



## Market review: March 2023

John Husselbee is Head of the Liontrust Multi-Asset Investment team

- End-March marks second quarter of recovery for markets
- Banks spark financial sector worries but policymakers move quickly and decisively to provide support
- Central bank rate hike continues, albeit less aggressively than in 2022

Global equities and bonds were moderately positive in March, which also marked the end of a second quarter of recovery in global markets. March will still be remembered though as the month in which some regional US banks, most notably Silicon Valley Bank, convulsed in the face of significant depositor withdrawals and Switzerland's second largest bank was taken over by its larger rival, UBS, sparking nervousness about the financial sector.

However, state support was quick to prevent any run on the banks, with the Biden administration wholly guaranteeing banks' deposits and the Swiss National Bank providing a liquidity backstop for Credit Suisse.

The volatility subsided as the markets appeared to move past the possibility of a systemic crisis, although there was a significant switch of assets held with banks into money market funds. A fund manager said: "The recent banking stress is not a repeat of the 2008 financial crisis, which arose from asset quality and systematic credit issues. The recent one is about deposit liabilities management under the high-rate environment. We think the policymakers can deal with the liquidity squeezes."

### Interest rates hiked in face of elevated uncertainty

Central banks continued to hike interest rates, albeit with less aggression than in 2022 but still reminding markets of their commitment to tackling persistent inflation. The Federal Reserve raised its benchmark interest rate by another 25 basis points to a target range of 4.75-5.00% but signalled that it was close to the end of its rate-raising cycle. Treasuries rallied in response, only to fall back as hopes faded that monetary tightening was over. There was further evidence of inflation easing when the personal consumption expenditures price index fell to an annual 5.0% in February from 5.3% in January. A US fund manager said: "We expect the economy will eventually slow. Inflation will drop and monetary policy will become looser. Bonds now offer an attractive diversification opportunity for portfolios given current valuations and income levels."

A US fund manager noted that US growth stocks were boosted in March by expectations of less tightening by the Fed, while the higher exposure to the financial sector hampered value-style companies.

There were also rate hikes across the Atlantic. The European Central Bank continued to raise rates with a 50bp hike, lifting the deposit rate to between 2.5% and 3.0%, while the Bank of England raised its base rate by a quarter point to 4.25%. These hikes were made despite some commentators suggesting that concerns relating to the banking sector could cause a hiking hiatus.

The ECB had been signalling its hawkish plans for weeks. ECB president Christine Lagarde warned that the cycle of hikes was only just starting to take effect and signs that inflation was persisting at high levels meant that rates would have to be raised sufficiently to dampen demand. She added that uncertainty about the future path of inflation had increased.

One fund manager saw European financials as a buying opportunity, however, because of their cheap valuations, strong balance sheets and the improving economic environment in Europe: "We do suggest being cautious though because fundamentals are still uncertain and prices can overshoot during volatile periods."

The BoE's hike came a day after figures showed that annual inflation rose to 10.4% in February, up from 10.1% in January. The increase was higher than the BoE and economists had expected – monthly inflation was up 1.1%, which was nearly twice the 0.6% forecast by analysts. However, the BoE accompanied its hike by stating that the UK should avoid a technical recession this year.

### **Japan's inflation picks up**

In Japan, which has maintained a loose monetary policy amid tightening by other developed countries, inflation was proving to be an increasing challenge. Japan's consumer prices rose at the fastest pace in 41 years in February, increasing pressure on the Bank of Japan's incoming governor in April to abandon the loose policy.

Japan also imposed export restrictions on semiconductor equipment to China, aligning itself with the US's similar curbs. China's Xi Jinping further stirred geopolitical tensions with the US when he told delegates at the National People's Congress to 'dare to fight', which was another stage in the country's challenge to the US-led world order.

Despite the tensions, one equities fund manager was optimistic on the outlook for China, saying: "Against the rising recession risk in the US and European Union, Asia's, and especially China's, equity market can be expected to outperform in the coming 6-12 months. After the National People's Congress, we expect the likelihood of growth beating the 5% target to be high, given the support by the fiscal stimulus that could fuel the earnings recovery."

Worries do still persist on markets, but a lot of bad news has now been factored in, including the risks of recession and persistent inflation, and there is a more positive underlying tone coming steadily through, albeit slowly, as reflected in the two quarters of recovery. Markets are still vulnerable, but it could well be a good time to invest providing a longer-term view is adopted, rather than just a three to six months perspective.

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