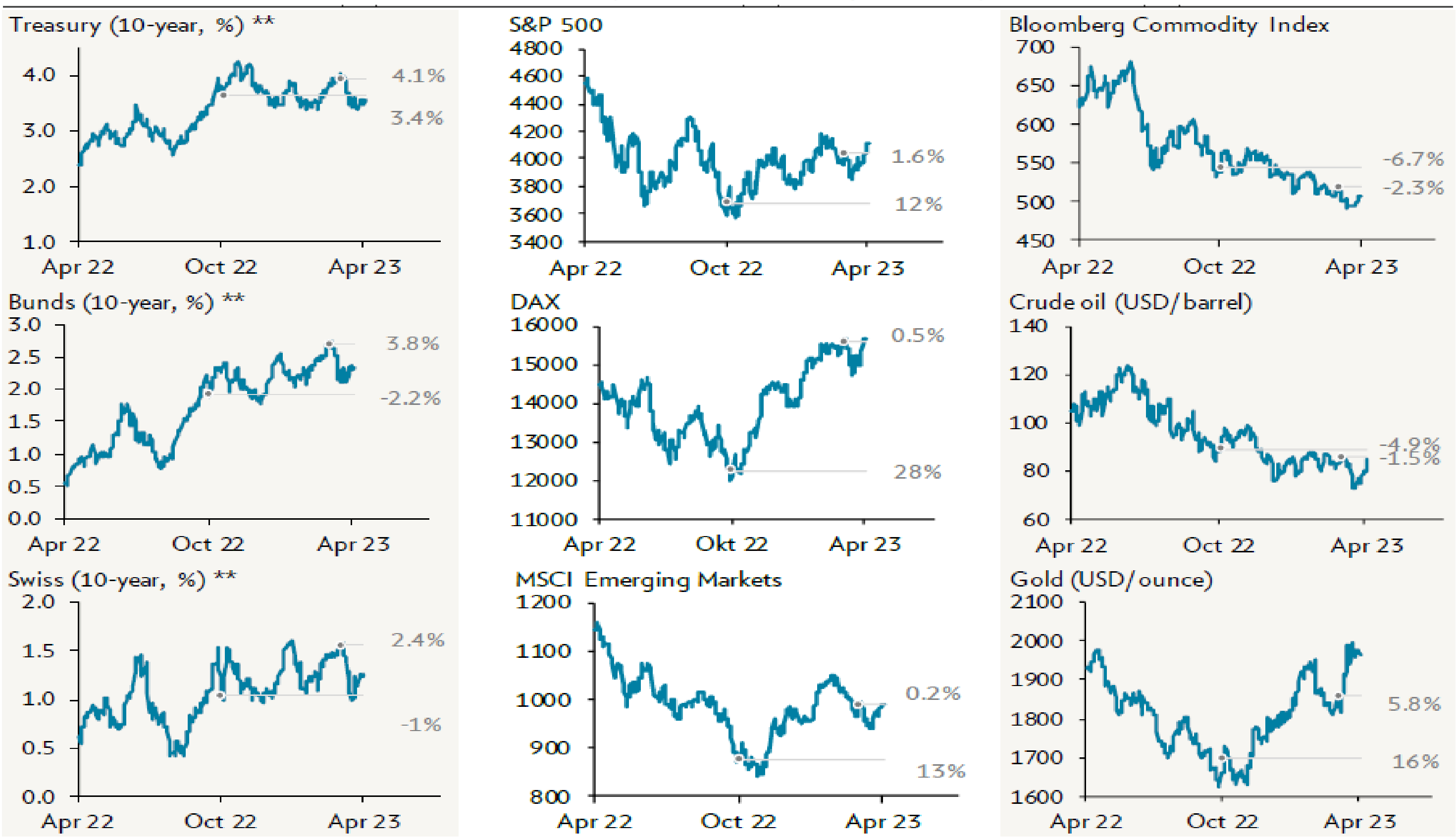
- Share focus: ELVIIA structured product
- Graph of the month

"Perhaps wars weren't won anymore. Maybe they went on forever. Maybe it was another Hundred Years' War."

- Ernest Hemingway, A Farewell to Arms

MARKET OVERVIEW

Review (1-month and 6-month performance)



Source: Julius Bear, 01/03/2023

31/03/2023	Last	Month %	YTD %	5Y ann. %
MSCI World	2791	2.8	7.88	8.58
S&P 500	4109	3.5	7.48	11.15
NASDAQ 100	12222	9.5	17.05	12.62
EURO STOXX 50	4315	2.0	14.32	8.54
MSCI EM	990	2.7	3.99	-0.56
HANG SENG	20248	3.1	2.74	-4.64
US Equities Volatility Index (VIX)	18.70	0.21	-2.97	21.10

Source: Edmond De Rothschild

Fears of a spreading **banking crisis** in the US and Europe dominated news flow during Q1 '23. This led to pressure on global banking shares. South African bank shares did not escape the heat, either. Prospects of lower interest rates somewhere on the horizon supported technology shares and the Nasdaq 100 entered a **bull market** during the last week of March.

Most central banks kept on hiking interest rates against a backdrop of hot inflation prints. The European Central Bank raised interest rates by 50 basis points, the Federal Reserve hiked by 25 basis points and the Bank of England is also expected to announce an interest rate increase in May. The Fed funds future is now anticipating a pause at the next FOMC meeting (3 May), followed by a rate-cutting cycle starting in June 2023.

Whether this will actually play out will depend on the following factors:

1) **US inflation** – Currently the Fed funds rate is higher than core inflation (y-o-y). It happened only twice since 2008. This suggests that the Fed may have room to pause or delay potential rate hikes. In addition, February's CPI reading was the 8th consecutive decline in the year-on-year rate of inflation.

2) **Mini-banking crisis** - Discussed below in more detail.

3) **US economy** - Leading economic indicators show that economic activity is starting to slow down. Company earnings are also contracting. This also suggests that a pause or even rate cuts might be in the offing.

Why did Silicon Valley Bank and Credit Suisse collapse? Will this turmoil be contained?

The business model of a typical bank works as follows - it generates returns by taking in deposits (liability for the bank) and then invests those deposits in bonds, short-term instruments, loans, etc. (assets of the bank). The difference between the interest received on the assets of the bank and the interest paid on the liabilities (deposits) is the bank's profit.

When a bank acquires assets the main considerations are:

1. Will the interest received from assets exceed the interest payable?
2. Does the duration of the assets match the duration of the liabilities?
3. Quality of assets (loans made by the bank).

Silicon Valley Bank (SVB) was known as the venture capitalist's banker. SVB's deposits tripled from 2019 to 2021 due to start-ups finding it easy to raise funds for their businesses in a low-interest rate environment. SVB had to acquire assets (give out loans) with the deposits to service their liabilities (interest to depositors).

The volume of deposits received was overwhelming and it struggled to make responsible loans. SVB opted to buy US treasuries with maturities of 10 years and longer, which are guaranteed by the US government. The problem was the *duration* of the asset and not the quality of the asset. SVB had a substantial duration mismatch between assets (long term) and liabilities (short term).

As interest rates spiked during 2022, treasury prices dropped. Subsequently, SVB had substantial unrealized losses on these assets. The mark-to-market loss would have been fine if depositors left their money at SVB until bond expiration when the bonds mature at par value (full value).

However, when depositors realized that SVB has a duration mismatch, deposits were called up *en masse.* This resulted that SVB became a forced seller of these bonds virtually overnight. The bank's paper losses on bonds were realized or locked in. SVB's share price went into a tailspin which spread to other US regional banks.

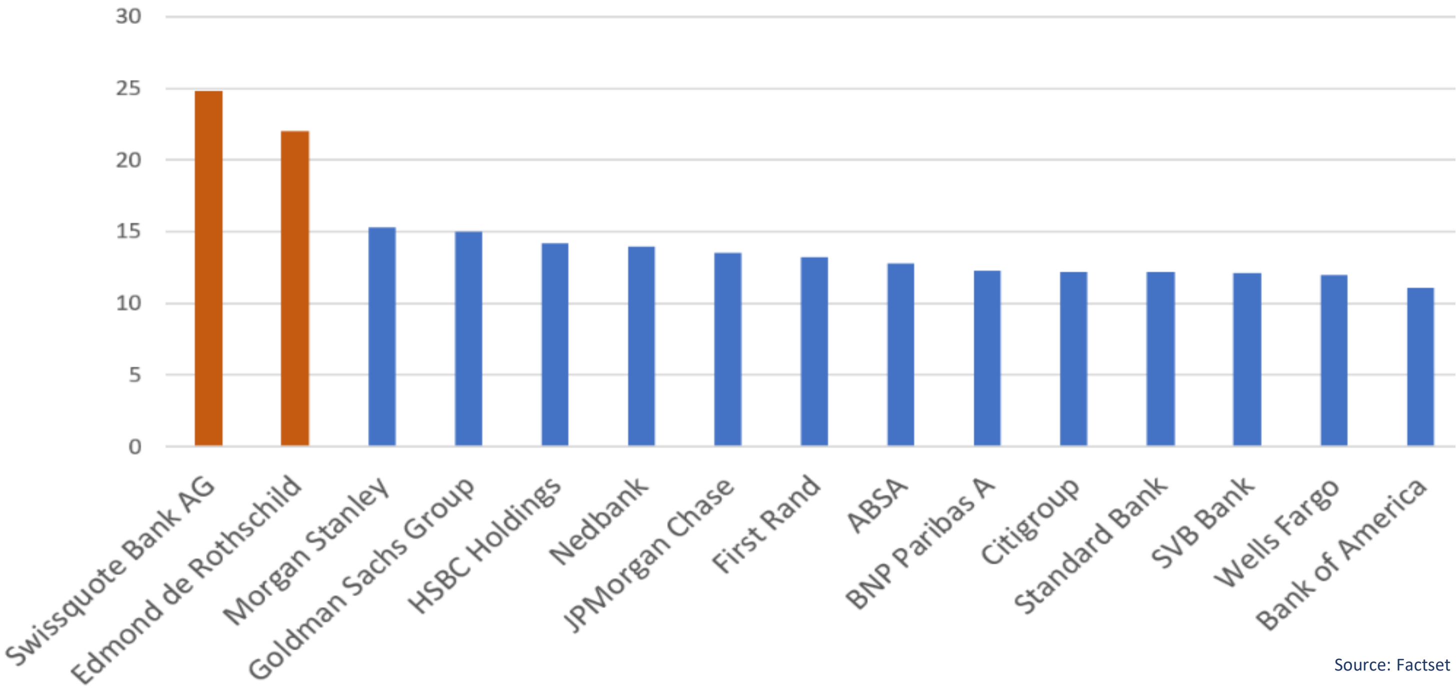
The question remains why were the regulators responsible for monitoring banks' asset quality, duration ratios, etc., not alerted to this dire situation much earlier?

Credit Suisse

Credit Suisse was plagued by a series of scandals, management shifts and significant losses in recent years. A staggering CHF 110 billion was pulled from Switzerland's number two bank during the last quarter of 2022.

Earlier this year Credit Suisse announced plans to borrow USD 54 billion to shore up liquidity and boost investor confidence. The relief was short-lived. The writing was on the wall for the 167 year old bank when its top backer, the Saudi National Bank, announced it won't increase its stake, citing regulatory barriers.

Figure 1: CET 1 ratios of Global Banks



Source: Factset

VEGA's offshore portfolios are hosted on the investment platforms of Swissquote AG and Edmond de Rothschild AG. **Figure 1** shows the strong liquidity position of these banks relative to their peers.

The CET 1 ratio is calculated by dividing the common equity tier 1 capital of a bank by its total risk-weighted assets. Common equity tier 1 capital includes ordinary shares, retained earnings and accumulated income.

What effect will the collapse of these banks have on the rate-hiking decisions of central banks?

When bad news is good news. Expectations for further (aggressive) interest rate hikes plummeted since the mini-banking crises started. The expected Fed fund rate for the year-end decreased from 5,7% to 3,9%. That's a substantial decrease of 180 basis points! The net effect of the steep interest rate hikes is beginning to manifest in the global economy. Tighter credit conditions are deflationary and a headwind for economic activity.

Summary

We believe that the crisis of confidence in the banking sector will be contained. Unlike in 2008, when banks faced a **solvency** issue because securitized assets held on their balance sheets were impaired, this time banks are faced with liquidity issues.

Governments and central banks are acting fast to avoid spillover effects by providing liquidity and guaranteeing deposits. It appears that the worst of the global interest rate hiking cycle is behind us. However, the fallout of these measures might still cause some market turbulence in the months ahead.

$ 389 Bn

March had the largest monthly loss in bank deposits in US history. This figure explains the severity of the U.S. banking crisis we have just witnessed. It is the main reason why the government and the Fed were so quick to restore stability.

DID YOU KNOW?

Finance represents 5.6% of Switzerland's GDP (including 1.2% for large banks), compared to 4.8% for Healthcare and 3.2% for the watch industry.

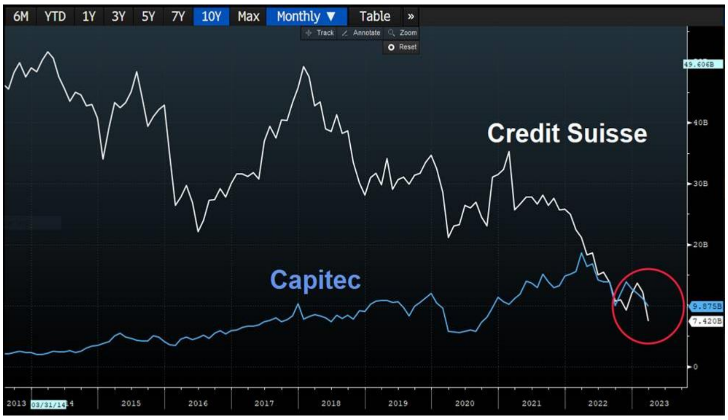
31/03/2023	Last	Month %	YTD %	5Y ann. %
JSE All Share	76101	-2.10	2.50	6.76
JSE Resources	66234	-0.74	-6.46	14.31
South Africa 10Y Bond	9.815%			
Net Foreign Equity Flow	-R12.3bn			
Net Foreign Bond Flow	-R63.7bn			
USDZAR	17.8139	1.89	-4.35	-8.56
EURZAR	19.3727	-0.26	-7.56	-5.96

Source: RMB

After a positive start to the year, the JSE All Share Index (Alsi) lost some momentum at the end of March. The JSE Alsi lost 2.1% for the month (+2.5% YtD). Non-residents remain net sellers of SA Inc. The equity market outflow for the month was **R12bn** and the bond outflow was **R64bn** (according to Bloomberg data).

Continuous load-shedding, runaway crime, deeply embedded corruption and a disintegrating national infrastructure network have an immeasurable detrimental impact on SA's economic growth potential. Promised reforms simply do not materialise. The governing party's public alliance with Russia doesn't bode well. No matter how the ANC slice and dice it. Any potential market rerating (off very depressed multiples) will most likely only materialise against a backdrop of a stronger global economy and a weaker USD.

Figure 2: Credit Suisse's market cap vs Capitec's market cap



Source: Bloomberg

Company news:

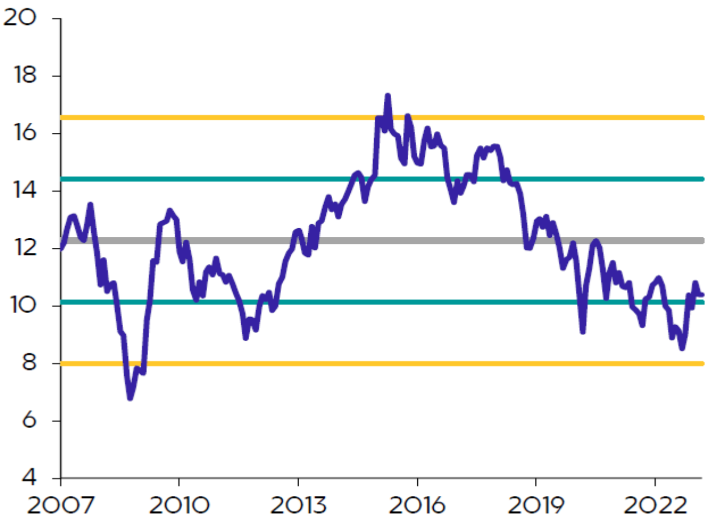
Gold shares featured among the best-performing shares this month on the back of a stronger gold price and shifting expectations on interest rates in the US. **Gold Fields** and **AngloGold Ashanti** announced a joint venture in Ghana which will be Africa's largest gold mine. The merger makes sense as the assets are next to each other and no extra capital will be required from either party. As a result, both will lower their all-in sustaining costs by 20%.

Coal producer **Thungela (TGA)** reported almost a threefold surge in its net profit from R6.9bn to R18bn for the 2022 financial year. The demand for coal soared after Russia's invasion of Ukraine. As a result, the company will pay a final cash dividend of R40 per share (total dividend of R100 for the year), as coal prices remain strong, even though the coal price has come off record highs this year. TGA is currently trading on a forward PE of 2x and a dividend yield of 39%.

Transaction Capital (TCP) was March's worst-performing share after the company released a trading statement thinly disguised as a profit warning. In December 2022 David Hurwitz (CEO) sold 30% of his stake in the company.

The combination of the profit warning, a slowing SA Taxi division and the CEO's peculiar timing of the transaction caused a severe and sharp downward move in TCP's share price. Subsequent to the trading update company directors bought shares, which to some extent calmed jittery investors. The company will be releasing its half-year results on the 10th of May.

Figure 3: The JSE Alsi 12-month forward PE ratio



Source: RMB

Figure 4: March 2023 Top 5 best and worst performing South African shares

Best performing	%	Worst performing	%
Gold Fields	+45%	Transaction Capital	-59%
Anglo Gold	+40%	Montauk	-23%
Sun International	+35%	Investec	-16%
Harmony	+31%	Woolworths	-15%
Aspen	+29%	Hammerson	-15%

Source: FactSet, RMBMS

ELVIIA STRUCTURED PRODUCT

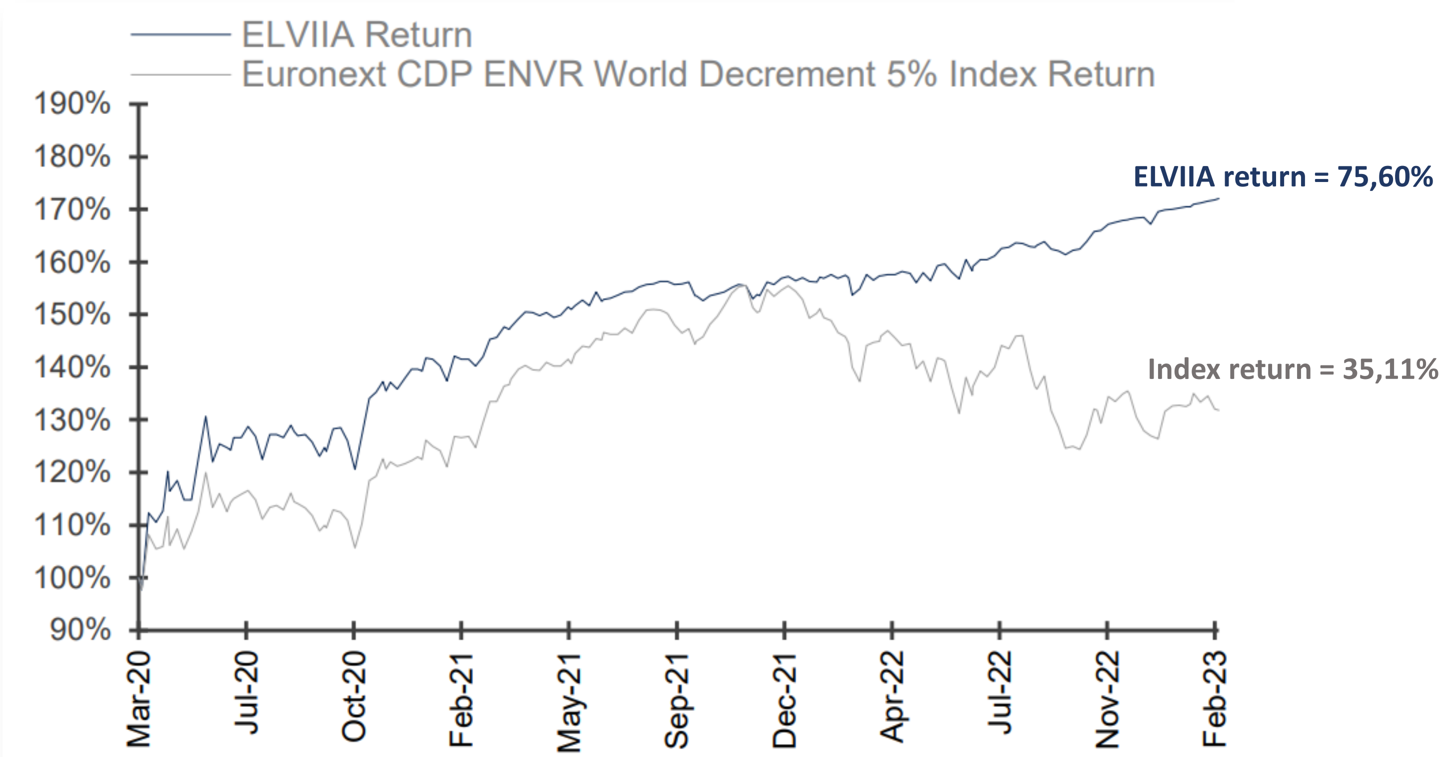
During March 2020 (in the midst of the first Covid lock-down) Investec listed a structured product on the JSE. The Investec Environmental World Index Autocall (JSE code ELVIIA) was written on the underlying Environment World Index ("WLENV Index"). The terms of this autocall were attractive. If the index was equal to or higher than the initial index level the product will return 25.2% per annum. In addition, the product provided 100% capital protection in ZAR at maturity, provided the index doesn't lose more than 40%.

After an investment period of 3 years, ELVIAA matured in positive territory. It delivered a cumulative return of 75.6% or 20.6% p.a.

Structured instruments have compelling advantages. The most important is that it may limit capital losses (up to a certain point) without forfeiting potential upside. Hence it is less correlated to the underlying index.

A crucial element when considering the investment merits of a structured product is the solvency of the issuer. Should the issuer default (goes out of business) the investor's capital is at risk in a similar way if the investor had had exposure to corporate bonds issued by the issuer. When identifying attractive structured products we are cognisant of the issuer's solvability and underlying credit risks.

Figure 5: Investec Environmental World Index Autocall returns



Source: Investec

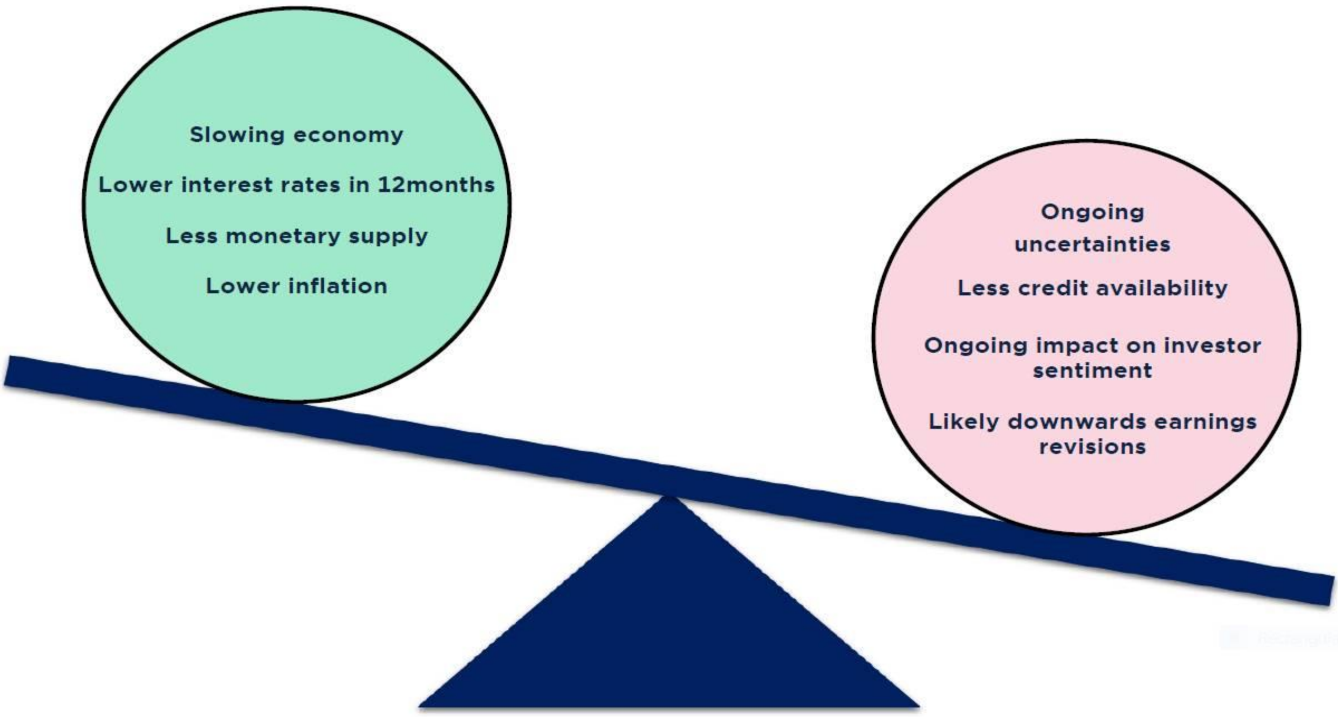
Figure 6: Top 40 Euronext CDP Environnment World EW Index constituents

Company	%	Company	%	Company	%	Company	%
ACCENTURE PLC-A	2,34	ENEL	2,49	CARLSBERG A/S CL. B	2,60	PEPSICO	2,55
ADOBE INC	2,55	ESTEE LAUDER COS INC	2,59	CELLNEX TELECOM	2,38	PHILIP MORRIS INT	2,57
ALPHABET CLASS A	2,39	GIVAUDAN SA	2,38	COCA-COLA CO	2,58	S&P GLOBAL	2,43
AT&T INC	2,50	INTEL CORP	2,39	COLGATE-PALMOLIVE CO	2,60	SALESFORCE INC	2,54
BANK OF AMERICA	2,62	L'OREAL	2,45	CSX CORP	2,45	SAP	2,41
BT GROUP PLC	2,48	MICROSOFT CORP	2,42	DANONE	2,58	SIMON PROPERTY GROUP	2,53
CAIXABANK	2,89	MONDI PLC	2,42	DEUTSCHE TELEKOM AG	2,53	SYMRISE AG	2,46
CANADIAN NAT RAILWAY	2,42	MOODY'S CORPORATION	2,40	DIAGEO	2,44	TELEFONICA	2,68
CAPGEMINI	2,32	ORSTED	2,49	DSM KON	2,38	UBS GROUP	2,56
ECOLAB INC	2,47	VISA INC	2,53	E.ON SE	2,65	UNILEVER	2,55

Source: Euronext

GRAPH OF THE MONTH

... IN A NUTSHELL - REMINDER:



Source: Edmond De Rothschild

SOURCES

Sources: Bloomberg, BNY Mellon, Credit Suisse, Compound Advisors, Edmond De Rothschild, ETFMG, FactSet, Haver Analytics, JP Morgan, Julius Baer, Morgan Stanley, Refinitive, RMB, Statista, Sygnia, Strategas, UBS

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