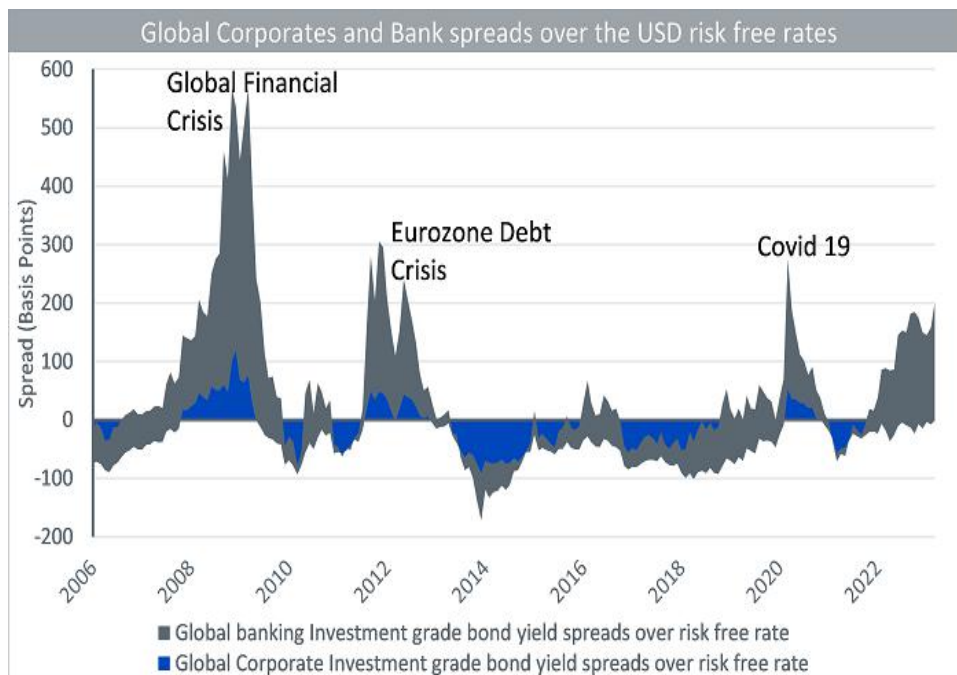

WHAT'S HOT: QUALITY IS BACK IN FOCUS, AMIDST THE BANKING TURMOIL

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History never repeats itself, but it often does rhyme. The recent collapse of Silicon Valley Bank (SVB) and Signature Bank in the US and the forced takeover of Credit Suisse by rival UBS have triggered concerns of contagion across the global financial system. The current stress in the banking sector is reminiscent of the 2008 financial crisis. However, unlike the 2008 financial crisis, uncertainty is not centred on the quality of assets on bank balance sheets but instead on the potential for deposit flight.

Tough ride for Banks ahead

US regional banks have witnessed significant deposit outflows which, combined with unrealised losses on their security holdings, have seen banks consuming their liquid assets at a very fast pace. In turn, sentiment towards European banks has deteriorated. This is evident in the widening of debt risk premia, making it more expensive for banks to fund their operations. It's important to note that banks were already tightening lending standards prior to recent events. So, lending conditions are likely to tighten further as deposits shrink at small and regional US banks and regulators respond to the new risk environment. The turn of events in the banking sector have led to higher uncertainty which is likely to be reflected in higher volatility in credit markets. So far, the impact on other sectors has been fairly contained, but a further deterioration of bank credit quality could drag other industries lower as well. We are still in the early innings, so the range of repercussions remains wide.



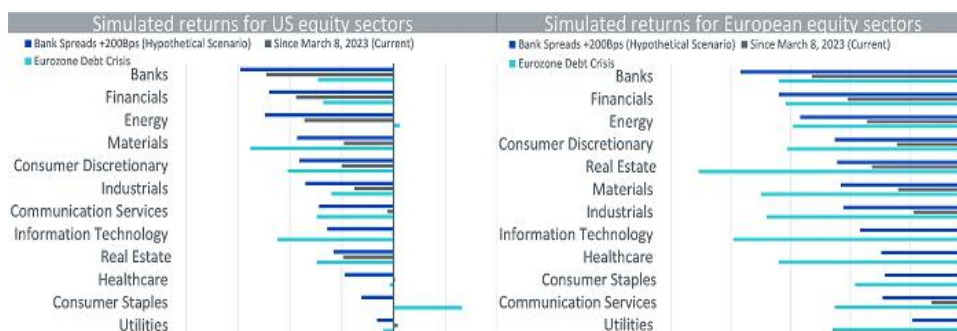
Source: Bloomberg, WisdomTree as of 29 March 2023

Historical performance is not an indication of future performance and any investments may go down in value.

Traditional defensive sectors offer more protection in prior weakening credit cycles

On analysing the impact of a further rise (by 200Bps) in credit spreads on US and European debt (highlighted by the dark blue bars) we found that not all equity sectors will be impacted equally on the downside. In fact, traditional defensive sectors like utilities, consumer staples and healthcare could offer some protection in comparison to cyclical sectors such as banks, energy and real estate.

Since March 8, 2023, the steepest price corrections have been centred around the banking and commodity related sectors such as energy and materials, while technology, healthcare, consumer staples and utilities have managed to escape the rout illustrated by the grey bars. The historical sector performance (in the light blue bars) during Eurozone debt crisis (the second half of 2011), confirm a similar pattern whereby the traditional defensive sectors tend to shield investors when spreads widen.



Source: Factset, WisdomTree as of 24 March 2023.

Please note: US sectors are represented by the sectors in the S&P 500 Index and European sectors are represented

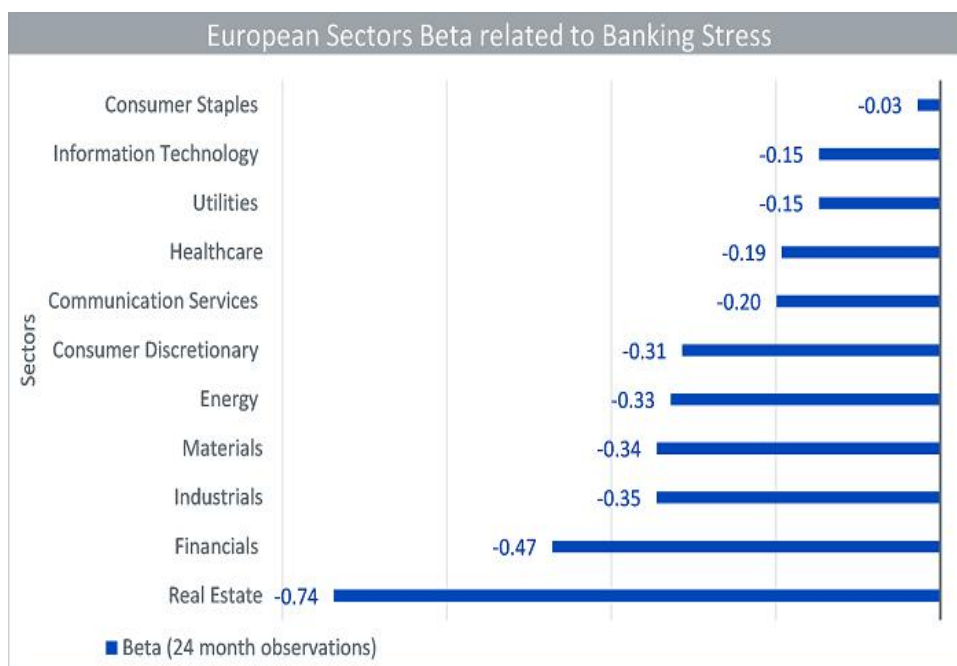
by the sectors in the EuroStoxx 600 Index.

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Europe earnings hold forth despite the banking turmoil

Interestingly despite the recent banking turmoil, the global earnings revision ratio continued to show resilience in March. Europe stood out as the only region with more upgrades than downgrades. Earnings remain the key driver of equity market performance. Europe has clearly gotten off to a strong start and it will be interesting to see if European earnings expectations can hold up as credit conditions deteriorate.

Within Europe we analysed the sectors that were most exposed to the banking stress. By observing the beta of the sectors in the EuroStoxx 600 Index relative to regional banking spreads, we found that real estate, financials, industrials, materials, and energy were most exposed on the downside to the high banking stress. On the contrary, consumer staples, information technology, utilities and healthcare showed more resilience.



Source: Factset, Bloomberg, WisdomTree as of 24 March 2023.

Please note: the Regional Banking Spread is the difference between the yields on US regional banks versus the 10-Year US Treasury.

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When the going gets tough, quality gets going

Investors should focus on companies with strong balance sheets which we often tend to find within the quality factor. Quality stocks, characterised by a higher earnings yield compared to its dividend yield alongside higher return on equity (ROE) and return on assets (ROA), would offer a higher margin of safety in periods of higher volatility.

Conclusion

While central banks in US, Europe and UK continued their hawkish stance at their most recent policy-setting meetings, the evolving banking crisis could alter the path for monetary policy ahead. Chair Powell conceded that tightening financial conditions could have the same impact as another quarter point rate hike or more from the Fed.

Given the rising concerns on the risk of banking industry contagion, shrinking corporate profits and central bank policy ahead we continue to believe that positioning your equity exposure towards the quality factor would be prudent.

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