Bank Runs and March Winds

Q1 2023 Passive Perspectives

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- The technology sector provides refuge during the banking crisis, with Apple and Microsoft driving outperformance
- The emergence of ChatGPT, the artificial intelligence chatbot, adds fuel to the technology theme rally
- The Fed continues to fight inflation

Introduction

A well-known saying is that March winds and April showers bring May flowers. March proved to be turbulent, particularly for the banking industry. Trouble within the banking system, starting with the collapse of Silicon Valley Bank ("SVB"), left markets slightly rattled, resulting in the Federal Reserve's (the "Fed") decision to scale back on the aggressive rate hike cycle that it has pursued since 2022.

Apple and Microsoft dominate the FAANG

Mega-cap tech stocks served as a haven in March during the collapse of SVB and the period of increased volatility experienced by the banking sector. As a result, investors flocked to the safety of cash-rich, tech stocks, specifically Apple (AAPL) and Microsoft (MSFT), whose weights continued to grow in the S&P 500 to 7.0% (AAPL) and 6.2% (MSFT).

Where the FAANG[1] stocks once dominated the tech sector, AAPL and MSFT, with a combined market capitalization of over $4 trillion, have split from the group and now account for 13.2% of the S&P 500. The already tech-heavy Index has become even more concentrated, posing a challenge to investors looking for diversified exposure to the U.S equity market. Nevertheless, investors continued to pour capital into the tech sector, which has gained momentum since the Fed Indicated its intention to slow or pause rate hikes.

[1] FAANG is an acronym for five well-known, U.S. technology stocks: Facebook (now Meta Platforms), Amazon, Apple, Netflix and Google (now Alphabet).

Exhibit 1. Core Index Comparison

Index	Benchmark	Q1 2023 Stratified	Q1 2023 Benchmark	Q1 2023 Rel.	12-Months (%) Stratified	12-Months (%) Benchmark	12-Months (%) Rel.
Stratified LargeCap	S&P 500	3.08	7.50	-4.42	-4.17	-7.73	3.56
Stratified MidCap	S&P MidCap 400	4.95	3.81	1.14	-3.61	-5.12	1.52
Stratified SmallCap	S&P SmallCap 600	3.81	2.57	1.25	-9.20	-8.82	-0.39
SEADM*	MSCI EAFE	7.29	8.62	-1.33	-2.88	-0.86	-2.02
Stratified LargeCap	S&P 500 Eq. Wgt.	3.08	2.93	0.15	-4.17	-6.31	2.13

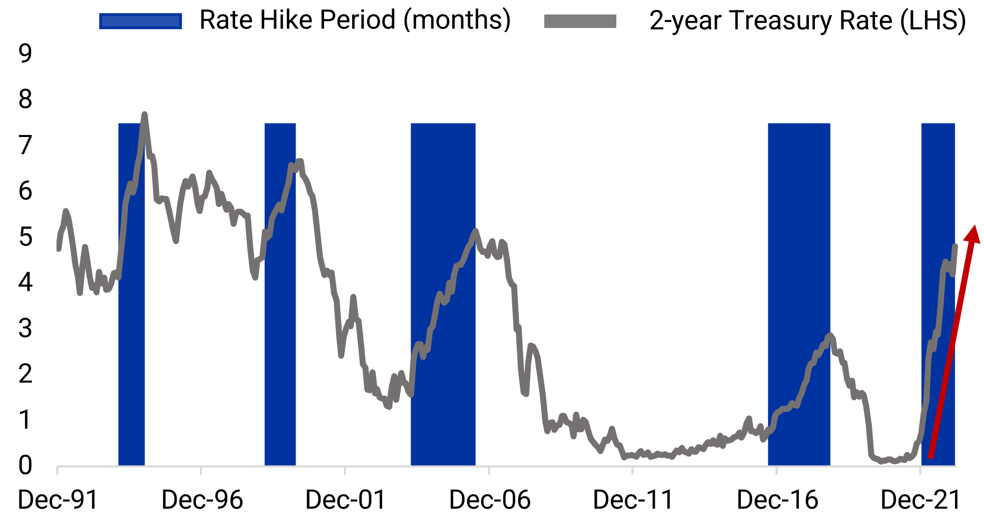
Source: Source: Syntax, S&P Dow Jones Indices, MSCI. Total return performance does not reflect fees or implementation costs as an investor cannot directly invest in an index. Performance as of 31 March 2023. *Syntax Stratified Europe & Asia Developed Markets (SEADM) Index is based on the MSCI EAFE universe.

Despite the volatility experienced by banks, tech names showed resilience, posting significant gains of 21.8% which drove the tech-heavy S&P 500's 7.5% return for Q1 (Exhibit 1). The Syntax Stratified Large Cap Index rose 3.1% in the first quarter. However, investors should pay attention to the drivers of the S&P 500's outperformance – namely, five companies: Nvidia Corp., Meta Platforms Inc., Tesla Inc., Warner Bros. Discovery Inc., and Advanced Micro Devices Inc., were responsible for most of the gains. In comparison, the S&P 500 Equal Weight Index rose 2.9% for the quarter.

Banking Sector Gets Fed Up with Rate Hikes

The Fed's most recent interest hike period (March 2022 – March 2023), as illustrated in Exhibit 2, was the fastest rate hike cycle over the last three decades. The Federal Open Market Committee raised target interest rates to 4.75%-5% from a meager 0.5% in March 2022. This recalls a similar trend from the 1980s when former Fed Chair Paul Volcker also pursued a series of aggressive interest rate hikes. While deemed necessary to control rampant inflation, the Fed's recent monetary policy tightening has hurt many regional banks, inducing significant mark-to-market losses in their asset portfolios, which often include allocations to treasury securities. Furthermore, bank runs from panicked depositors created a downward spiral and led to the collapse or near-collapse of several regional banks. It began with Silvergate, a bank known for its largely crypto client base, followed by the U.S. government takeover of SVB and the subsequent demise of Signature Bank. Then the contagion spread to global investment bank, Credit Suisse, forcing its eventual acquisition by UBS. Whether these banks have set off a broader domino effect within the financial sector will be closely watched as the year progresses.

Exhibit 2: Historical Interest Rate Hike Periods by the Fed



Source: Syntax, Bloomberg

Affinity Thematic Lens

Using the Syntax Affinity® platform, we can view the market through a wide range of unique thematic lenses and analyze the performance of groups of relevant companies. Themes are often persistent in the markets for several months or quarters; related stocks can persistently out (or under) perform. During the first quarter, the following emerged as themes to watch:

Technology Revolution

Microsoft-backed Open AI, the company behind ChatGPT and other AI projects, dominated headlines during the first quarter, fueling the performance of chip makers such as NVIDIA, Advanced Micro and Intel, which rose 94%, 53% and 25%, respectively. Despite the subdued economic outlook, the performance of these tech stocks remained resilient as investors expressed excitement about this revolutionary technology. Outperformance in groups within the Syntax Technology Revolution Theme includes companies which were identified as having business exposure to 5G-enabling technology, high-performance compute and artificial intelligence.

Clean Energy

In examining the Affinity Clean Energy Lens, electric vehicles gained traction in the first quarter, with Tesla rebounding and recovering some of its losses from 2022. Tesla was up 71.8% year-to-date as of the end of March. Alongside Tesla, other electric vehicle companies such as Lucid also posted positive returns but have yet to recover to their 2021 peak prices.

Real Estate

Since the pandemic, many companies have adopted remote and hybrid work practices, leading to reduced demand for commercial real estate. To make matters worse, rising interest rates have resulted in lower commercial real estate valuations. The Affinity REIT Thematic Lens reflects these developments, showing negative returns from commercial and office real estate companies, such as Boston Properties and W.P Carey, which were down 27.3% and 12.1% respectively, for the quarter. Commercial real estate will be an industry to monitor going into the second quarter.

Banking

Facing the pressure of rising interest rates, the financial sector was by far the biggest underperformer during the first quarter. Over this period, the non-real estate banking segment declined 30%, while securities brokers and dealers were down by 25%. The seemingly isolated bank failures in March led to a significant deterioration in investor confidence, and as a result, many banks have continued to underperform.

Caution Required Ahead

The emergence of new technologies such as ChatGPT and slowing rate hikes by the Fed have supported the technology sector's rallies witnessed during the first quarter of the year. Whether the Fed will continue to increase rates to combat inflation as recession fears mount remains to be seen. Investors should, however, continue to pay close attention to their portfolio exposures to ensure their investment convictions are expressed as intended and that their portfolios remain diversified.

The table on the following page illustrates the performance results for specific themes within the S&P 500. The ability to dissect the market in this manner is made possible through our proprietary classification technology and Affinity platform.

Syntax

	3M	1Y	5Y	Since Inception
Technology Revolution				
5G-enabling Technology	12.7%	-5.1%	17%	6.5%
Banking, Insurance, and Investment Technology	10.0%	-2.2%	13%	5.3%
Cybersecurity	8.0%	-17.8%	15%	6.1%
High Performance Compute & Artificial Intelligence	17.4%	-25.5%	15%	5.3%
Internet of Things	11.9%	-11.3%	12%	1.8%
Clean Energy				
Batteries and Electronic Materials	7.7%	-17.8%	18.4%	5.2%
Clean Energy	13.8%	2.4%	17.0%	9.1%
Electric Vehicles	68.4%	-42.2%	-2.5%	-0.4%
Solar Power Equipment	10.6%	24.1%	9.5%	-3.7%
REIT Sector				
Diversified Commercial Real Estate	-23.0%	-62.2%	-20%	-2.7%
Healthcare	-13.1%	-36.7%	0%	0.3%
Industrial	-13.8%	-37.6%	0%	0.4%
Nursing Home and Senior Care	-12.4%	-36.0%	-1%	1.9%
Office Real Estate	-19.9%	-55.0%	-14%	-1.3%
Pharmaceutical and Life Science	-13.8%	-37.6%	0%	0.4%
Real Estate				
Real Estate Developers	18.6%	31.5%	14.0%	12.0%
Real Estate Financial Products	-72.2%	-82.6%	-26.0%	-5.0%
Software-as-a-Service (SaaS)				
Consumer SaaS	-19.9%	-35.3%	-4%	-0.7%
Content Creation SaaS	14.5%	-15.4%	8%	1.2%
IT SaaS	27.8%	-9.6%	22%	21.0%
Sales and Marketing SaaS	50.7%	-5.9%	11%	9.5%
Sector				
Analog and Mixed Signal Integrated Circuits	25.6%	7.8%	14%	13.8%
Auto Products	25.7%	-8.5%	3%	0.2%
Banking	-24.9%	-38.3%	-5%	6.1%
Digital Integrated Circuits	28.0%	-12.0%	22%	15.2%
Integrated Circuits	25.8%	-1.7%	23%	16.5%
Internet Search and Social Networks	25.9%	-21.3%	7%	5.0%
Non-Real Estate Banking	-30.1%	-49.1%	-9%	4.9%
Securities Brokers and Dealers	-24.9%	-26.3%	7%	5.5%
Semiconductor Services and Equipment	22.2%	6.7%	30%	14.5%

Source: Syntax, Affinity, S&P Dow Jones Indices. Performance is calculated as the weighted average total return of the subset of the S&P 500 Equal Weight Index constituents who are members of the Affinity Theme. 3M, 1Y, and 3Y show total return for the 3, 12 and 26 months ending 31 March 2023 Since Inception shows total return from 31 December 1991. Performance does not reflect fees or implementation costs.

Important Disclaimers