

*"It's dangerous to go alone! Take this."**

Executive Summary

- A reassured market that permits modest gains during a brief period of calm.
- Despite curves and news reports that continue to forecast darker skies, markets performed well.
- The return of risk-free rates to their usual behaviour: performing under pressure, rather than causing it.
- Central Bank 2.0 : a focus on communication and assistance.

"A true friend is someone who is always there for you, in good times and bad, no matter what."Unknown

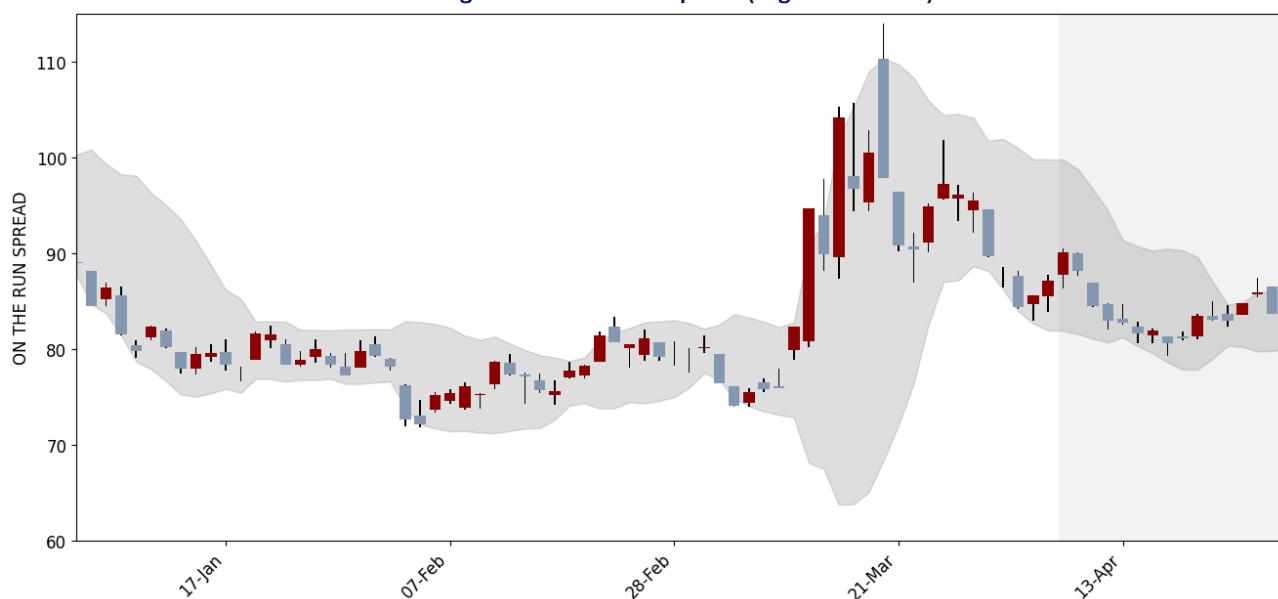
*Old Man, in first game of The Legend of Zelda

The storm is over...here.

April was a more peaceful month than March, which was characterised by turmoil on both sides of the Atlantic in the financial sector. Indeed, the interventions of the SNB for Credit Suisse and the FED for US regional banks reassured the market. Also, in general, Central Banks had reassured markets with their overall support and responsiveness (including the ECB, BOE, and BOJ).

April was even less volatile than January and February for the iTraxx index (Fig.1). The FED signalling its intention to halt rate hikes after May's 25bps increase, as well as ECB providing a clearer course with a rate hike pause in July, after likely three consecutive 25bps hikes, are major contributors to the relative calm.

Fig. 1: iTraxx main 5Y spread (High-Close-Low)



Source: Selwood AM France, Bloomberg.

As we have discussed in previous letters, April is typically a favourable month for risky assets in part due to a variety of factors, including the absence of major CB meetings (returning in early May with the FED and ECB).

Even though the markets have been reassured there are still threatening clouds on the horizon. Inverted curves continue to predict a recession, which may occur as early as this autumn. In addition, the level of absolute interest rates will likely complicate the refinancing of weaker companies, resulting in a return to default. Also, interest rates have a significant impact on a country's ability to service its debt, in US budget debt servicing go beyond defence spending! And we're also back to talking about the US debt ceiling. In Europe, France struggled to pass its retirement reform, which is likely to make the acceptance of future reforms more challenging. The data on Inflation, Employment, and Growth will continue to be diligently monitored. As inflation continues to decline too slowly Central Banks may be forced to surprise the market with additional rate hikes. Therefore, the positioning and consensus on various assets remains extremely defensive.

In this letter, we will focus on the following subjects: (i) the prospect of an end to rate hikes, which has altered the relationship between risk-free interest rates and risky assets (ii) the belief that since 2008 (Credit Crisis) in the United States and 2010-

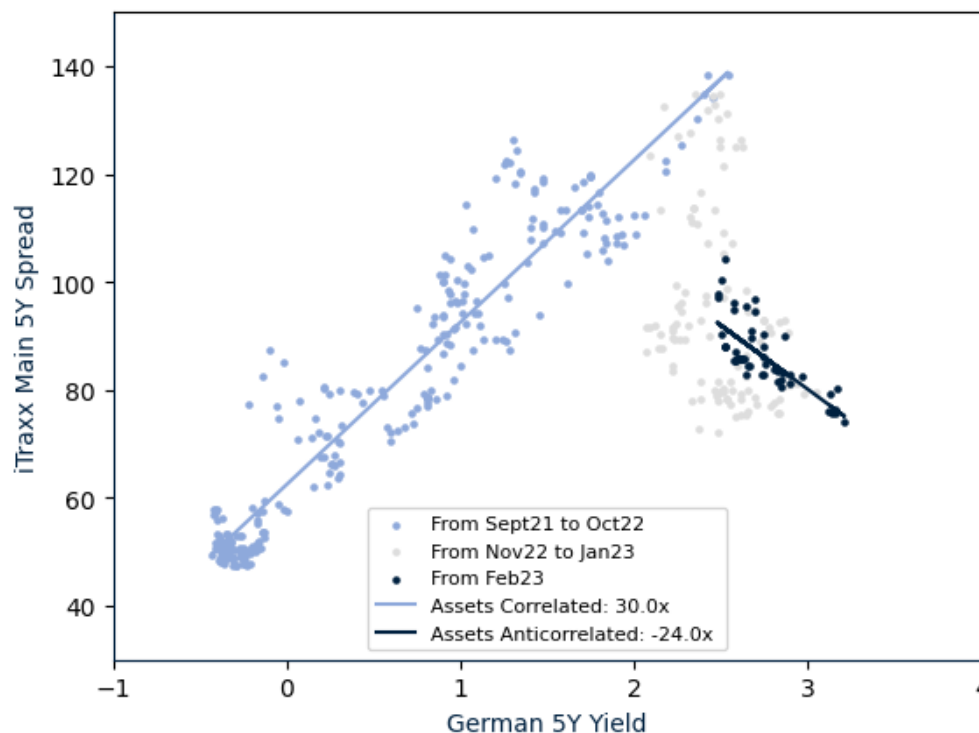
2012 (European Crisis) in Europe, Central Banks institutions have adopted a more supportive and more dovish stance than they should, given that inflation has remained constant since 2021.

The return of duration?

The current level of interest rates suggests that investing in assets with extended maturities can serve as a financial buffer during periods of economic downturns. In addition, because Central Banks have signalled their intention to closely monitor growth to prevent an adverse effect on the economy, they are likely to react if data deteriorate. **Investors may have interest to add duration in this environnement**, as the correlation between interest rates and spreads became negative.

Considering fig.2 below, there have been three distinct periods to highlight since 2021. First, the 2021-2022 cycle of rate increases (in light blue) which caused spreads to widen to a point where rate curves started pricing a recession within a year (Oct 2022). A second period in which long-term interest rates were less volatile with spreads contracting (in grey) and the third, current period (since Feb 23), in which spreads moved in the opposite direction (in dark blue).

Fig. 2: Correlation between 5Y Germany and iTraxx Main Spreads



Source: Bloomberg.

Are the last-resort lenders back?

In 2022, with inflation figures soaring to 10%, many economists blamed Central Banks for being too passive or reacting too slowly.

Since 2008, in the United States and 2012 in Europe, Central Banks became slightly more inclined towards a dovish stance. In 2018 in the United States, J Powell, a less academic Chairman of the Federal Reserve (he previously worked in investment banks and Carlyle), replaced J Yellen as Chair (an academic economist), reflecting D Trump demanding a more accommodative monetary policy.

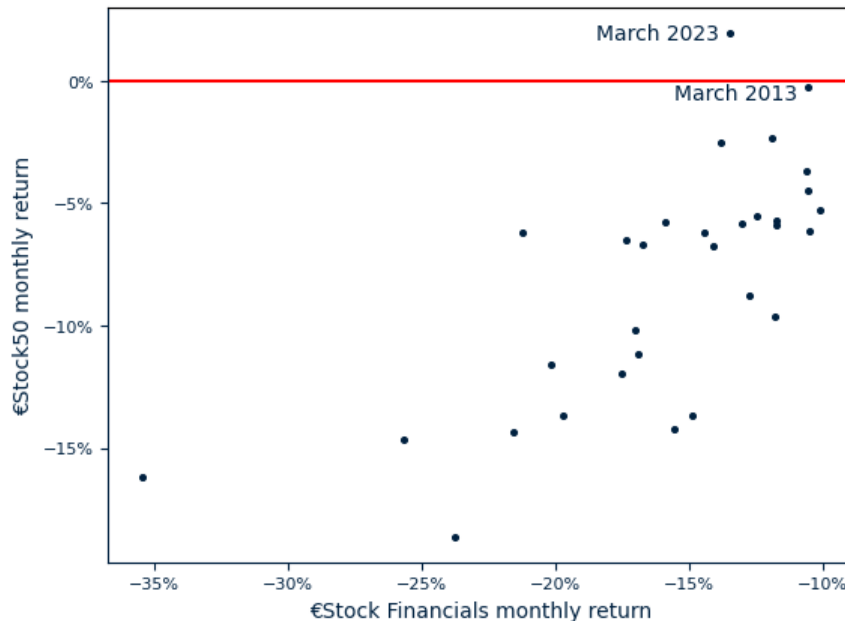
In Europe, the behaviour disparity between JC Trichet and M Draghi was also significant, as Trichet raised interest rates on the verge of the European crisis, in contrast to Draghi's "Whatever It Takes" policy. Draghi pushed unorthodox measures in Europe, such as OMT and TLTRO, in order to assist countries battling their sovereign bonds spread widening. Trichet was a more conventional economist and public servant, whereas Draghi's tenure at Goldman Sachs demonstrated a distinct, more market-oriented approach. C. Lagarde, who succeeded Draghi, have also a pragmatic approach and market awareness, being a former lawyer and politician.

March was a positive month for the € Stock 50, as shown in Fig.3, while the € Stock financials saw a 10% decline. If we examine the returns between indices while the financials index underperformed by more than 10% in a month, we will see a

This indicates a shared perception of the reliance on central banks for addressing contemporary financial/recessionary/inflationary challenges, similar to how they resolved the European crisis in 2013.

We firmly believe that currently Central Banks are market-friendly, closely monitoring the impact of their actions on the market. We may have left behind the purely academic economists who focus solely on data, and economic theory. Not to mention that communications have also significantly improved to prevent unpleasant surprises or shocks.

Fig. 3: €Stock 50 monthly return when €Stock Financials lost 10% in a month.



Source: Selwood AM France

Conclusion:

In April, despite a predicted and priced recession, markets were calm following the March crisis. Diverse factors acted as catalysts, but the Central Banks' "Put" appears to be in place despite financial policy shifts with respect to interest rate levels and quantitative easing. Due to the fact that Central Banks' key interest rates are approaching their targets, we think that duration provides a hedge in times of turmoil. We prefer 2-4 year rates over longer terms because the curves are inverted and can normalise abruptly with a soft landing. The positioning and investor sentiment is unquestionably cautious, but the Cassandara effect regarding the end of Central Bank support has not fully materialised. Having CBs institutions on their side could help investors.

Fig. 4: April word cloud**



**** Word Cloud** from Selwood Asset Management France streaming of financial news during the month. A word cloud is a visual representation of text data, which is used to depict keyword metadata on websites, or to visualize free form text. Tags are usually single words, and the importance of each tag is shown with font size or colour

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