

Global Investment Outlook

This isn't 2008



Introduction



Stephen Dover, CFA

Chief Market Strategist

Franklin Templeton Institute

Beware the ides of March, indeed! In recent years, capital markets faced unique events during March, each time leading many investors searching for shelter (literally and figuratively). March of 2020 brought COVID-19 lockdowns, March of 2022 brought the Russian invasion of Ukraine into focus, and this year March brought the events of the Silicon Valley Bank (SVB) failure. Over the last few weeks, I have talked to dozens of our investment managers, clients, researchers and colleagues. This *Global Investment Outlook* focuses on the most important conversations and takeaways. I hope it helps make a bit of sense out of what just happened—and all the opportunities that lie ahead.

- **This is not a repeat of the 2008 global financial crisis (GFC).** Today's banking "crisis" is far less severe than 2008, and it's not systemic. Indeed, the quality of overall bank assets and capital ratios are dramatically better. The central banks are now coordinating globally to offer banks daily access to the capital they need to operate smoothly. SVB failed because of a mismatch between its short-term depositors who were withdrawing assets and its longer-term assets, mostly US Treasuries, that had dropped in value as interest rates increased.
- **The banking system will almost certainly get more oversight and regulation.** Much of this oversight will likely be focused on regional banks. We continue to see investment opportunities within regional banks, but each bank will need to be evaluated on a case-by-case basis, not as a group.
- **Cash deposits are moving from regional banks to money market funds.** As clients look for higher returns on their investments, more deposits are leaving the banking system. Money market funds have been the biggest beneficiary; with over US\$286 billion of inflows in March, this has brought money market balances to the highest level on record.¹ Bigger banks are also benefiting according to the Federal Deposit Insurance Corporation, as flows to the largest 25 banks increased by US\$120 billion.²
- **Who are potential winners against this backdrop?** We see opportunities in income, especially fixed income and dividend paying equity. We generally favor investment-grade and sovereign debt, while the outlook for emerging market local currency debt also looks promising. Non-US equity is apt to be attractive as China reopens and Europe shows more resilience than expected.
- **Private credit will likely be one of the beneficiaries.** In the aftermath of the regional banking turmoil, private credit will likely replace some of the current regional bank loans. We believe the current market disruptions may present the most attractive investment opportunity for private debt since the GFC.

For more detailed insights and outlooks from our investment teams, please read our full *Global Investment Outlook*.

A handwritten signature in black ink that reads "Stephen Dover". The signature is fluid and cursive, with the first name and last name clearly legible.

Crisis of confidence

Throughout the first three months of 2023, capital markets oscillated between euphoria and pessimism. Rapid changes in expectations for US Federal Reserve (Fed) policy driven by conflicting data on US growth and inflation, as well as hopes that China's economic reopening will boost global growth this year, have driven shifting sentiment. Most recently, attention has focused on fears of financial stress—or worse—in the United States and Europe. All that is taking place against a backdrop of flagging corporate profits as rising costs are creating margin pressure.

The arrival of the banking turmoil is of particular importance. While the implosions of Silicon Valley Bank (SVB) and Credit Suisse have distinct “own goal” elements to them, they serve to remind us that systemic risks start as isolated cases, which then expose more profound vulnerabilities. And while bad loans were not the source of today's banking turmoil, there are probably other banks that could be at risk if large losses result from securities holdings that need to be sold to satisfy large and rapid depositor withdrawals. However, given all the regulatory actions post the global financial crisis (GFC) to help de-risk banking business models in both the United States and Europe, this does not look to be a systemic situation at this stage. In the sections that follow, our investment teams weigh in further on reasons why the current turmoil is different from the GFC and the potential policy implications.

The rapid response of various government entities to provide liquidity in mid-March has reduced the tumult, but it still has not addressed the banking system's fundamental sources of risk. US Treasury Secretary Janet Yellen's frank admission

about the absence of universal deposit insurance in her Senate testimony of March 22 only underscores the fact that other banks could experience depositor runs in the event they are perceived to be poorly managed. Meanwhile, the Fed's unrelenting campaign of interest-rate hikes only increases the risk of bank deposit intermediation by higher-yielding money market funds, a potential source of both liability pressures for banks and reduced credit funding for an already weakening economy.

As Fed Chair Jerome Powell noted in his most recent press conference, the US banking turmoil will act to slow lending, spending and growth in the economy.³ This may be particularly acute within the regional banking sector, which provides the lion's share of lending to small and mid-sized businesses in the United States. While that may permit the Fed to raise rates more cautiously, it may also lead to a continued shift of banking toward non-bank private credit sources. In addition, all of this disintermediation serves to reinforce one of our existing 2023 themes—namely regional growth de-coupling. China provides the clearest source of likely divergence, given its belated COVID-19 reopening supported by modest credit and fiscal easing.

Notwithstanding the demise of Credit Suisse, the banking turmoil is likely to be economically less damaging in Europe, where stresses are less apparent, and banks operate in a more tightly regulated environment. Lower interest rates also suggest that both deposit disintermediation and securities losses are apt to be less problematic. The European Central Bank (ECB) increased its benchmark interest rate 50 basis points (bps) at its March policy meeting, suggesting

The rapid response of various government entities to provide liquidity in mid-March has reduced the tumult, but it still has not addressed the banking system's fundamental sources of risk. US Treasury Secretary Janet Yellen's frank admission about the absence of universal deposit insurance in her Senate testimony of March 22 only underscores the fact that other banks could experience depositor runs in the event they are perceived to be poorly managed.

that it does not currently see US-style banking risks in the eurozone. That action gave financial markets a dose of confidence.

In Asia, central banks may be inclined to implement accommodative and growth supportive policies to cushion any liquidity stresses, creating a more constructive environment for the region. Most banks in Asia have been maintaining both strong capital buffers and prudent leverage following Russia’s invasion of Ukraine, even as the Fed embarked on a monetary policy tightening path.

Given this divergent growth backdrop, we see opportunities as follows.

Focus on income

The stability of a regular stream of cash flow can provide a stable source of return in periods of increased volatility. Historically, yield offers the largest component of return within fixed income, and we believe current levels create a more attractive forward total return profile.

Focusing on higher credit quality leads us to favor investment-grade and sovereign debt. With the consensus view for 2023 expecting US growth to come in below that of Japan,

as well as China and many other emerging markets, the outlook for emerging market local-currency debt also looks promising. Opportunities are evident in Europe, where the eurozone economy is doing better than many had forecasted, underpinning credit fundamentals.

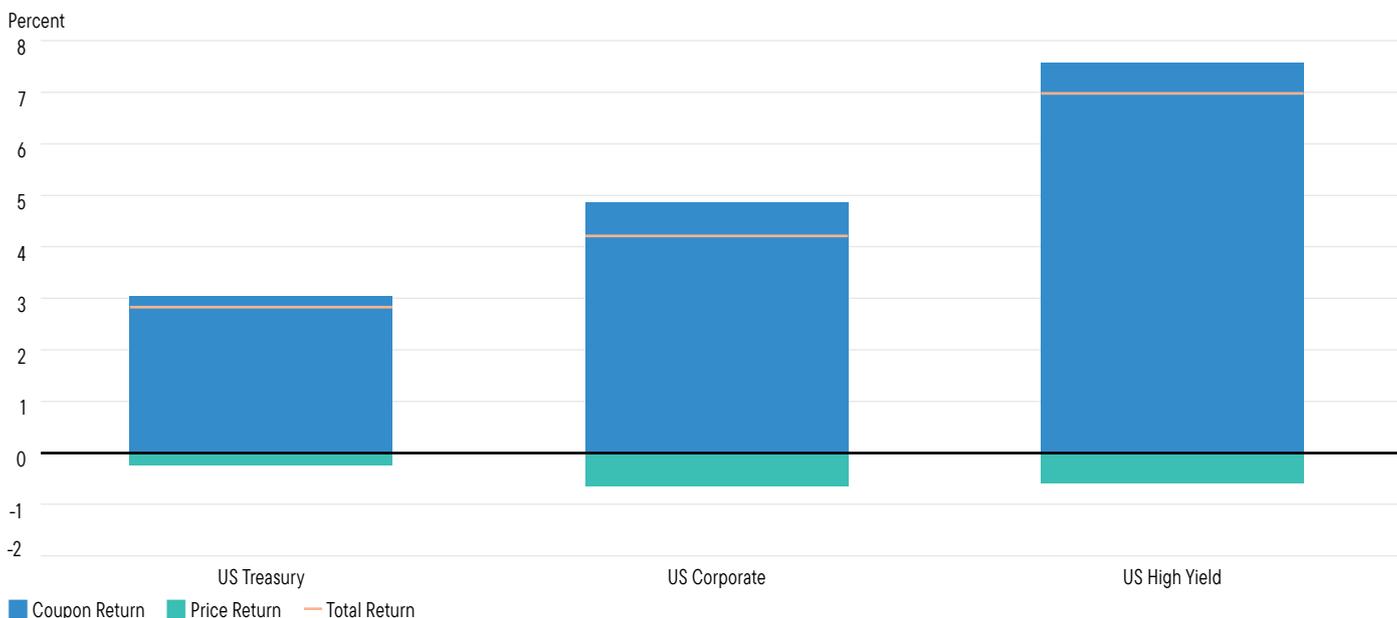
Eventually, we believe one of the biggest fixed income opportunities for 2023 will be to position for a flattening and then a steepening of the US Treasury yield curve. While it is premature to position for yield-curve normalization, the unwinding of the currently inverted yield curve is likely to have significant investment implications, in our view.

The way the yield curve normalizes is of crucial importance. If short rates fall relative to long rates on fears of a deep or prolonged recession, then yield curve normalization is likely to lead to significant weakness in equity and credit markets. If, on the other hand, yield curve normalization reflects the restoration of low inflation amid an ongoing expansion (a “soft landing”), it bodes well for corporate profits and hence equity and credit returns. For instance, in periods since 1962 when inflation peaked and started to decline, US Treasuries generated an average of 14% returns and the S&P 500 Index an average of 10% returns in the 12 months after peak inflation.⁴

Yield Driving Fixed Income Returns

Exhibit 1: Fixed Income Return Composition 20-Year Annualized Return

April 1, 2003–March 31, 2023.



Source: ICE BofA, Franklin Templeton Institute Analysis as of March 31, 2023. US Treasury represented by ICE BofA US Treasury Index; US Corporate represented by ICE BofA US Corporate Index; and US High Yield represented by ICE BofA US High Yield Index. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Another big equity story for the rest of 2023 is apt to be the attractiveness of non-US stocks, reversing a significant trend lasting more than a decade. One of the reasons is China's re-emergence from COVID-19 lockdowns, supported by a policy easing—most recently evidenced by a cut in banks' required reserve ratio.

Discerning between those two yield-curve normalization possibilities is a key focus for the Institute throughout 2023. For now, however, our focus within equities is a “barbell,” composed of more exposure to countries, regions and sectors likely to benefit from China's reopening, complemented by higher-quality, dividend-yielding equity holdings in the United States.

Importantly, during periods of elevated inflation, returns from dividends become more significant. From 2000–2022, for instance, when inflation exceeded 2.5%, the MSCI US High Dividend Index outperformed the MSCI US Index by 11.5%.⁵ The same is true during episodes of Fed rate hikes, when the MSCI US High Dividend Index generated higher returns than the MSCI US Index 78% of the time.⁶

Equally, during periods of financial stress, income-focused equity allocations have provided more resilient return profiles. During the 1970s and 1980s, for example, high inflation and interest rates created a challenging environment for stocks, and equity income indexes outperformed broad equity indexes. The same is true when the technology bubble burst in 2001, as equity income indexes, which were less exposed to the technology sector, outperformed the broad market. Finally, during the 2008 financial crisis, equity income indexes also outperformed broad equity indexes as investors sought out more stable and reliable sources of income.

Increase quality through shifting sector and global allocations

Another big equity story for the rest of 2023 is apt to be the attractiveness of non-US stocks, reversing a significant trend lasting more than a decade. One of the reasons is China's re-emergence from COVID-19 lockdowns, supported by a policy easing—most recently evidenced by a cut in banks' required reserve ratio. The other reason is a theme of resilience in Europe, which has held up and adapted better, and faster, than expected to the challenges posed by the Russia-Ukraine war.

Those factors offer opportunities for investors. Equity markets outside the United States—in China, the emerging markets complex, and Europe—command lower valuations than the United States. Should growth and earnings prospects improve in those regions as China pivots, then more favorable absolute and relative valuations in non-US equity markets could provide a springboard for performance potential.

Lastly, we continue to underscore other secular trends as opportunities for long-term investors. Dislocations due to high inflation and interest rates have, if anything, created more favorable entry points in sectors such as biotechnology, alternative energy or the digital ecosystem—all areas we believe have excellent long-term growth prospects.

Finding selective opportunities

In sum, the continuing message for 2023 is one of selective opportunity. Differences in growth rates, macro policies and valuations will create differentiated outcomes in the year ahead. We believe investors are likely to be rewarded in higher-quality fixed income and dividend yields allocations, and on the equity side, looking across the globe—with an eye on emerging markets—makes sense to us. As a result of recent dislocations, areas such as private equity, private credit and commercial real estate also might be viewed with a new lens. Using episodes of market weakness to build positions in the industries of tomorrow is, as always, a prudent strategy for long-term investors.

Fixed income

The banking turmoil roiling markets in March also affected interest-rate expectations. The big question for investors is whether the situation is dire enough to cause central banks to change course and actually cut interest rates, instead of continuing to raise them to fight inflation. Western Asset Management's Ryan Brist, Michael Buchanan and Annabel Rudebeck; Franklin Templeton Fixed Income's Sonal Desai and David Zahn; and Franklin Income Investors' Ed Perks discuss the impacts of the events on the fixed income markets, and the opportunities market mispricings present.

2008 is not on repeat

Michael Buchanan, CFA

Deputy Chief Investment Officer
Western Asset Management

Ryan Brist, CFA

Head of Global Investment-Grade Credit, Portfolio Manager
Western Asset Management

Annabel Rudebeck

Head of Non-US Corporates
Western Asset Management

Stephen: Michael, let's start with you. Many investors are comparing the current banking issues to the global financial crisis (GFC) in 2008. Is that a fair comparison?

Michael: I think one must differentiate between the banking issues we're witnessing right now and the GFC. What happened in 2008 really was about solvency and asset problems. Banks were too levered; they were thinly capitalized. In 2008, banks had too many bad loans, both in the form of residential mortgages—in subprime as well as corporate loans—and the combination of that thin layer of capital along with bad loans translated into an all-out crisis that really came to fruition when the global economy screeched to a halt. And as we know, government intervention was needed to avoid greater systemic risk. Today when you look at the asset quality at banks, it's good. Bad loans are minimal.

Capital ratios are dramatically improved, thanks to this intense regulatory oversight and the ongoing stress tests that banks have really had to endure, and I think what we're witnessing today really is a crisis of confidence.

The key question from here is how likely it is that this situation will spill over into the non-banking economy. A lot will depend on the near-term response we get from banking regulators—such as a broader expansion of depositor guarantees. We think we need proactive and urgent communication that will calm depositors and investors. The banking “crisis” should cure itself if that happens.

Ryan: For the last 10 years, I've been saying banks have more and better capital. The capital stack is really generous today versus during the GFC, but more and better capital doesn't thwart a classic run on the bank. If we can calm down the fire in the banking system, I think we will learn that this situation is isolated. Perhaps more banks will go down, but I think the banking system in the United States, by and large, is much safer. And if you look at it from a loss perspective, we're in a much different place today than we were in 2008.

Stephen: Annabel, can we draw a line between Silicon Valley Bank (SVB) and Credit Suisse?

Annabel: Credit Suisse has had issues for quite some time, and the big strategic update it announced last October reflected the need to make a seismic change in their business. However, that was going to take time. What happened is that we started to see an increasing concern around deposit flight. Credit Suisse had very strong capital, a very clear plan, and the liquidity coverage looked good, but the market has been nervous and moving fast. Without SVB, it does seem rather unlikely deposit flight would've been a worry; the liquidity state of Credit Suisse probably wouldn't have been called into question in the same way. I think there's a linkage, and I think all banks now look to some extent perhaps not vulnerable, but they are going to be subject to greater scrutiny.

“As I look at my market, I think the beneficiaries are going to be the big blue chip, non-financial names where we don’t have to talk about deposit flight and can talk instead about measurable assets. And you could argue that the big US banks, perhaps over time, will exhibit the same kind of pricing power, but certainly with a lot of regulatory palaver along the way, I think.”

Annabel Rudebeck

Stephen: What does this mean for the economic outlook and monetary policy?

Michael: The prospect for a US recession has probably increased. I don’t think there’s an extremely high probability of a deep recession, but perhaps something between a soft landing and a mild recession seems like a reasonable prospect.

Annabel: With regard to the central banks, they have the dual challenges of price stability and financial stability. While price stability is the foremost mandate, I think we could all make arguments in both directions on the inflation and growth data at the moment. But one thing I would say is that there’s a real impact from the recent disruption in the banking space on the real economy, in terms of jobs and so on.

Stephen: And what about the regulatory implications?

Annabel: I think regulation will change in the United States—regulators are going to be looking very closely at smaller banks. The deposit protection element that they have come out with is interesting. We can’t let these smaller banks fail, quite frankly, without causing systemic volatility.

Regional banks in the United States are arguably a bit more like smaller domestic banks in Europe. In Europe, however, regulations for smaller banks are already more rigorous than they are for their US counterparts. Also, European banks hold a higher percentage of deposits that are insured, and deposit flight is less likely across national borders.

Of course, SVB shines the light on the other big distinction between Europe and the United States, which is venture capital/private equity/tech, and that space obviously had very different banking needs over time and probably will continue to do so. That is one of the areas that presumably is going to feel some degree of pressure here and particularly the crypto piece within that.

As I look at my market, I think the beneficiaries are going to be the big blue chip, non-financial names where we don’t have to talk about deposit flight and can talk instead about measurable assets. And you could argue that the big US banks, perhaps over time, will exhibit the same kind of pricing power, but certainly with a lot of regulatory palaver along the way, I think. I would also imagine there is going to be some sort of shake up with all this volatility in the private markets, primarily due to not marking things to market.

Stephen: How do you look at things now from an investment lens?

Michael: Last year was brutal for fixed income across the asset class. The positive byproduct was that yields moved higher and we saw wider spreads. That said, just because yields are high doesn’t necessarily mean it’s time to buy fixed income. Investors need to look at the intersection between valuations and fundamentals. When we look at fundamentals, this is where we would then hone in on sectors. I do think developed market corporate credit is in a pretty good place, but generally like the idea of sticking with higher quality.

I think you can insulate yourself from perhaps a deeper draw-down that a recession may cause by sticking with some of the higher-quality credit—investment grade or high yield—and still get attractive potential returns. The area of caution we see is in the structured credit space.

Ryan: US Treasuries are the basis of everything we do in the fixed income market. They’re the perceived risk-free asset, and we price everything against Treasuries. Right after the news of SVB’s collapse hit, the front end of the Treasury yield curve moved 60 basis points (bps) lower, and the market was trying to tell the US Federal Reserve (Fed) there was a near-term problem. We saw a highly inverted yield curve, and we all learned in business school an inverted yield curve is the best telltale sign of economic trouble looming.

So the question we have as investors is, when do we deploy assets?

“I think US banks are a lot stronger today literally than when the SVB news first broke... There are some quality situations that I think investors should be spending time looking at, and maybe picking up some things along the way in terms of opportunities, and that relates down the capital structure.”

Ryan Brist

Stephen: I'm getting a few things out of our discussion. First is that you are positive on fixed income this year, and focused on quality. But within quality, really needing to actively participate and figure what that is.

Ryan: In the world of corporate bonds, all I think about is that spread component of the overall yield. And the real truth over the last 18 months, if somebody knocked me on the side of the head and said, “hey, fixed income portfolio manager, pay attention to the all-in yield—it’s pretty darn good.” A 6% yield for an investment-grade, high-quality portfolio is a pretty good yield. The quality of the companies you’re getting are large, multinational companies that are very safe in a lot of scenarios; that’s a pretty good starting point.

I think US banks are a lot stronger today literally than when the SVB news first broke. As our Chief Investment Officer Ken Leech always says, “focus on price.” There are some quality situations that I think investors should be spending time looking at, and maybe picking up some things along the way in terms of opportunities, and that relates down the capital structure. I’m sure there will be reverberations, but when there’s volatility, we should have our antennas high and be looking for opportunities.

Stephen: Annabel, any thoughts on valuations in regard to the United States and Europe?

Annabel: Actually, I had been thinking before all of this that US banks looked quite attractive. I still think the big ones do, but I think it will very much depend on each particular name. I think there’ll be more dispersion within the space, generally.

Market mispricings present opportunities

Sonal Desai, Ph.D.

Chief Investment Officer

Franklin Templeton Fixed Income

David Zahn, CFA, FRM

Head of European Fixed Income

Franklin Templeton Fixed Income

Stephen: We haven’t had a lot of systemic shocks to the system, even if we really look, even over the last 50 years or so. Was this a systemic shock? And if it was, what does this mean?

Sonal: I’m a macroeconomist, and from where I’m sitting, SVB did look rather special—more than 90% of its deposits were uninsured,⁷ which doesn’t appear to be the norm, and the deposit base was unusually concentrated, consisting mostly of tech firms. Its assets were heavily skewed to long-term Treasuries and agency bonds, and SVB had failed to hedge its interest-rate exposure. It had even gone eight months without a chief risk officer. So SVB looks too much of a special case to have a systemic impact.

Unfortunately though, SVB’s failure has created a lot of market instability. This makes the Fed’s job harder because this market instability doesn’t take away from the fact that inflation is still high and wages are still strong. If this market turmoil leads banks to tighten credit, then the Fed might have less need to tighten, but with inflation still running high, I think the market has gotten well ahead of itself in pricing in that the Fed will need to cut rates.

I hesitate to say this, but I think someone has to: This is a problem of the Fed’s own making. Much like what we saw in the United Kingdom, it is the direct result of having rates very, very low over an extremely long period of time, which leads banks and individuals to make riskier decisions perhaps than is wise—not to mention that regulators have strongly incentivized banks to invest heavily in government bonds.

Stephen: Yeah, it’s Warren Buffett’s very famous statement that you don’t find out who’s naked until the tide goes out. And that has created a situation here with an asset bubble, but I do want to emphasize this isn’t a time to panic. In fact, this panic may be really mispricing things right now.

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Sonal Desai

Sonal: What we see being priced in the market right now is a pretty catastrophic scenario, and I would take a step back and note that the reality is nowhere near as bad. So yes, I do think this panic creates mispricings that also offer up interesting opportunities. I think bonds are mispriced because markets have gone too far in pricing Fed cuts. And in situations like this, some very strong corporates can also suffer temporarily in a way that is not justified by their fundamentals.

David: I think that the market is scouring the sector for any banks that have potential problems, and then looking at how to deal with that. The thing that also is interesting is how the central banks are dealing with it—giving liquidity facilities to help support the banks. We saw that in the United States and in Switzerland, and I think that all the central banks are talking to one another in terms of how they can handle these situations. But I don’t expect that we’re going to see sudden rate cuts coming from central banks. They’re still combating inflation, and that’s an issue that needs to be dealt with.

“We would want to be short duration because we believe the European Central Bank (ECB) will likely continue to raise interest rates in order to bring inflation back down to target. The ECB will likely over-tighten, which will give us great opportunities in fixed income.”

David Zahn

Stephen: This isn’t just on the US shores alone. SVB had relatively small but impactful offices in China and in Europe and India. But it was also an investor to entrepreneurs globally. Any thoughts on that and perhaps even where you see concerns or opportunities?

Sonal: I don’t see something which is truly systemic here.

This is not like 2008—this is a bank run for the oldest reason in the books since banks were invented, and quite frankly, the reason the Fed was established. Banks are in the business of borrowing short in their liabilities and lending long; that’s what banking is. SVB just grew too much too fast.

Stephen: David, what about the regulatory implications of recent events?

David: I think that regulation will inevitably increase. This is something that we’ll likely see going forward, especially in the United States. It’s really interesting how the United States has basically guaranteed all deposits in these troubled institutions, which is very much a European approach. I think, from that perspective, you could see more regulation in the United States that is more in line with Europe. The other big area that this is really going to be a focus of corporates is, where is my cash? Many people got caught out having too much money in banks, and they’ve received a sort of “get out of jail free” card so they can now move that cash around. I expect there will be more interest in diversifying across banks, and also across fixed income—how to put that into short-dated funds, money market funds, etc., which all have their own idiosyncrasies. I think people will be looking at how to diversify their cash base to ensure they do not have this type of concentrated exposure going forward.

Stephen: From a European perspective, we know volatility can create opportunities though.

David: Overall, I think that we’re going to see continued volatility, but the fundamental profile of the wider European banking system is quite sound and well-capitalized. And, it’s a banked economy that isn’t as disintermediated by the capital markets like in the United States. We think, though, it’s prudent to stay in higher-quality national champions rather than going down to smaller banks.

We would want to be short duration because we believe the European Central Bank (ECB) will likely continue to raise interest rates in order to bring inflation back down to target. The ECB will likely over-tighten, which will give us great

opportunities in fixed income. There definitely are good names out there in the banking sector, but we think it's worth looking at areas outside of banking, such as industrials, as well as green/sustainable bonds. I think investors could benefit from green bonds, and social bonds in particular, within a diversified portfolio going forward, both within corporates and sovereigns.

Stephen: Sonal, explain the difference between bank deposits and money market funds.

Sonal: There is a fundamental difference, and it is a part of the reason that we're seeing smaller depositors pull money out of banks. As the Fed has raised interest rates, money markets now offer better yields. Investors have transparency into where money market funds are invested, which is typically on very short duration, high-quality assets at the very short end of the yield curve. With banks, depositors have much less visibility. In a traditional fractional deposit system, while your deposit is insured in the United States up to US\$250,000, the bank is responsible for deciding how to invest, and there can be a duration mismatch as we saw with SVB, because it invested in 10-year Treasuries and even longer-term mortgage-backed securities. This is not a problem in and of itself—indeed a bank's normal business model relies on borrowing short and lending long. The issue is the magnitude of a bank's long-duration exposure, and whether it is hedged or not in an environment of rising rates. So, given the debacle of SVB, people have increasingly been moving money from bank deposits to money market funds simply because the interest rate is more attractive given an inverted yield curve, and there is more transparency of where money market funds are invested, usually very high-quality, low-duration, very well-regulated assets.

Stephen: And the implications of all this for central banks?

David: As I mentioned, I think that the ECB will continue to hike rates because it is an inflation "targeter," and inflation is still a problem, particularly in core inflation. I also think that the Fed will want to continue hiking rates given the inflation problem and the continued strength of the job market. We don't view what's happened so far in the banking system as something that should impact US macroeconomics that much.

The Fed and the ECB will likely continue to hike, but probably will have lower terminal rates than before. But overall, both central banks will continue to tighten monetary policy,

and I think that's really the key. If we are wrong, then it implies we're heading into a deep recession because the central banks will have way over-tightened, and therefore risk assets will sell off and investors will want to just own core rates.

Fixed income remains our focus

Ed Perks, CFA
Chief Investment Officer
Franklin Income Investors

Stephen: How are you shifting allocations between equity, fixed income and alternatives into the second quarter of 2023?

Ed: What happens with interest rates and inflation throughout the rest of 2023 will primarily drive our allocation decisions. We believe the move higher in rates is likely almost done, as markets have begun to price in the end of the Fed's hiking cycle. As the events of the last couple of weeks have unfolded, it has become clear that the pace and scale of interest-rate hikes has placed bank balance sheets under considerable stress. As a result, the Fed faces greater uncertainty around its path forward, particularly if the lagged effect of tightening financial conditions and a more

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Ed Perks

challenging growth environment results in a real pullback in fundamentals. We have already made a significant shift toward fixed income during the past year, driven by profit-taking on equity sectors that outperformed in 2022—such as pharmaceuticals, consumer staples and utilities. If equity prices remain expensive relative to the yield we can achieve in fixed income, then the shift into bonds may continue, albeit at a slower pace as we are now above a 60/40 allocation in favor of fixed income over equities. The rate of change will depend upon where markets go. If investment-grade corporate bond yields move back toward 6%, then we may well increase the strategy's sector exposure at a faster pace, taken from either equities, equity-linked notes, high-yield bonds or US Treasuries.

Stephen: What is driving your thinking from an income perspective?

Ed: Yield is set to be a much more important component of total return for investors during the next few years, as the move higher for rates and spreads has significantly expanded yield opportunities across fixed income. This is a very different scenario from 12–18 months ago, when there really was no alternative to equities, and investors were locked into a desperate search for yield across all asset classes. That search appears to be over, and the expansion of yields and spreads is adequately compensating fixed income investors on a risk/return basis.

Investment-grade credit is our preferred asset class in terms of total return, income and risk management. In a positive economic scenario, we believe these assets could potentially perform quite well as rates move lower and spreads narrow. A year ago, yields on high-quality credit did not seem attractive, prospects for total returns were poor, and bonds were not acting as a diversifier. Today, we believe the same assets offer better total return potential than equities, while the positive correlation with stocks is also breaking down, allowing fixed income to offset equity market volatility.

Elsewhere, it has been some time since the yield on US Treasuries was healthy enough to meet our income requirements, but the changing market environment has also created options in this sector. When 10-year US Treasury

yields were around 2%, they were unattractive in our view, but extending the duration of our investments to lock in yields at 4% is much more compelling from a portfolio perspective. As a result, US Treasuries will likely continue to form a core part of our ongoing strategy throughout the second quarter and beyond as market conditions stabilize following recent volatility and the Fed maintains its focus on fighting inflation.

Stephen: What opportunities and concerns do you see across the fixed income asset class throughout the rest of 2023?

Ed: While investment-grade corporates are our preferred sector within fixed income, the high-yield bond market may be more resilient than many investors believe, absent a significant negative impact on corporate earnings. Most high-yield issues won't need to be refinanced in the next few years; therefore, a recession in 2023 with a modest pullback doesn't overly concern us. As a result, while the investment community focuses on whether spreads are wide enough to justify a move into credit, we see opportunities at current yields, which have shot up to levels not seen for 15 years. We believe yields are adequately compensating us for the risks at this point, and lower US dollar prices make the opportunity more attractive. While constructive, we continue to believe in the importance of being selective in high-yield credit, particularly given the prospect of a difficult economic backdrop.

Recessionary conditions could put pressure on over-levered companies that need to refinance their debt, but we have the resources to engage with the public companies we are already invested in around refinancing solutions. We are less likely to target private middle-market companies because we believe the opportunities for healthy returns in the public markets are currently very attractive, and we wouldn't be adequately compensated for the illiquidity premium associated with such private investments.

Equity

The ideof March hit equity investors, as the biggest bank collapse since the 2008 GFC caused a flight from financial stocks. But markets remained resilient, with many investors rotating toward the technology sector instead, as discussed by Scott Glasser of ClearBridge and Franklin Equity Group's Dan Nuckles.

Re-evaluating recession odds—and investment opportunities

Scott Glasser

Chief Investment Officer, Portfolio Manager
ClearBridge Investments

Stephen: Scott, how has the economic outlook changed in light of recent events in the banking sector?

Scott: First, I think it's worth reiterating that people should absolutely not think that what's going on right now in the banking sector is similar to 2008. I think that the natural expectation is that we are going to see more restrictive lending across the board and tighter liquidity conditions. We have now seen a tightening of existing liquidity conditions and a lowering of longer-term inflation expectations, and so the silver lining is that it actually gives the Fed more flexibility to achieve its goals.

The flip side of that is that, in general, the market has assumed the United States would experience a fairly mild recession, but I think people are now reevaluating that scenario. This situation certainly skews that outlook more negatively by creating an environment where lenders will likely be a little bit more cautious and restrictive. Borrowers will be more cautious, and consumers are probably going to be a little bit more cautious in terms of their spending. It just makes the whole general economic outlook a little bit more tenuous than it was two months ago. So I think that's the kind of effect from a general economic perspective.

Stephen: The US equity market has held up fairly well though.

Scott: The markets have had a pretty significant response, but it hasn't really been visible to investors because large

technology stocks occupy a large part of US market capitalization, and they have held up well. The tech sector has been seen as the "safety" trade over the last week or so, and it's made the underlying averages look better than they otherwise would look. If you look underneath the surface, if you look at small-cap stocks, cyclicals, or sectors like energy and industrials, it's not as sanguine. There actually has been a severe deterioration in what I'd call the breadth of the overall market. So I view that as fairly negative.

My outlook is often based upon both macroeconomic projections and the breadth of the market. The breadth of the market is sort of like an x-ray, where the outside of the body could look healthy, but the internals may not be. People are worried, and the market has started to price in a more significant probability of a more severe recession, not just a mild recession. That said, when you look at this market on a very short-term basis, it's oversold, in our view. We see potential for a pretty good rally off the bottom. There's a lot of bad news baked into the market.

Stephen: Do you agree with the market view of a US recession ahead?

Scott: My market outlook is leaning negative. The Fed was making a significant move from the easiest money we've had in the post-World War II period to much tighter money, and we knew that transition would be a difficult one. The first step was raising the fed funds rate and the discount rate. Stocks and other long-dated assets bore the brunt of that, so we saw significant multiple compression. I think 80%–90% of that multiple compression has already happened. The second part was in the effects of that tighter liquidity, the effects of a more restrictive monetary policy and what that meant for financial assets. Eventually, that would lead to a recession. This is probably the most-predicted and slowest-moving recession that we've seen over the last 30 years. It's like watching an event in super slow motion.

But what I underestimated was the sizable amount of COVID-relief stimulus that's still in the system and is still in many ways counteracting the restrictive liquidity environment that's still to come.

Monetary policy acts with the lag, so it hasn't really kicked in. We haven't seen the full force of interest rates moving from 0% to 5%. I do think that eventually shows up; it was just kind of pushed out. We had a market consensus for a mild recession—I have found the consensus is often wrong—which means we either get no recession or we get a more severe recession. Right now, I would say the banking crisis we are living through points toward a slightly more significant downturn. Putting it on a scale of one to 10, with 10 being the worst, I think the market expected a two, and now we are headed toward a four. Looking back to 2001–2003, enormous liquidity drove speculative excess that took sectors and sub-sectors to valuation extremes. During that timeframe, we saw a mild recession. The situation today reminds me of that time in many ways. I don't think the excessive valuations and the extremes were nearly as bad back then, but they certainly existed, and a lot of times you don't really realize the extremes in certain asset classes until after the fact.

So, in my view, S&P 500 profits are 15% too high. I don't see a significant recession, and I don't see a significant bear market, but as an investor, I'd be looking for bargains. To take a step back further, the key is going to be both how the consumer does over time and what actually happens with corporate margins, which will determine profits.

Stephen: Where do you see opportunities right now in the equity markets, and where do you have concerns?

Scott: What we've been advocating is a well-balanced portfolio, meaning not just growth, not just value, but some balance across that continuum. What I would say is, I'd want to avoid both of the extremes. The super high growth stocks are still at high valuations. I like low beta over high beta.⁸ I like high quality over low quality, and I like large over small, at least for this kind of interim period that we are going through.

From a sector perspective, I think many people are surprised at the return of some of the larger-cap tech stocks, including Facebook, Amazon, Apple, Netflix and Alphabet's Google (the FAANG stocks). Part of that performance is from a perceived safety trade during the recent banking turmoil, and part of that represents the aggressive moves tech companies are making on the cost side. I think those stocks continue to represent leadership. On the cyclical side, I like the industrials, absent a severe recession. Then on the defensive side—which falls more into the value bucket—I still like health care, broadly speaking. And then finally in financials, I think a lot of what's going on in the financial world, as we've talked about, is not necessarily a credit issue. I think the

“The way I'm thinking about equities is to stay balanced. We've discussed this environment of “TINA” in the recent past—meaning, there is no alternative to equities. I think that era is gone.”

Scott Glasser

banking industry will have more of an earnings issue over the next three to five years than it has a credit issue. I think some of the regional banks that have been sold off indiscriminately will rebound in the short run. In the longer term, I like securities exchanges more in this environment than I like banks. The way I'm thinking about equities is to stay balanced. We've discussed this environment of “TINA” in the recent past—meaning, there is no alternative to equities. I think that era is gone.

Examining the financials sector post-SVB

Dan Nuckles, CFA, CPA

Research Analyst—Banks and Financials
Franklin Equity Group

Stephen: Dan, as an equity analyst covering banks, where are we today, and how are you looking at this situation?

Dan: Even though the government has given us guarantees and assurances that deposits are safe at the institutions that they're with, I think that the logical question now is what can be done next (if necessary). One possibility is a full guarantee for all deposits. I think that would give the most confidence in the system.

I also think we *could* see the FDIC (Federal Deposit Insurance Corporation) take over more banks, and we could see more banks buying other banks. The Fed wants to see industry competition and doesn't particularly want to see the larger banks get stronger, so I don't think that's a desirable outcome. It would be politically divisive for the government to do anything too extreme in terms of injecting capital, but I think policymakers will be looking at different solutions to provide some stability to the banking system.

Incidentally, lower interest rates also reduce the size of unrealized security losses in the portfolios of these banks, which reduces the risk profile of their balance sheets and could actually stabilize the system if they fall enough. So that could be a market-driven solution.

Stephen: So what else might we have to worry about?

Dan: I think we have to worry about other banks that are most similar to SVB, meaning those with large amounts of uninsured deposits, those with essentially the mismatch in their assets and liabilities, basically having much more long duration of assets. Where you get the difference in terms of how much of the deposits are insured has a lot to do with whether they serve businesses or individuals. SVB was a business bank. It served predominantly technology companies, so it had very large balances on average because of that. The other thing is that its deposits during the pandemic period had more than tripled in just a couple of years. So SVB had massive amounts of inflows of deposits and had to put them to work, and that's why it built out its securities portfolio so rapidly when interest rates were very low. So they were in a very unique circumstance, probably the fastest-growth bank during that time period. While other banks have issues, they are not to the same extent as SVB.

With the facilities now in place, we hope the market can get enough confidence to know deposits are safe and we won't see contagion to other banks. I do think SVB was at the extreme. What happens is once you start having these concerns, it's easy to spread those concerns to other banks, particularly those that still have predominantly uninsured deposits, and still have a large portfolio of long-duration assets. A lot of them actually are not securities—they are loans—so the security facility doesn't quite help as much. They might be making fixed-rate mortgage loans, for example, that were long duration, and so those were yielding 2%. With funding costs rising so much, you end up having more problems with those because you can't back those—the facility doesn't back those—and they are not liquid.

Stephen: Can you comment on the impact for brokerage firms?

Dan: There are some different dynamics going on there. One of the things is that brokerage firms do bring in cash deposits. And if there are any concerns about cash deposits, the brokers could put them into money market funds.

That's one issue. The other issue is they could have a large security portfolio with unrealized losses on that portfolio, which can give them a similar dynamic as banks. But they also generally have cash as a buffer, so there are offsetting factors.

The other thing that's pretty important to note is that they tend to have very high levels of insured deposits. So I think there are potential investment opportunities at this point, but I think they're kind of getting pushed in with the rest of the banking sector given the concerns over basically unrealized losses and insured deposit levels.

Stephen: So Dan, what are we not looking at that we should be looking at—and where are the potential opportunities?

Dan: I'm not sure if there's another shoe to drop as it relates specifically to these issues. Certainly, if interest rates continue to move up further, they would compound the problem. People would be moving deposits, and the losses on the investment portfolios would grow. So that's one thing. The part that I'm trying to think about as well is the long-term implications for the banking sector, and there are some negative implications. The regulatory burdens are likely to be larger for the regional banks than they would have otherwise been. That's going to cause banks to do things differently, which impacts earnings. For example, if they have to hold more short-duration securities for liquidity purposes, they are not going to get as much yield. There is also a potential dynamic of deposits moving to the larger banks.

That could happen for a while. But you also asked the question earlier about opportunities, and one of the things we have seen is that smaller regional banks have sold off more than the higher-quality, larger regional banks, and the money center banks have performed strongly. We saw really wide-scale selling, and I think that can create some opportunities for investors.

I was relatively cautious on banks a couple weeks ago, but I think there is an opportunity to revisit some of these opportunities.

Private markets

The banking turmoil clearly impacted stock and bond markets. But what about private markets? How are they maneuvering in today's topsy-turvy environment? To find out, we spoke first with James Cross. As co-head of private equity investing at Franklin Equity Group, James was on the phone with his venture capital (VC) clients throughout the SVB failure. For a private credit perspective, we asked Rich Byrne, President of Benefit Street Partners, if private lending to Silicon Valley startups might increase. To close out our conversation, Jeb Belford, Chief Investment Officer of Clarion Partners, explains how the pandemic has turned the commercial office sector upside down.

Upside opportunities in a treacherous credit environment

James Cross, CFA

Co-Head Private Investing
Franklin Equity Group

Stephen: James, in the wake of SVB's collapse, everyone's wondering what will happen to small venture-backed companies. Give us your outlook from where we stand today.

James: For most of 2022, we were optimistic that VC markets were on a glidepath back to normalcy. In the prior period of 2020–2021, valuations were extremely high. In our view, many venture-backed companies were getting overfunded because venture investors had stopped asking them to hit their normal milestones. In normal times, startups typically raise just enough VC to hit specific milestones, like launching a viable product or getting more customer traction. Companies typically needed to cross these milestones before getting more capital. In that sense, the VC

industry was very incremental. But the VC market had gotten very loose and frothy in 2020. We saw VC firms looking through milestones and funding three years of work. So that's clearly not healthy—those numbers don't work out very well. So going back to normal prices for startups improves our outlook for VC quite a bit. You don't have to overpay, and we're excited about that.

Coming into 2023, we thought getting back to normal was just a matter of time and figured an industry shakeout might happen in the back half of this year. In our view, many tier-three and tier-four companies were already in trouble. We thought these startups would start running out of cash and try to raise fresh capital, only to find there wasn't new money that was anywhere near their last valuation round. We expected this process might take up to two years. Instead, with SVB's collapse, the return to normalcy may now happen over a period of weeks or months.

Stephen: Wow, that's really accelerated. Is that all due to SVB?

James: So a lot of startups have debt financing in their capital plans. Most VC managers like us knew SVB had about 50% of this venture debt market. At the same time, many limited partners (LPs) who may have wanted to bail out their top-tier startups also banked at SVB. That meant they couldn't go through SVB to generate the wires to deliver capital to their best startups. This illustrates how incredibly tight the Silicon Valley ecosystem is. It's a little bit of a closed loop. I think the run on SVB was partly because many VCs knew the weakness of this ecosystem. They were trying to get ahead of it. I can't speak to the bond side of things because we are equity investors, but I think the response was rational because VCs were trying to take risk off the table. You don't normally think of VCs as being risk averse, but I think that's what they were doing.

“ We thought these startups would start running out of cash and try to raise fresh capital, only to find there wasn't new money that was anywhere near their last valuation round. We expected this process might take up to two years. Instead, with SVB's collapse, the return to normalcy may now happen over a period of weeks or months. ”

James Cross

Stephen: How do you see this rolling out from here?

James: Now that we're lurching back to a more normal environment, we're actually pretty sanguine about the path forward. We got in touch with all our companies and assessed the situation right away. Looking further into 2023, we're seeing a bit of buyer strikes on software companies. Traditionally, enterprise software offered some of the highest returns in the VC ecosystem. The growth was there, and margins were excellent with solid recurring revenues. Well, many corporate chief financial officers have been pulling back on their software spending over the last 18 months. So our VC peers are starting to look at other sectors they are less familiar with.

Upside opportunities in a treacherous credit environment

Rich Byrne

President

Benefit Street Partners

Stephen: Although the recent banking turmoil isn't exactly like 2008, we know the GFC helped turbocharge private debt markets. Rich, how is today's turmoil in banking impacting the private credit space?

Rich: I think two things can exist at the same time. For one, it's going to be a treacherous market for reasons that I'll explain, creating real credit issues across private and public credit markets alike. But at the same time, we're kind of licking our chops, for lack of a better term. This is one of the best investing opportunities we've seen since the GFC. We're seeing real differentiation in private credit. You are rewarded for taking risk if you do your homework, but severely punished for mistakes. This environment tends to favor private credit firms that focus on deep credit work and structure unique deals.

Since the pandemic, it feels like we've been moving from crisis to crisis. Obviously, today's topic is the banking "crisis," which I put in air quotes. But before that, there was the Russia-Ukraine war, supply-chain disruptions and now the prospect of a future recession. These are the concerns everybody has around their portfolios. In my view, the big iceberg that already hit private credit was the rise in interest rates. When you have a rise in rates where the risk-free rate goes from almost zero to almost 5%, it creates a dramatically different market.

“Going forward, it's lenders with fresh money that will see really interesting opportunities. For now, most folks that invest in private credit are sitting on the sidelines, either because they're hoarding liquidity or because they are in vehicles, like closed-end funds, that can only invest based on proceeds coming back in the form of prepayments.”

Rich Byrne

To date, people are looking around and noticing there hasn't been a massive increase in defaults. Do you know why that is? It's because there's still a lot of fixed-rate debt in people's capital structures. A lot of it is hedged. The real problem, however, generally arrives at maturity. When loans matured over the last 12–14 years, good companies and not-so-good companies alike kind of got bailed out. Markets were awash in capital, and refinancing markets were so robust that companies could kick the can down the road.

Today it's different. When loans mature, it's going to be trickier because companies are worth less just by virtue of rates having gone up. I think the simplest analogy is a multi-family apartment. We do real estate lending, so I think it's very analogous. People pay less for properties when their borrowing costs increase. So as rates go up and cap rates go up, property values go down. The same is true for corporations. Whether the sponsors that own many of these companies put in more equity, whether lenders take the keys, whether there's amendments—this all remains to be seen. In our view, only the very best-performing companies will get through this relatively smoothly. Many others will face problems.

Going forward, it's lenders with fresh money that will see really interesting opportunities. For now, most folks that invest in private credit are sitting on the sidelines, either because they're hoarding liquidity or because they are in vehicles, like closed-end funds, that can only invest based on proceeds coming back in the form of prepayments. And those have

slowed to virtually zero. So there's less supply now, and also way less demand for new deals coming to market. The deals we're looking at right now are less leveraged and only with better companies. Being rewarded in today's environment means we have to be super selective and focus on high-quality companies.

The last point I'll make is that back in the old days, the high-yield markets often paid 10% coupons and up. That could offset a lot of mistakes as far as credit losses. You could literally lose 10% of the principal of your portfolio without having a negative return. We're finally getting back to that world again. When you hit environments like this, private credit firms can really differentiate themselves by their ability to originate good deals, to structure them the right way and, of course, making the right bets.

Stephen: With regional banks under pressure, could that open private credit managers to new lending opportunities? For example, will private credit replace some of what SVB was doing in terms of lending to technology startups?

Rich: Good question. Within the private credit space, there's already a cottage industry that lends to the tech sector. I'm not talking about lending to early-stage software startups, but lending to more mature technology-based companies. SVB obviously was a big player, alongside a handful of private credit managers specializing in venture lending. It's a very specific discipline. If venture capital isn't your core competency, you're going to be adversely selected on deals. And here's why.

When we make a loan, we try to find companies where the dynamics are stable, with easily predictable cash flows and a high-free-cash-flow conversion. Most venture companies are the opposite. They *burn* cash. In those scenarios, you're playing a long-term game where the payoff is further down the line. In our view, that's more of an equity investment than a debt investment. So that hasn't been our business, but I suspect some private lenders with venture expertise will happily fill this gap.

Where I think it's interesting, though, are firms like Signature Bank that have been lenders to non-tech spaces. It remains to be seen if new bank regulations change the risk calculus among mid-size banks. As you know, private credit really thrived from bank disintermediation after the GFC. Banks were regulated out of the business and went up market. Today, really the only banks that we ever compete against when we're looking at private credit debt loans are smaller

banks. So, to the extent that new regulation changes the risk profile of smaller banks, the competition to make these types of loans could shrink. To be clear, I'm talking here about broad industry sectors, not the tech sector specifically. But clearly, lending to the technology sector is also changing.

The pandemic's lingering impact on commercial real estate

Jeb Belford

Chief Investment Officer

Clarion Partners

Stephen: When the banking turmoil first arrived, the impact on valuations was immediate across public markets. Of course, buildings don't price that way. Jeb, give us your take on concerns and opportunities in commercial real estate looking forward.

Jeb: I'd like to take a step back and explain why some of the challenges and opportunities we're seeing in real estate come from long-term factors, which aren't associated with events in the banking sector over the last couple of weeks.

Real estate investment is typically concentrated in four major property types: office buildings, apartments, industrial warehouses and retail shopping centers. While these sectors didn't historically always perform in exactly the same way, they tended to move within a band in the same direction. We have rarely seen a large and persistent divergence of performance between property sectors. That changed well before the pandemic started with the rise of e-commerce, which engendered a significant structural change in how people purchase goods. The volume of goods flowing through warehouses grew very rapidly to reach people buying goods online. Just as quickly, retail shopping, which was historically one of real estate's best and most consistent sectors, faced a challenge. As a result, industrial warehouses, which historically were an average performer, became the best-performing major property type, while retail became the worst and, importantly, the performance gap was very wide. This really changed the direction of retail and industrial, along with the desire to invest in them, and this divergence continues today.

More recently, another big sea change has occurred, this time resulting from the pandemic. The dramatic effect COVID has had on the office sector has been widely followed,

“Today, investors are still trying to gauge where interest rates are going to settle out, and therefore what’s the right pricing for real estate assets. That’s the big debate we’re seeing in our space right now.”

Jeb Belford

of course, with work from home and much less work from the office. This has led to caution among tenants as to long-term space commitments, higher vacancy rates in office buildings and significantly poorer performance of office vs. the better positioned property types.

This performance gap between property types is remarkable, and we believe it will persist over at least the near term. And this makes portfolio allocation critical. In our view, we generally want to orient our allocations to property types where we see long-term strength of performance, while being very cautious and significantly underweight to sectors facing longer-term weakness. This framework, by the way, also applies equally to geographic regions and markets.

Stephen: How does the rise in interest rates fit into your team’s thinking? Is that impacting your allocations?

Jeb: Absolutely. Borrowing costs very much affect required returns in our space. For the first time in a long time, our industry has been experiencing significantly higher borrowing costs, starting in early/mid 2022 with the change in rates engendered by the Fed. The immediate reaction across the real estate sector, broadly, was to pause and assess where the overall economic picture was headed before making incremental buy/sell investment decisions. For properties that

are healthy, well-leased and generating cash flow, and where you don’t have loan maturity issues, owners can afford to wait and see how things play out. This healthy category actually encompasses a large portion of our space. So the most immediate reaction to rising rates was the transaction market slowing significantly as buyers are cautious and sellers are hopeful for a reversion to lower borrowing costs—thus both very far apart on pricing.

Today, investors are still trying to gauge where interest rates are going to settle out, and therefore what’s the right pricing for real estate assets. That’s the big debate we’re seeing in our space right now. Until we get better direction and visibility, we believe you’re likely to see commercial real estate be relatively quiet compared to historically higher norms for transactions. In the meantime, we will likely see continued health in many places, but some signs of distress.

And that brings us back to one of the bigger trouble spots, which is the office sector. There’s still meaningful uncertainty as to where the office sector ultimately heads. Overall, we’re seeing office tenants take a wide variety of approaches, but if you had to average it out, tenants are taking less space, and vacancies are increasing. It’s still hard to say where more permanent trends end up, but it’s been a significant negative for the office sector overall. However, it hasn’t been even across the board. Within the office sector itself, there has also been a wide variety of performance, with high quality, generally newer assets doing very well—high occupancy, strong leasing and rising rents, in many instances. Meanwhile, less well-located and older assets are facing challenges attracting and retaining tenants. It’s not a uniform story, and you can’t paint every asset with the same brush.

Meanwhile, several sectors continue to exhibit significant strength and appear much better positioned to weather the economic turbulence we are facing, notably the industrial sector, housing broadly, life science and self-storage.

Endnotes

1. Source: Masters, B, Harriet C, and K. Duguid. “Money market funds swell by more than \$286bn amid deposit flight,” *Financial Times*, March 26, 2023.
2. Source: Stone, B. “How You Can Monitor The Severity Of The U.S. Banking Crisis,” *Forbes*, March 26, 2023.
3. Source: Transcript of Chair Powell’s Press Conference, March 22, 2023.
4. Sources: Analysis by Franklin Templeton Institute, SPDJ, US Department of Treasury, Macrobond. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**
5. Sources: Analysis by Franklin Templeton Institute, MSCI Indices, Macrobond. Notes: Rising interest rate means an increase in US policy rate over the calendar year. Higher inflation means more than 2.5% inflation for the calendar year in the United States. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.** MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI.
6. Ibid.
7. Hayes, D. “SVB, Signature racked up some high rates of uninsured deposits,” *S&P Global*, March 14, 2023.
8. Beta (β) is a measure of the volatility—or systematic risk—of a security or portfolio compared to the market as a whole.

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Notes

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